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Providing Information and Value Customers Deserve • Transforming the Life Insurance Marketplace

January 14, 2011

Mr. Michael Boot, Mr. Greg Heidrich, and Mr. Bruce Iverson
The Society of Actuaries - Via emails, and
475 North Martingale Rd., Suite 600, Schaumburg, Illinois 60173

Dear Gentlemen:

Over the past few months, I have been informingⁱ many organizations and individuals, including some other members of the Society of Actuaries, about my campaign to reform the life insurance industry's terribly inadequate disclosure and problematic sales practices. Earlier in 2010, my web site began providing the disclosure on life insurance policies that consumers have always needed and deserved, and every day more and more consumers are learning about and benefiting from this disclosure. Today, I am inviting the SOA to endorse my disclosure approach. The American public deserves a professionally certified life insurance policy disclosure approach.

Detailed information regarding my disclosure approach is attached, and I welcome opportunities to further discuss my approach with you, and answer any questions you have. Given my disclosure approach's straightforward simplicity, that it provides the essential policy cost and rate information that consumers have always needed, has been used to accurately explain new sales illustrations and actual historical performance policy in hundreds of meetings with clients and advisers over the years, and can be corroborated by insurers' financial and contractual data, I am highly confident that you can readily recognize it as a valid disclosure approach worthy of industry-wide adoption and publicity. If, however, you think there are any problems with my approach or that other ideas such as the many that the SOA has considered in the past need to be re-evaluated, then please sponsor a 'competition' and organize a panel of genuine financial expertsⁱⁱ to certify an appropriate life insurance policy disclosure approach. Again, given my approach's simplicity, versatility, validity, and usefulness, I am highly confident of the SOA's endorsement.

This task of reviewing and endorsing an appropriate policy disclosure approach is a fundamental professional responsibility for your professional organization. So that the basis of this assertion can be well understood, please allow me to review some facts and industry history. Without appropriately informed consumers, the marketplace does not, has not ever, and in fact can never work properly. Without a professionally-certified policy disclosure approach, consumers cannot be

totally confident about being properly informed, and the economic losses to our nation from such have been, and will continue to be, enormous.ⁱⁱⁱ While the history below focuses upon the actuarial profession's serious shortcomings, please know that, in my opinion, all the other major participants in the life insurance marketplace have commensurate or greater failures. Echoing a famous historian's words, that 'the road to Auschwitz was paved with indifference,' it is time for the SOA to speak-up against the practices that have enabled the life insurance industry to deceive and to impoverish American families.

A modern history of the life industry's disclosure problem begins by recalling that it was not until 1970 that the industry repudiated and statutorily prohibited the inherently misleading and financially invalid policy comparison approach of evaluating policies on the basis of the difference in the sums of their annual premiums^{iv}. For an industry endeavoring to be the leading financial adviser to families, the century-old, financially invalid method was a pathetic practice; and SOA's countenance of such, baffling. An equally ignominious black mark was the SOA's decision decades ago to not respond to Professor Joseph Belth's inquiry^v about actuaries' professional responsibilities regarding life insurers' sales practices. Since virtually all of the industry's age-old and on-going sales practices problems can be traced to the Society's failure to answer Professor Belth's question, I invite you now to reconsider Professor Belth's inquiry, and to respond differently this time.

While some might try to point to the adoption in the 1970s of the interest-adjusted policy comparison indices as an actuarial accomplishment, the indices, as you well know, have always been inherently-defective and flawed in so many ways. An NAIC task force in 1980 advocated terminating their use, and the American Academy of Actuaries repudiated them in the early 1990s. Sadly and - I think almost all would concur with me - shamefully, actuaries and other industry leaders have never even endeavored to replaced these faulty indices in all the ensuing years.

In 1992, actuary John Keller's told the SOA that the reason the insurer did not conduct focus group research with recent purchasers of the company's policies is that 13 of 15 such policyholders would be disappointed with what they would have learned in such a focus group.^{vi} *The Hellhound of Wall Street*^{vii} does not document any more egregious admission of financial services misconduct by any business. Somehow, though, the SOA took no action following Mr. Keller's statement. Similarly, the SOA has virtually ignored the industry's horrific lapse problem. Industry data clearly show that some life insurers are really just commission generating enterprises as it can be statistically known at time of sale that their policies are much more likely to financially harm, than benefit, consumers^{viii}. Consequently, I have attached, and very much welcome your thoughts about, a list of assignments that could express SOA's remorse by having its members fulfill 10,000 hours of annual public service.

Please also recall that a 1992 SOA task force's final report declared that the caveat, "sales illustrations should not be used for comparative policy purposes," should appear atop all illustrations shown to consumers. The SOA, however, not only failed to effectively persuade regulators of the importance of this caveat but also failed to show how policies should be compared or to provide the

new buyer's guide it also recommended. Abdication of responsibility, willful blindness and muteness, and 'ball dropping', are, as you well know, hardly traits of leadership. In light of this sad history of ineffective advocacy and ethical lethargy, I hope that the SOA will have a qualified outside organization develop new or revamped continuing education classes in effective advocacy, salesmanship, and ethics for SOA's members.

Finally, with the start of this new year and the concomitant setting of goals and aspirations, I ask you to also consider having SOA establish a fund to compensate the tens of thousands of individuals who are annually recruited as agents, yet within a few short years more than 80% fail out of the business, and, because of the industry's practices which typically require recruits to be classified as independent contractors, have no unemployment insurance. Please be aware that I am also asking insurance commissioners to establish a fund to help compensate the thousands of consumers who have purchased and/or mismanaged policies because to the inadequate information and pervasive misrepresentations in the marketplace. If some of your members contend that they have no legal responsibility or obligation to help, in essence, fund a private unemployment insurance system for unsuccessful agents, I might simply reply by asking: Does SOA want to be on record as not caring about its industry brothers and sisters who have misleadingly been enticed to be agents? I don't believe SOA would want that. Indeed, voluntary actions like this would set a memorable, honorable example and foster creating a new era reflecting our genuine interconnectedness as Americans and an enlightened awareness of the true meaning of such.

Clearly, there are no blandishments in this letter out of respect for you and your appreciation of candor when subjects of serious national importance are being discussed. I have also deliberately avoided currying favor at the same time that I am seeking your review and endorsement of my policy disclosure approach. **No doubt, though, you recognize the enormous opportunities this letter presents to the Society of Actuaries to chart a new path, to help improve not only our industry but also our nation's discussions about myriad important financial matters.** Please know that I well understand that good disclosure and information, in and of themselves, do not automatically mean that decision-making becomes easy; after all there will always remain uncertainty and challenges evaluating competitive alternatives' trade-offs. But good authoritative information is absolutely essential to facilitating good decisions and reducing misinformation's extraordinary harmful impacts, and it is the SOA's professional responsibility to contribute to the provision of such authoritative information. May the summary of the industry's problematic history achieve its objective of demonstrating the importance and urgency of the various inter-related problems and of the transformative value and benefits that your prompt and wise actions on my request can now produce. I appreciate your good work, and look forward to hearing from you.

Sincerely,



R. Brian Fechtel, CFA, Agent, and Founder of Breadwinners' Insurance

Attachments/Enclosures: 1) Campaign Announcement, 2) Commissioner Cline's Reply, 3)"Policy Disclosure – Press Release" article, and 4) Disclosure Spreadsheet

Copies: NAIC President Commissioner Voss

ⁱ The September 2010 'Campaign Announcement' letter to the AARP's Executive Director is similar to announcements that were sent to a few of the leading national actuarial firms and many other organizations. It contains, among other information, my August 2010 letter to the then 2010 NAIC President, Commission Cline; a separate attachment contains Commissioner Cline's reply. For addition information about my work etc., you might find it especially useful to review my August 2010 letter to IMSA's President and other articles and blogs at www.BreadwinnersInsurance.com .

ⁱⁱ The 'competition' would be one where the committee of jurors would evaluate each disclosure approach with respect to its accuracy, its versatility with different products, its genuine usefulness to consumers, etc. The committee of jurors could well include leading academics and others in the financial community, as the subject matter is not so inherently technical. Furthermore, non-SOA members could offer some additional advantages to the Society in such an endeavor. I would be glad to submit additional ideas regarding such a committee and the competition itself, if the Society would welcome such.

ⁱⁱⁱ The economic losses arising from the life insurance industry's age-old disclosure problem are enormous and manifold: 1) consumers buy and keep policies that are terribly cost-ineffective and/or otherwise inappropriate; 2) consumers' general distrust of agents and the life insurance marketplace are important factors contributing to this marketplace's tremendous operational inefficiencies; 3) the industry's historically-persistent and terribly-woefully inadequate market penetration, both in terms of percentage insured of those needing coverage, and low coverage amounts relative to need; and 4) the socially-wasteful recruiting practices that rely upon misleading presentations of the career opportunity of sales agent when the industry's compensation practices are inherently unsustainable and an instrumental factor in more than 4/5 of recruits failing in the business. Obviously, each of these four broad categories of economic losses could be further segmented and described. Such details would only more irrefutably substantiate the conclusion, which is just what economic theory teaches: markets without good information do not function properly, and society's total economic losses from such are myriad and enormous.

^{iv} This prohibited comparison is still widely used, directly or indirectly, in actual sales training and presentations. Comprehensive and effective consumer education would contain a list and examples of this and other misleading sales practices, so that financially unsophisticated individuals would be explicitly warned about such faulty presentations.

^v Professor Belth in November 1970 asked the chairman of the committee on professional conduct of the Society of Actuaries, **"Is it the professional responsibility of the actuary to take positive action to eradicate deceptive practices, or is it the professional responsibility of the actuary merely to refrain from endorsing deceptive practices?"**

Belth has written, "In May 1971, the chairman of the committee wrote me that, after discussion 'at length,' the committee was unable to answer the question. After the shock wore off, I asked a friend who was a member of the committee to tell me what [had] happened. [Here is] the gist of his explanation:

If the committee concluded it is the professional responsibility of the actuary merely to refrain from endorsing deceptive practices, the Society would become the laughingstock of professional organizations. On the other hand, if the committee concluded it is the professional responsibility of the actuary to take positive action to eradicate deceptive practices, the Society would condemn many members to being fired by their companies."
Insurance Forum 8/94 issue

^{vi} *Transactions*, 1992. Actuary Keller said, "I'll respond briefly to the suggestion that we use focus groups to get the consumer point of view. We did consider that early on in our work and rejected it for a couple of reasons. One was the

time constraints we were under and the cost of doing focus groups. But probably the most important reason is that if you get 15 people in a room who are recent purchasers of life insurance and then spend an hour or two dissecting the sales process and the use of their illustrations in that sales process, you're likely to have 13 people coming out slightly or greatly disillusioned over what they just did. We found that our field force and our marketing department didn't like that idea at all. So if somebody could think of a way to get to the consumer without causing real problems among recent buyers, who are our most fragile customers, we would like to hear it."

What appropriate cost disclosure facilitates, and what the quoted actuary has always known, but wanted few others – especially no "recent buyers" to understand, is that the industry's opposition to disclosure has fundamentally been a battle to keep consumers from exerting pressure upon whole life's historical and unacceptable costs, which would thereby drive such costs from the market. Quite frankly, the enormity of the cost disparity between whole life and term, as readily shown in my disclosure approach, ought to have raised the following question among any ethical industry executives and any self-respecting regulatory authorities: How can whole life with its much greater costs be honestly sold? The short answer is that it can't be honestly sold. That is why misrepresentations are so prevalent and have prevailed for so long in the life insurance marketplace. This is the multi-generational financial crime wave that actuaries' silence on appropriate policy disclosure has facilitated.

^{vii} Michael Perino's recent and wonderfully interesting and thorough book on how Ferdinand Pecora's 1933 investigation of the Great Crash forever changed American finance by actuating appropriate regulations in the securities industry.

^{viii} Please visit my blog "What Lapse Data Indicates About Regulatory Approvals and Sales Practices" for more information on this subject. Industry data show that more than 40% of many insurers' policies sold on being "permanent" lapsed within just nine years, thereby strongly indicating that these insurers' sales of permanent policies are statistically more likely to harm, than help, their typical consumer. This is, unquestionably, a very problematic matter.

Explanatory Note Regarding Breadwinners' Life Insurance Policy Disclosure Approach

This policy disclosure approach is thoroughly explained in the attached document, "Policy Disclosure – Press Release," which is also available on my web site, www.BreadwinnersInsurance.com. To facilitate your review, let me call to your attention a few especially important pages which may be best reviewed in the following sequence. 'Page 10' (in the original article) provides the approach's formulas. 'Page 24's Notes 4 & 5 address a common question regarding whether the rate used to discount is gross or net of investment management expenses; the short answer, as can readily be demonstrated with an analysis of any variable policy, is it can be either provided that it is defined. 'Page 11' applies these formulas to recent sales illustrations, and 'Page 3' summarizes unit cost data as illustrated in various recent sales illustrations. 'Page 4' shows the application of this approach to an insurer's actual historical policy performance data from 1989 to 2009, which can be reconciled with data from the insurer's Annual Statement*. 'Page 8' is in essence a Table of Contents to the full Policy Disclosure Press Release, showing how this policy disclosure approach can be used to compare any and all types of life insurance policies, and thereby can facilitate your review of some other applications of this disclosure approach that you might want to review. In summary, this policy disclosure approach demystifies sales illustrations and thereby facilitates comprehension of the mechanics of life insurance policies so that consumers can demand information relevant and necessary to assessing the future performance of these financial products.

A second attachment, a series of spreadsheets, presents an Informative and Transparent Illustration based on applying this disclosure approach to a traditional sales illustration for a whole life product. This facilitates a consumer's comprehension of this policy by clearly separating its guaranteed and illustrated insurance amounts and cash values, and by showing the annual maximum, illustrated, and unit costs. The usefulness of this informative illustration and its supplemental materials can be readily realized by recognizing all the natural and important questions it enables a consumer to answer regarding the operation of the policy, and is a marked contrast with the policy's traditional illustration and the currently required NAIC illustration. Note that this informative illustration can be readily compared with the insurer's actual historical policy data ('Page 4' referenced above) to understand, for instance, the factors accountable for the difference in values between what was originally illustrated and what was actually achieved. Very worthy of close attention are two spreadsheets that compare the costs and present value costs of this whole life policy and an alternative term policy. A forthcoming Breadwinners' Insurance web site article will

* It is an axiomatic truth that simultaneous equations representing all of an insurer's policies can be reconciled with an insurer's disclosed financial performance in its Annual Statement. Concerns about insurers' possible misrepresentations of their actual performance fail to take into account this fact. Unlike quantum physics with its uncertainty principle, financial matters can be cross-checked, reconciled, and audited. That the specter of possible misrepresentation of policy performance is treated credibly by so many actuaries, regulators, and insurance executives seems a sad testament to either the industry's secretive and unethical practices (which are not unchangeable despite the industry's history) or many individuals' apparent unawareness or forgetfulness of the above mathematical/accounting truism. Furthermore, disclosure of results is not disclosure of methods, which can rightly be proprietary. Moreover, when historical performance information is available on every other financial product, consumers cannot be expected to buy life insurance products without historical performance and other relevant data.

also present a means to specifically identify the causes of the differences in after-tax dollars provided by these two age-old alternative products.

Financial product disclosure is not quantum physics; it is not really any more involved than telling the truth. And the necessary financial truths can be told simply. My disclosure approach is nothing profound, indeed it is incredibly straightforward. Financial products, after all, are comprised of fundamental, simple components: costs, time value rates of return on money, the application of a few basic accounting rules, and in the case of insurance, a specification of the covered risk. There is nothing about life insurance that renders it incomprehensible or difficult to explain for anyone who truly wants to do so. The transformation of the life insurance marketplace has always just merely depended upon reporting the financial performance of policies in a manner that consumers readily understand and that can be verified as accurate by an independent, objective, and knowledgeable authority. As some recognized industry authorities and I have written for many years: Only by embracing good disclosure will the life insurance industry be freed from its problematic past and on-going problematic practices, and enabled to enter a golden age in which consumers will understand the treasured value of life insurance because they will finally be appropriately informed and thereby able to seek competitive value and suitable coverage. The American public deserves a life insurance policy disclosure approach certified and endorsed by the Society of Actuaries, and I am highly confident that my disclosure approach best satisfies this need.