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AN ANALYSIS OF THE DEVELOPMENT OF THE LIFE INSURANCE INDUSTRY  
IN THE UNITED STATES

By

H. L. Reese

B. S., Appalachian State Teachers College, 1965

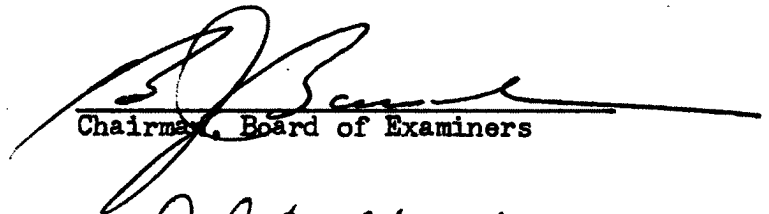
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1977

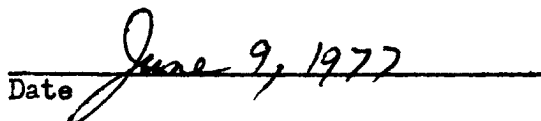
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## CHAPTER I

### INTRODUCTION

Death is inevitable. Death comes to two million Americans every year.<sup>1</sup> Life insurance policies covered 1.3 million of these Americans. The lives of four out of every five men, three out of five women, and one out of two children under 18 are covered. The average policy is \$18,000.00 per family. Over 130 million people own life insurance. Sixty-five percent of the United States population is insured against death. \$1.9 trillion worth of life insurance policies are in force.<sup>2</sup> It staggers the imagination. Why has the life insurance industry grown to be one of the largest industries in the country? Is life insurance really necessary? If life insurance is such a good thing, why doesn't everyone have a life insurance policy? These are only a few of the questions regarding life insurance that are answered in this paper.

#### Objective of the Paper

The primary objectives of this study were to show how the life insurance business came into being in the United States, what

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<sup>1</sup>The actual death rate was 1,933,000. Newspaper Enterprise Association, The World Almanac and Book of Facts - 1976 (New York: Newspaper Enterprise Association, 1976), p. 962.

<sup>2</sup>Ibid., p. 963.

need brought about this growth into one of the largest industries in the United States, how the average consumer has sometimes been misled in life insurance buying, and offer some recommendations to life insurance consumers.

### Scope

The topics discussed include basic information about life insurance, the types of policies available, some of the government regulations, the agent/personnel selling approaches, and marketing plans. Publications on life insurance and personal contacts with life insurance agents have been the primary source of information used in this paper.



## CHAPTER II

### WHAT INSURANCE IS

Insurance is a device to handle risk. Its primary function is to diminish or reduce uncertainty resulting from the economic cost of disastrous events. Insurance relies heavily upon the "law of large numbers." Life insurance can be defined as a plan under which large groups of individuals can equalize the burden of loss from death by distributing funds to the beneficiaries of those who die. From the individual family standpoint, life insurance is a system of sharing financial risks among many people so that a family does not bear the full burden of an economic loss brought about by the death of the head of the family.

The primary purpose of life insurance is to aid in protecting a family from financial hardship during the period of adjustment after a death. Life insurance is an intangible product. Many consumers do not know what life insurance can do and what it is all about.<sup>3</sup> There is the idea of sacrifice involved, and procrastination is sometimes present in the mind of the average American consumer. The thought of death is repugnant to the average American and to win in the life insurance game, you must die. Yet the

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<sup>3</sup>Vladimir P. Chernik, The Consumer Guide to Insurance Buying (Los Angeles: Sherbourne Press, Inc., 1970), p. 84.

foundations for consumer behavior rest on need, for without needs, consumers would never have a reason to purchase life insurance. A need is the lowest common denominator of consumer behavior.<sup>4</sup> The need for life insurance is an emotional need. This need arises after the consumer has taken care of needs concerned with his physical well-being; for example, the need to be part of a group, to associate with others, and to be accepted by his fellow men.

Life insurance is generally purchased by the individual consumer. The individual consumer perceives the policy, the price, and the environment. His actual purchase decision is the end result of his personal makeup, his perception, and his relationship to the environment that influences his personal makeup.<sup>5</sup> The consumer may be influenced by others, but, in the final analysis, it is the individual who must decide. Only the individual can interpret the market information and make decisions. The individual is influenced by his environment.

The life insurance industry is the biggest business in the world, and life insurance itself is one of our society's most remarkable and universal institutions.<sup>6</sup> The industry's determined effort to make the consumer buy more and more insurance has long been recognized.

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<sup>4</sup>C. Glenn Walters and Gordon W. Paul, Consumer Behavior, An Integrated Framework (Homewood, Ill.: Richard D. Irwin, Inc., 1970), p. 242.

<sup>5</sup>Ibid., p. 228.

<sup>6</sup>James Gollin, Pay Now, Die Later (Baltimore: Penguin Books, Inc., 1969), p. 17.

During the past decade, there has been increasing concern both in public and private sectors for the rights and interests of the consumer. The allegations made by consumer advocates are sharply critical of business, particularly marketing practices and the performance of the marketing system.<sup>7</sup> Surveys have shown that consumers believe that advertisements are not reliable sources of information and do not present a true picture of the products advertised. Consumers believe that the messages of advertised products are exaggerated to a considerable degree, yet they find that advertised products are more reliable than unadvertised ones. Most Americans know little about their own life insurance and almost nothing about the industry that provides it.<sup>8</sup> The most important reason for this, beyond the fact that it is a relatively complex subject, is the consumer's own lack of sophistication, indifference, or ignorance and/or a reluctance to put forth the effort required to make informed buying decisions.<sup>9</sup>

Part of the lack of knowledge stems from the life insurance industry's determination to keep secret its methods and practices and to operate as much as possible behind tightly closed doors. The industry's traditional mistrust of the public and underestimation of consumer knowledge only causes confusion. Another reason why the

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<sup>7</sup>Hiram C. Barksdale and William R. Darden, "Consumer Attitudes Toward Marketing and Consumerism," The Journal of Marketing, 36 (October 1972), p. 28.

<sup>8</sup>Gollin, Pay Now, Die Later, p. 17.

<sup>9</sup>Barksdale and Darden, "Consumer Attitudes Toward Marketing and Consumerism," p. 32.

consumer understands very little about life insurance is because he does not want to know. The American consumer has some rather strange ideas and some curious uncertainties about life, death, and money. The American society has nurtured this vast institution which the consumer likes to believe can prolong life, abolish death, and even make him rich. In return, all he has to do is pay money, cooperate, and not be too inquisitive.

Nearly 80 percent of all personal insurance written in the world is bought by Americans.<sup>10</sup> The reason is simple. Americans are the most affluent people of the world and insurance is the protection of one's possessions and the assurance of a better future for one's family despite the adversities of life. Nowhere else do material possessions accumulate as fast as they do in the United States and nowhere does a man have as much opportunity to put his money into investments. People in the United States can afford to buy insurance and so they do. The majority of the population of the United States is middle class; this class is most insurance-prone. The poor have no money with which to buy insurance, and the rich have no real need to buy insurance. Middle classes influenced by the forces of poverty and wealth must find a guarantee that they will retain what they have acquired. Insurance is that guarantee.

The family breadwinner has a need to insure that his family is taken care of in the case of his absence. It is the socially acceptable, modern, American thing to do. Where once a succession of kinfolk was ready to stand in, today a typical family unit can seldom

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<sup>10</sup>Chernik, Consumer's Guide to Insurance Buying, p. 11.

look much beyond its own household for economic security when the chief provider dies. Families have little choice but to insure heavily the life of the family income source.<sup>11</sup>

To buy security and protection in the form of insurance appears to be a reasonable act for someone living in a free and highly developed economic system. Why do people in the United States buy life insurance? To obtain protection--there is no other answer. With over \$200 billion spent in life insurance premiums each year, it is not accidental that one of the tallest buildings in the United States is the Prudential Insurance Tower in Boston.

#### How It All Began

The institution of life insurance is old by any standard of comparison. The preamble of the earliest English statute on insurance, of date 1601, speaks of insurance as a usage which had existed "time out-of-mind." Some writers have observed points of resemblance between modern mutual insurance and the alliances or societies formed by ancient Greeks, Romans, Chinese, Hebrews, and early Christians for mutual benefits and assistance. Insurance as we know it seems to have been first expressed in the customs and usages of merchants. The laws of insurance have gradually taken form and developed until at present we find a huge mass, both substantive and statutory, which covers practically every conceivable form or kind of risk.

Life insurance in the United States was an outgrowth of marine

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<sup>11</sup>Consumers Union, The Consumers Union Report on Life Insurance (New York: Consumers Union, 1967), p. 13.

insurance, which was written prior to the Nineteenth Century by individual underwriters. The formation of life insurance companies as we know them today had to await the scientific methods of mortality tables, which involve mathematical calculations of the duration of life. In the United States it was not until the 1840s that the development of scientific life insurance began, and before that time the life insurance business was small.

In colonial and revolutionary times, marine insurance was transacted in coffee houses by individual insurers and the shipowners and sailors. As business increased, public insurance offices were established in Philadelphia, Boston and New York. Occasionally the underwriters granted insurance covering the risk of capture by pirates, but not often. Policies later covered the risk of death during a voyage, but were few in number. Customary policies were for the duration of a voyage, six months, or a year, and the premium rate was five percent.<sup>12</sup> Such insurance was purely a gambling proposition, with no real basis for determining the odds.

In 1759 the Synod of Philadelphia established the Presbyterian Ministers' Fund, which was the first corporation in America to furnish benefits payable on the occurrence of death. Premium rates were charged on an arbitrary basis and not graded by age. Originally only for clergymen, coverage was later extended by the company to students of Presbyterian colleges. It was basically a widows' fund

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<sup>12</sup>United States Encyclopedia of History, Volume IX (Philadelphia: Curtis Publishing Company, 1967), p. 1722.

and was not the first life insurance company, although under its later expansion it did become one. The Insurance Company of North America, chartered in 1794, was the first corporation to transact life insurance in America, although in five years only six policies were issued.<sup>13</sup> This was due to lack of public knowledge or demand for life insurance and the company discontinued the life insurance business in 1804. Occasionally, individual insurers were unable to pay, and the need for a better guarantee of payment was accomplished by the organization of stock life insurance companies during the first forty years of the Nineteenth Century. Among the more successful ones were the Pennsylvania Company for Insurance of Lives and Granting Annuities (1809), the first commercial corporation in the United States organized for the sole purpose of issuing life insurance policies, and also the first to require medical examinations before issuing policies; the New York Life Insurance and Trust Company (1830), the first to establish an agency system to make active efforts to secure business; and the Girard Life Insurance and Trust Company of Philadelphia, which in 1836 inaugurated the principle of granting to policyholders a participation in the profits of the business. Before 1840 there was a great deal of prejudice against the life insurance business on moral grounds, but the prejudice disappeared as the public became more aware of life insurance as a practical measure.

The first company to use the mutual plan was the Mutual Life Insurance Company of New York, chartered in 1842. The plan provided

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<sup>13</sup>Ibid., p. 1723.

that active business would begin only when applications had been made for a sufficiently large amount of insurance to provide an adequate basis of operation. Mutual Life issued 4,000 policies within five years. Policyholders were entitled to share in the management of the company through election of directors, and all the profits belonged to the policyholders. The Equitable Life Assurance Society of the United States (1859) was responsible in part for the great stimulus given to the business at the end of the first half of the Nineteenth Century.<sup>14</sup>

The Civil War's immediate effect was to arrest progress of the life insurance business, since policies between Northern companies and Southern policyholders were mostly void by their terms in case of war. But the life insurance business shared in the general expansion of trade, and during the last three years of the war the annual increase in life insurance was over 30 percent. In the postwar period, many people were disappointed when dividends were reduced or did not come up to expectations; this shook public confidence and caused a great number of companies to disappear during the 1870s, although the Metropolitan Life Insurance Company, formed during this period, later became the largest life insurance company in the world.<sup>15</sup>

Although the Twentieth Century saw two wars and various epidemics, the insurance business prospered, in spite of increased taxation, reduction of investment income, shortage of personnel, and increased expenses. The influenza epidemic of 1918 had a much more

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<sup>14</sup>Ibid., p. 1723.

<sup>15</sup>Ibid., p. 1723.



serious effect on the companies' mortality experience than either of the two world wars. Insurance business decreased during the Depression of the early 1930s also; mortality rates increased, dividends were reduced, and premiums went up. Defaults in payments under mortgage loans greatly increased, and the real estate taken in foreclosure was sold at great loss to the companies. Insurance companies continued to grow and benefit, however, from Federal government activities. The Social Security Act of 1935, which provides some old age welfare, essentially made the Federal government the largest insurer of all time. Insurance continued to develop into one of the greatest businesses in the United States today.

#### How It Works

Using life insurance in its simplest form, a person pays an insurance company a given amount each month for a policy which guarantees that his beneficiaries will receive a specified sum if he dies. Many life insurance policies combine this form of protection with other forms. Some provide for the policyholder to receive a regular income after he reaches retirement age. Some provide funds for a college education for the policyholder's children. Some will pay off the mortgage on a person's home if he dies or becomes unable to work.

Straightforward as it may appear, life insurance policies are usually filled with provisions that may limit the coverage. Most policies have a reinstatement period provision. This is used when the policy lapses because the premiums have not been paid. The company will usually permit the policyholder to reinstate the insurance within a prescribed period by paying the overdue premiums with interest

providing he still meets the company's medical standards. The time allowed varies. Some insurers will reinstate up to five years.

Insurance companies normally give themselves two years from the effective date of the policy to contest statements made on the policyholder's application. After that, the company cannot claim misrepresentation to void the contract or deny payment of the proceeds to the beneficiary.

Some policies have an automatic premium-loan plan. Under this provision the company will automatically use enough of the policy's cash value to cover a premium if the policyholder fails to pay it on time. In effect, the policyholder is getting an interest-bearing loan, similar to one borrowed against the cash value of the policy. This is a safeguard against inadvertently letting a policy lapse.

Annual premiums paid in installments rather than a lump sum ordinarily involve a carrying charge calculated according to a percentage known as a "factor."<sup>16</sup> For example, the charge for semiannual installments might be expressed as a factor of .51, which means that the policyholder pays 51 percent of the annual premium in six-month periods.

Companies will usually exchange one policy for another type back-dated to the policyholder's age at the time the original policy was purchased. This option, and the costs and conditions involved, are not always part of the policy itself. This is the change-of-plan provision.

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<sup>16</sup>Changing Times, The Kiplinger Magazine, July 1975, p. 42.

Often companies allow the dividends paid on a participating policy to be used to purchase one-year term insurance additions to the policy. As lower premiums are charged for term insurance, the policyholder can materially increase his coverage by buying term insurance with the dividends.

The policyholder can borrow against the cash value of his straight life insurance policy. He has access to cash any time he needs it without asking anyone's approval and he gets an interest rate that is fixed in the contract. If the policyholder dies while the loan is outstanding it will be deducted from the face amount of the policy. There is no requirement that the borrower pay the loan back during his lifetime.

Certain high-risk occupations usually cause the premium payments on life insurance to be higher than average. Some occupations included in this category are bartending, race car driving, and occupations involving explosive, radiation and chemical hazards. Occupations that involve a change in atmospheric pressure such as underground excavation and skin diving also lead to extra premiums.

Life insurance comes in several forms and at a wide range of prices. When arranged to produce only death benefits, it can be remarkably inexpensive. But most consumers do not buy it that way. Instead, they are talked into buying a combination of insurance plus savings account. The most widely sold policy, ordinary or straight life, is just such a combination. Wisdom in spending the insurance dollar begins with a good understanding of present insurance needs and of the likely pattern of future needs. A young consumer's financial responsibility

to his family increases rapidly for a number of years as children are born and as his rising salary allows for their greater comfort. He probably should increase his life insurance coverage periodically during those years. But once family size and living standards stabilize, the breadwinner's financial responsibilities and insurance needs tend to decrease year by year. But wisdom does not come easily in the insurance market. The agent sells a confusing array of wares, and he seems to have a habit of keeping his pure protection policies tucked out of sight.

## CHAPTER III

### LIFE INSURANCE AND GOVERNMENT CONTROL

Federal law relating specifically to insurance states that "The business of insurance, and every person engaged therein, shall be subject to the laws of the several states which relate to the regulation or taxation of such business."<sup>17</sup> The Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, are applicable to the business of insurance to the extent that such business is not regulated by state law. No Act of Congress should be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance.<sup>18</sup>

What has been done to regulate the life insurance industry? What has been done to protect the life insurance industry from itself as well as protect the consumer? These questions are best answered by looking first at the structure of the life insurance regulations. Life insurance companies are governed primarily by state statutes.<sup>19</sup>

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<sup>17</sup>Commerce and Trade, U. S. Code Annotated, Title 15, Chapter 20 (St. Paul: West Publishing Company, 1976), p. 151.

<sup>18</sup>Ibid., p. 151.

<sup>19</sup>George J. Couch, Couch Cyclopedia of Insurance Law (Rochester, N. Y.: The Lawyers Co-operative Publishing Company, 1959), p. 438.

In the 1868 case of Paul vs. Virginia, the United States Supreme Court ruled that an insurance policy is a contract of indemnity, not a transaction in commerce, and hence not subject to Federal regulations.<sup>20</sup>

The Federal regulations in the life insurance area state, "Because of the far-reaching effects of the life insurance business upon the individual policyholders and the economy in general, it is a business which is affected with a public interest. A state must regulate business to prevent it from committing wrongs or injustices in the exercise of its corporate functions, to protect the public from evils, or an unregulated and unlicensed operation of a general insurance business, to protect the public from surrendering its money in exchange for questionable or worthless pieces of paper."<sup>21</sup>

Although the state statutes vary to some extent, most states appoint an Insurance Commissioner to insure that each insurance company complies with its charter. He insures that the insurance company fulfills its obligation and files an annual report of its affairs. He investigates complaints and makes regular examinations of domestic corporations. He regulates the sales efforts of agents and brokers, makes sure the company has sufficient funds to carry out its obligations, and protects the insurance company from fly-by-night operators. The insurance commissioner has augmented his personal fortune by accepting bribes on rare occasions; however, his record is very

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<sup>20</sup>R. Carlyle Buley, The American Life Convention, A Study of the History of Life Insurance (New York: Appleton-Century-Crofts, Inc., 1953), p. 83.

<sup>21</sup>Couch, Cyclopedia of Insurance Law, p. 437.

favorable compared with that of most administrative officials.<sup>22</sup>

As the insurance commissioner is the sole regulating agency, all states require by decision or statute that life insurance must be defined by a contract. The contract calls for the insuring party, for a stipulated consideration, customarily called a premium, to pay another a certain sum of money upon the happening of a given contingency which is the death of the insured under the ordinary contract and is the termination of a specified period under a contract in which the endowment feature is incorporated.<sup>23</sup>

An application is not generally required by state law as it is simply a proposal. However, most companies require an application, a request for a contract of insurance to be issued to the applicant, for the purpose of obtaining information as to the risk it is proposed that the insurance will cover.<sup>24</sup> Once the application is processed, the contract is published. Since the life insurance company drafts the terms of the contract leaving the purchaser with no voice as to the terms, the courts, as a rule, construe the terms of the contract more against the insurance company.<sup>25</sup> It is not being suggested that insurance purchases are made blindly with no idea

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<sup>22</sup>Buley, Study of the History of Life Insurance, p. 136.

<sup>23</sup>Couch, Cyclopedia of Insurance Law, p. 448.

<sup>24</sup>Ibid., p. 300.

<sup>25</sup>Mississippi Law Journal XXXVI (1964-1965): 223.

as to what is being purchased. It is perhaps more unreasonable to assume that the public's understanding is what the insurance industry intended for them to understand. The agent would appear to brief the customer according to the general understanding of the purchasing public rather than the legal precedent. The size of the type/print on the contract does not affect the legality of the contract; however, most states do have a statute on the size of the print.<sup>26</sup>

Punctuation in the contract is not material if the meaning can be determined without it. Strict rules of grammar do not prevail over the intent of the parties as shown by the whole instrument. Clear and unambiguous words and phrases are construed in their plain, ordinary, natural, fair, usual, and popular, rather than philosophical, literal or technical sense unless they have been given a contrary legal meaning.<sup>27</sup> Typewritten or stamped clauses are legally binding. Generally, ambiguities are resolved in favor of the insurer and against the insured.

The terms "received by" and "delivered to" the insured are synonymous. Delivery is not essential to the completion of the contract. It becomes effective according to its terms. Upon the issuance of the policy, it is signed and executed by officials of the insurer, who are legally authorized to bind it and register it in the office of the state superintendent of insurance. The contract must be one that is offered to all insureds of the same class at the same rate. The insurance company is bound in good faith to execute and deliver the

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<sup>26</sup>Couch, Cyclopedia of Insurance Law, p. 339.

<sup>27</sup>Ibid., p. 638.



contract and thereby consummate the contract. They cannot escape liability by neglecting to do so. The insured need not formally accept the policy to complete delivery. Delivery through the mail is delivery to the insured (when posted) even though he dies before he receives it.<sup>28</sup>

After delivery, most state statutes provide for an incontestable clause. After a certain period (usually three to five years) the life insurance companies are estopped from defending against any claim arising on the policy by reason of any errors, omissions, or misstatements made by such assured on which said policy was issued except as to age or fraud. It is a guarantee of good faith by the company.<sup>29</sup>

Most states regulate life insurance advertising. Generally, any advertising that has a tendency to mislead is prohibited.<sup>30</sup> Most states have a statute similar to the Nebraska "Unauthorized Insurers False Advertising Process Act." The purpose of this act is to subject to the jurisdiction of the Director of Insurance and to the jurisdiction of the courts of this state insurers not authorized to transact business in this state which place in or send into the state any false advertising designed to induce residents of the state to purchase insurance from insurers not authorized to transact business in the state.<sup>31</sup> Through this act, the state exercises its power to protect

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<sup>28</sup>Ibid., p. 434

<sup>29</sup>Insurance Law Journal, March 1969, p. 142.

<sup>30</sup>Couch, Cyclopedia of Insurance Law, p. 542.

<sup>31</sup>Nebraska, Revised Statutes of Nebraska (1973) III: 373.

its residents and also exercises its powers and privileges available to the state by virtue of the United States Congress which declared that the business of insurance and every person engaged therein shall be subject to the laws of the states. An "Unauthorized Insurers False Advertising Process Act" prohibits any unauthorized foreign or alien insurer to make, issue, circulate, or cause to be made, issued, or circulated to residents of this state any estimate, illustration, circular, pamphlet, or letter, or cause to be made in any newspaper, magazine, or other publication or over any radio or television station, any announcement or statement to such residents misrepresenting its financial condition or the terms of any contract issued or to be issued or the benefits or advantages promised thereby.<sup>32</sup> Whenever the Director of Insurance has reason to believe that any such insurer is engaged in such unlawful advertising, it is his duty to give notice of such fact by either registered or certified mail to such insurer and to the insurance supervisory official of the domiciliary state of such insurer. If after thirty days following the giving of the notice such insurer has failed to cease making, issuing, or circulating such false misrepresentations or causing the same to be made, issued, or circulated in the state, and if the Director has reason to believe that a proceeding by him in respect to such matters would be to the interest of the public, and that such insurer is issuing or delivering contracts of insurance to residents of the state, he shall take action against the insurer under an Unfair Trade Practice

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<sup>32</sup>Ibid., p. 374.

Act.<sup>33</sup>

The purpose of an Unfair Competition and Trade Practices Act is to regulate trade practices in the business of insurance by defining, or providing for the determination of, all practices which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices defined in or determined by the Act.

The Nebraska "Unfair Competition and Trade Practices Act" states that no person shall engage in any trade practice which is defined as an unfair method of competition or an unfair or deceptive act or practice in the business of insurance. Appendix 1 lists the unfair methods of competition and unfair or deceptive acts or practices in the business of insurance as recorded in the state statutes of Nebraska.<sup>34</sup>

Most states have also an "Unauthorized Insurers Act." The purpose of this act is to subject certain insurers to the jurisdiction

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<sup>33</sup>Ibid., p. 374.

<sup>34</sup>Appendix 1 contains a direct quote of the pertinent portions of the statutes of Nebraska dealing with unfair methods of competition and unfair or deceptive acts or practices in the insurance business. Ibid., p. 339.

of the Department of Insurance and the courts of the state in suits by or on behalf of the state. This act is concerned with the protection of residents of the state against acts by insurers not authorized to do an insurance business in the state, by the maintenance of fair and honest insurance markets, by protecting authorized insurers which are subject to regulation from unfair competition by unauthorized insurers, and by protecting against the evasion of the insurance regulatory laws of the state. This act attempts to define what constitutes transacting an insurance business in the state and makes unlawful for any insurer to transact insurance business in the state without a certificate of authority from the state director.<sup>35</sup>

The granting, renewal, and revocation of the life insurance license is generally the duty of the State Insurance Commissioner. Normally when the insurer satisfies the state statute it is the duty of the Commissioner to issue a license. He can refuse to renew or cancel a license if the company does not perform in accordance with the state statutes or does not pay a judgement rendered.<sup>36</sup>

Agents likewise must first secure a license to operate in a state. Most states' statutes list qualification requisites. An insurance company is answerable for its agents as a general rule. However, if the act of its agent is outside the scope of his authority, unless there is apparent authority, the company is not held

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<sup>35</sup>Ibid., p. 388.

<sup>36</sup>Couch, Cyclopedia of Insurance Law, Vol. II, p. 455.

answerable.<sup>37</sup>

Occasionally an agent will subscribe to the practice of "twisting." This is the practice of giving misleading information to persuade an insured to give up one policy in favor of a new one. This practice is prohibited by most state laws.

It is noteworthy that the life insurance business makes up the largest financial institution in the United States to escape meaningful public interest-oriented Federal regulations. Banks, investment companies, and the securities field are regulated by Federal agencies. The basic premise in regulating these institutions is full public disclosure of their dealings. One cannot help but suspect that fear of public disclosure is the real reason the life insurance industry opposes Federal regulations.

Most state regulations in the life insurance area are now pretty thorough due to past experience. However, it is still impossible to speak in terms of uniform insurance laws or practices. I would suggest that the life insurance statutes, court decisions, and departmental rules and regulations be researched in each state to determine the rights of policyholders and insurance companies in each situation. The best of these laws should then be made Federal regulations. The American consumer wants and needs help and is ready to accept legislative solutions to his insurance problems. Consumer problems are important and deserve more attention than they now receive. Government regulations appear to be the only means of

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<sup>37</sup>South Eastern Digest, 1975 Annual Pocket Part (St. Paul: West Publishing Company, 1975), p. 92.1.

solving consumer insurance problems.

## CHAPTER IV

### BASIC TYPES OF LIFE INSURANCE POLICIES AVAILABLE

#### Term Insurance

Term life insurance covers the policyholder for a specific number of years rather than a lifetime. Term insurance generally does not have a cash value. Because of the time limitation, term insurance is often called "temporary insurance" and the premiums are lower. A term insurance policy is often purchased to meet a special situation; it can be used, for instance, to pay off a mortgage should the policyholder die. Term insurance is bought to cover the possibility of death for a certain period only. Since it has no cash value, it cannot be used for a loan or collateral. It is protection pure and simple, and that is all.

The advantage of term insurance is that it costs considerably less than any other form of life insurance, but even though it costs less, it affords the same protection. Since the premium is smaller, you can buy more protection or you can invest the difference in more profitable savings plans. Term policy premiums buy three or four times as much dollar protection as other policies. It buys nothing but protection and the consumer must die in order to be repaid. Like all insurance, but particularly with term, the opportunity to purchase it is a function of the consumer's age. Term

insurance is the simplest and lowest-priced premium form of life insurance. Upon receipt of the premium the company agrees to pay the insured the face value of the policy if he dies during a stated period. After that stated period, the consumer does not get a dime. Term insurance is pure protection against the financial consequences of death.

Many term insurance policies are both renewable and convertible, and each of these features adds to the premium rate.

If the policy is guaranteed renewable and easily convertible, it can be increased or converted at a later date into whatever program seems to fit the need at that time. "Renewable" means that the policy can be put back into force after its expiration without a physical examination. "Convertible" means that the term insurance can be changed into a whole life or other form of permanent policy at a higher premium even if the policyholder becomes uninsurable because of health. Insurance needs change during an individual's lifetime. The individual should have the freedom to buy according to his needs and not be bound by a program bought when he was young, without any thought for his ultimate economic position.

Nearly all term insurance can be converted to a permanent plan at any time without the need of a physical examination.

Another type of term insurance is designed to provide the same amount of coverage for a stated period of time during which the premium remains the same. If the insurance is renewed, the premium goes up because the policyholder would be older. In later years the costs rise sharply.

Still a different form of term insurance is designed to provide



decreasing protection. The insurance declines each year until there is no protection left and the policy expires. Premium payments for this type of term insurance remain the same each year.

Although premiums increase as the policyholder grows older, he never pays as much as for other forms of coverage. For example, on a man's \$100,000.00 policy, bought at age 25, the annual premium will vary like this:

<u>Age</u>	<u>Whole Life Premium</u>	<u>5-Year Term Premium</u>
30	\$1,600.00	\$450.00
35	\$1,300.00	\$500.00
45	\$ 900.00	\$700.00

What agents fail to point out is that as premiums increase, so does earning capacity, while at the same time, there is a decrease in the need for insurance.

Term insurance is not permanent; it offers only temporary protection and salesmen may stress this, too, but many persons need the flexibility of term insurance. As long as the policy can be renewed and converted, future insurance needs can be adequately met.

Term insurance can be obtained either as a separate policy or in combination with whole life insurance. A combination policy might be useful to a young family which needs a base of whole life protection plus additional low-premium term insurance while the children are growing.

There is no cash surrender value and no loan value. However, the money invested in low-paying life insurance savings programs may be better placed in programs of investments with higher returns. It is sometimes said that term insurance is the most expensive way to

buy life insurance. This is false. Despite what some agents may show with paper, pencil, charts, and dividend tables, term insurance is always the cheapest form of life protection.

Term insurance is written for a limited number of years--one, five, ten, and so on--or to a specific age and expires unless renewed. Generally, term insurance cannot be renewed past age 65 or 70. Premiums are held level only for the policy period and then increased at renewal in step with increased age. Companies charge smaller premiums for term insurance at the start because with term, one is not building a reserve to defray later costs.

A young married man with a family who can barely afford insurance should, without a doubt, consider term insurance. Fewer than one in ten new buyers manage to retain their primary objective of buying protection.<sup>38</sup> Most begin with fancy and complicated life insurance plans. A favorite diversionary tactic of salesmen who encounter a determined customer is to sidetrack him into a combination of term and straight life insurance.

Term insurance is the best buy in life insurance today.<sup>39</sup> It offers the widest possible coverage at the lowest possible price. Yet less than one-fourth of the ordinary life insurance in force in the United States in 1970 was term insurance.<sup>40</sup> It is true that the

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<sup>38</sup>Chernik, Consumer's Guide to Insurance Buying, p. 93.

<sup>39</sup>Michael H. Levy, Your Insurance and How to Profit By It (New York: Harcourt Brace and Company, 1955), p. 27.

<sup>40</sup>Institute of Life Insurance, Life Insurance Fact Book 1972 (New York: Institute of Life Insurance, 1973), p. 30.

premiums on some forms of term insurance go up steeply in middle age and that term protection is not generally available after age sixty-five. But in these later years, insurance needs decline and by that time the insured has presumably developed his other types of savings. Term insurance should be the foundation of the average life insurance program if the consumer will also save in other ways. During the early years of adulthood term premiums are so low that the head of the household can protect his family thoroughly and have money left over for conservative investments. With the years, and the maturing of his family, he can gradually cut down his term insurance and watch the investments mount until income from savings will take over completely. The average consumer may have been deprived of these basic facts.

Buying term insurance and investing the difference, as mentioned earlier, is a concept that once had many converts between 1951 and 1968. The advocates of this philosophy could support their position by pointing to the stock index, which during this period had an average rate of return exceeding 15 percent.<sup>41</sup> During the same period, rates of interest on bonds and mortgages were between 3 and 8 percent. Since life insurance companies invest their funds almost entirely in mortgages and bonds, it was impossible for them to match the yields available to most investors. Cash value life insurance is a form of semi-forced savings and imposes a sometimes needed discipline to save. An automatic debit to one's checking account by a mutual fund or

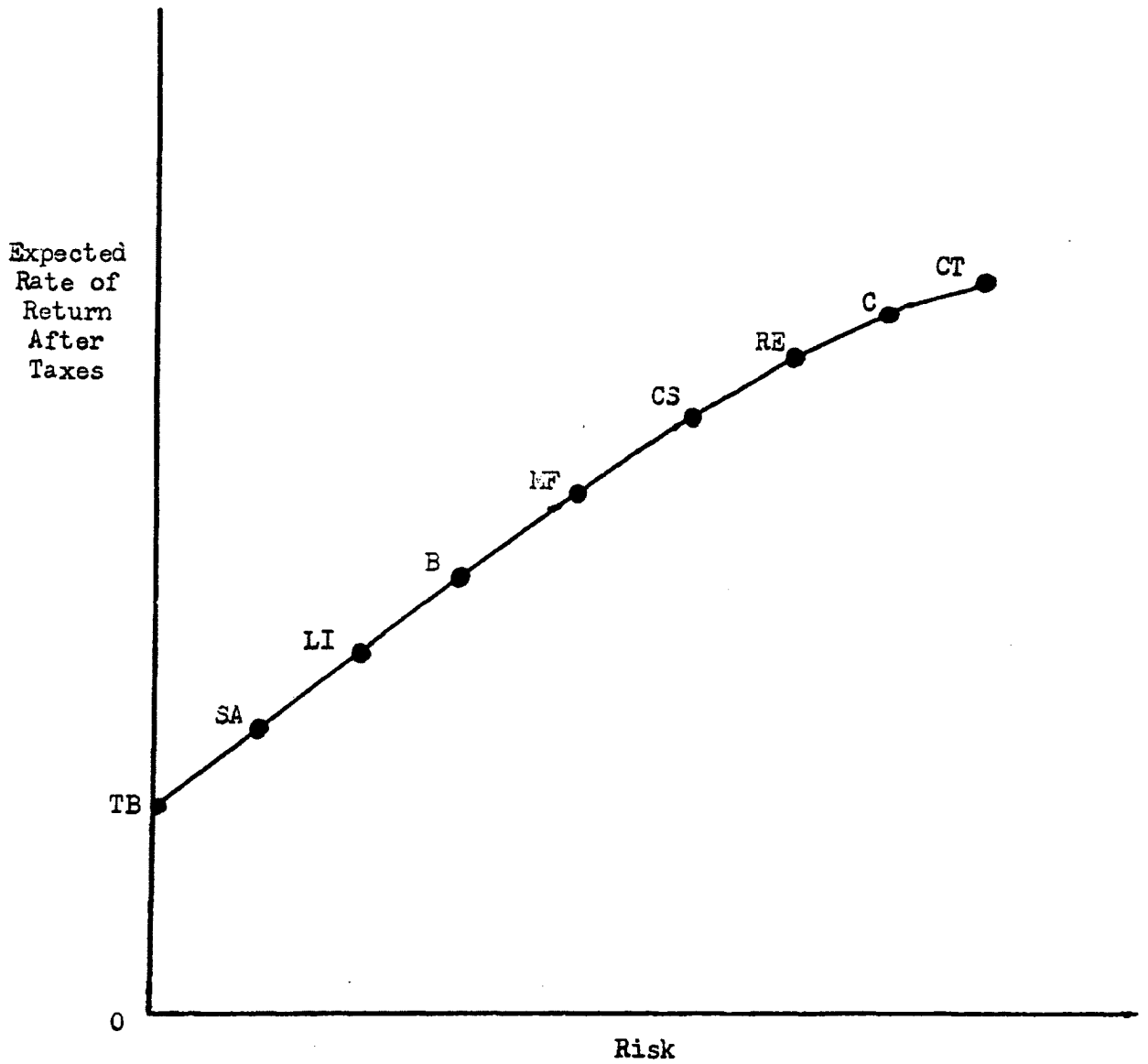
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<sup>41</sup> James S. Trieschmann and E. J. Leverett, Jr., Buy Term and Invest the Difference--Where Are You Now? Best's Review--Life/Health Insurance Edition (Oldwick, N. J.: A. M. Best Company, Inc., February 1975), p. 10.

savings account accomplishes the same thing.

Of course, the risk is greater when buying term insurance and investing the difference. Financial risk can be defined as uncertainty as to loss of principal. When buying life insurance this risk can be very low. For investments in equities the risk can be quite high. Table I shows a risk-return relationship for various types of investments.

Considering all factors--financial risk, purchasing power, and return--one can conclude that cash value life insurance has some benefits. While the return is not outstanding, the risk is quite low. Life insurance strictly as an investment is too conservative. A wealthy person does not want the major portion of his investments in riskless securities. But not all individuals can afford to take equity risks. Since the average American consumer appears unwilling or unable to assume a great degree of risk, "Buy term and invest the difference" may be poor advice. For the individual who has the self-discipline and can afford some degree of risk, "Buy term and invest the difference" is good advice.



TB - 90-day Treasury bills	MF - Mutual funds common stock
SA - Federally insured savings account	CS - Individual common stocks
LI - Life insurance	RE - Real Estate
B - Long-term bonds	C - Commodities
	CT - Currency speculation

TABLE I. A RISK-RETURN RELATIONSHIP

### Whole Life Insurance

Whole life insurance is designed to protect the insured and beneficiaries for as long as the insured lives and the policy is in force. The premiums, which are based on the age of the insured when the policy was put into effect, never increase. There are two forms of whole life insurance--straight life insurance and limited payment life insurance.

A straight life insurance policy pays money to the beneficiary whenever the insured person dies. The insured cannot outlive the insurance; it continues for the entire lifetime. It is often called ordinary life. Straight life is non-cancellable for health reasons and it builds up an ever-increasing cash equity or cash value. The reserve fund, known as the cash value, is available to the consumer in emergencies in the form of loans. This cash value is not available to the beneficiary at the policy owner's death; only the policy amount is paid out.

Protection is the chief function of straight life insurance. This type of coverage may be considered by a person in a secure position. It is a conservative policy for conservative people. It provides protection throughout life and is payable yearly. It is the cheapest type of permanent life protection. It has some elements of a savings program as well, since you can borrow on the policy and will receive a surrender value if you decide to withdraw from the program. Through the use of dividends (if you buy a participating policy) you may have a paid-up policy by the age of 65. A great advantage of a straight life policy, however, is flexibility. It

can be converted easily into other types of policies. A portion of the premium can be recovered if the consumer decides to discontinue the policy.

You do not buy as much protection as you can with term insurance for the same premium. Although the premiums remain constant, the premiums must be paid every year as long as the consumer lives and building up cash value is not like putting money in the bank. Every year the policy is in effect the amount of insurance decreases and the amount of cash value in the savings account increases. The sum of these two, at any time, always equals the policy face amount. The policy owner can borrow most of the cash value. The policy is not cancelled but stays in force with the death benefit reduced by an amount equal to the unpaid balance of the loan.

A limited payment life insurance policy is one in which the policy becomes paid up after a certain number of years and no further premium payments are due. Premiums are higher for this type of policy and cash values accumulate more rapidly.

Cash value is the backbone of the whole-life policy and a thorn in the flesh of those who wish for clear comparisons between companies. When pricing a whole-life policy, you cannot simply compare its premium against that of other policies. You must also consider dividends (if any) and the accumulation of cash value over the years.

Life insurance salesmen have been known to say that whole-life insurance is "free" because at some point the cash value and the paid-out dividends equal the sum the buyer has paid in premiums

over the years. Such an argument ignores the time value of money. Had the cash not been spent on insurance premiums, it could have been busy multiplying itself. Money earning five percent interest after taxes, for example, doubles in fourteen years.

There are two kinds of people for whom whole life insurance is a sensible form of life insurance. One is a person who simply cannot save money. The other, paradoxically, is the person in a very high tax bracket. The person who cannot save money probably is not wealthy. Someone who is not wealthy cannot afford an adequate insurance portfolio consisting entirely of whole life. That individual should make whole life a part of his portfolio only as a means of "forced" savings. The consumer has other forced savings plans open to him. These include monthly investment plans, payroll deduction plans, and vacation club accounts at banks. It is hard to compare whole-life insurance with these forced savings plans because there is not an accurate way of saying what interest rate is received on the savings component of a policy. The premium covers both the insurance protection and the savings element combined into one package. To figure out the return on the savings element, an artificial way of separating the two parts of the package would have to be devised. Experts who have performed theoretical separations frequently find that the savings element gives the policyholder an annual return of somewhere between four and five percent.<sup>42</sup> That rate of return is not as high as with other forced savings

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<sup>42</sup>Consumer Union of the United States Inc., Consumer Reports (Mt. Vernon, N.Y.: Consumer Union of the United States Inc., 3 March 1974) 39: 221.



programs; however, life insurance cash values are closer to being tax-free than some of the other forced savings plans. Taking the tax situation into account, the return on a whole-life policy is about the same as on other forced-savings programs with a fixed rate of return.<sup>43</sup>

Tax considerations heavily influence a wealthy person. As mentioned, a wealthy person should consider whole life for part or all of his insurance. The money that accumulates in the savings element of a whole-life policy is not subject to taxation at all until the policy is turned in. Once the policy is turned in and the owner receives the cash value, he need pay no taxes on it unless it exceeds the sum of the premium (minus dividends) he has paid over the years. If the cash value is greater than the sum of the premiums, he pays taxes only on the excess. In practice, this means that most, if not all, of the cash value is tax-free. The tax shelter aspect of whole life is the main reason wealthy persons use whole life to insure their own lives. Under current tax laws relating to gifts, wealthy people can choose to give their children a head start on an insurance program by buying them whole-life policies. The law allows tax free gifts of \$3,000.00 to be given by an individual to any other individual in a particular year. In addition, \$30,000.00 of tax-free gifts may be spread out over a lifetime. By buying whole life policies for relatively young children, the parent can permanently fix the annual premium at a comparatively low level, benefitting the son or daughter who eventually takes over the policy payments.

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<sup>43</sup>Ibid., p. 222.

### Endowment Insurance

Endowment contracts run for a stated period of years and provide for payment of the face amount upon the death of the insured within that period and payment of the face amount at the end of the period if the insured survives.

Endowment insurance accounts for about five percent of the life insurance in force. Unlike straight life insurance, of which there is about the same amount of insurance in force as there was a decade ago, endowment insurance is now a smaller share of the insurance in force.<sup>44</sup>

There are two concepts of endowment insurance--the mathematical concept and the economic concept. Under the mathematical concept, the company makes two basic promises that are exactly opposite in nature. It promises to pay the face amount in the event the insured dies during the endowment period and it promises to pay the face amount in the event the insured survives to the end of the endowment period.

Under the economic concept, the investment element increases gradually over the endowment period, reaching the face amount at the end of the period. At any time period prior to the end of the endowment, the decreasing term insurance component is equal to the difference between the face amount and the investment accumulation on that date.

A pure endowment is a contract which promises to pay the face amount only if the insured is living at the end of the period specified,

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<sup>44</sup>Davis W. Gregg and Vane B. Lucas, Life and Health Insurance Handbook (Homewood, Ill.: Richard D. Irwin, Inc., 1973), p. 75.

nothing being paid in case of prior death.

The endowment insurance contract serves as an effective way to accumulate a specific sum of money over a period of time, with the savings program protected by insurance against the contingency of premature death. Endowment insurance is often used to accumulate funds for specific purposes--such as college educations for children, old age, debt retirement, or a long-awaited trip abroad.

As the primary purpose of endowment insurance is not to provide protection, and due to the fact of a heavy savings element, the premiums are usually the largest of any life insurance plan but provide the smallest amount of protection for each dollar of premium paid. Endowments, therefore, should not be used when there is a need for protection. The average consumer has limited funds available and life insurance needs must emphasize the protection element.

### Annuity Contract

An annuity contract is not really life insurance, but an arrangement through which one can be guaranteed an income for a specified period of time--for a number of years, or for life. Variations of annuity contracts can include regular payments to a named beneficiary or even to one's estate if death should occur before the plan runs out.

Annuities provide protection against the possibility of outliving one's financial resources. They can be set up to pay income currently or in the future at regular intervals. Most annuities are intended to provide guaranteed retirement income of a predetermined

amount, usually for life. There are many different annuities and under some variations payments are made only for a specified number of years.

More broadly an annuity has been defined as a "periodical payment to continue during a given status." In this sense of the term, payment may be made monthly, quarterly, annually, or at other intervals.

An annuity is life insurance in reverse. Life insurance is concerned with the creation of estates. In life insurance, many contribute so that funds can be paid to those who die. With the annuity, those who live long benefit at the expense of those who die early. In life insurance, protection is obtained against dying too soon; in annuities, protection is purchased against the hazard of living too long (outliving one's income). In contrast with life insurance, which emphasizes estate creation, the annuity emphasizes estate liquidation.

Essentially, an annuity provides for payment of money by a life insurance company in installments over a time period. Each payment represents part interest and part principal, and payments generally are made for the annuitant's lifetime. The annuitant is assured a fixed income that cannot be outlived and upon his death the residue of the principal reverts to the company. There are various plans of distribution of annuities. Pure annuities, refund annuities, installment annuities, and cash refund life annuities are a few of these.

An immediate annuity can be purchased by one lump sum payment. Many annuities are purchased by the payment of periodic premiums. The annuitant usually pays periodic premiums during the entire deferred period. Annuities can and often are written to provide for joint and last survivorship and to cover inflationary trends.

### Special Life Insurance Contracts

The range of needs for life insurance protection and income after retirement can be met by the purchase of term, whole life, endowment, and annuities policies. The life insurance industry has developed combinations or unusual arrangements of these basic policies into attractive packages to fit the special needs of the insuring public.

The multiple protection policy is one of the so called special life insurance contracts. The multiple protection policy provides a layer of level term coverage for a number of years. For example, for every \$1,000.00 of ultimate face value, the multiple protection policy may provide \$2,000.00 or \$3,000.00 of death benefits for some initial period of years, such as twenty. The multiple protection policy spreads the premiums evenly over the entire period.

The family income policy or decreasing term coverage is designed to meet the insurance needs of young family heads. It is intended to guarantee an income for those years during which there will be dependent children and provides decreasing term insurance for a stated number of years or to some age. The term coverage is used to provide monthly installment payments of a stated amount in the event of the insured's death. The installments are paid from the month of death to the end of the original term period.

A guaranteed insurability rider may be added to a life insurance policy. This option permits the insured to purchase additional insurance at one or more specified "option dates" in the future without submitting new evidence of insurability at that time.

A small extra premium is charged for the guaranteed insurability rider to compensate the insurer for the extra mortality expected on business issued without any underwriting. A marriage and birth of a child option can also be provided in the same manner. Many insurance buyers, especially young heads of families who expect their incomes to increase in the future, find they need or want more insurance than they can afford at the regular rates for their age. Insurance companies have developed programs to be started at relatively lower premium rates. The initial advantage in premium rates is offset by the use of higher premium rates after the insurance has been in force for a period of time. There are usually premium increases each year for a given period of years, such as ten, after which the premium remains level.

Since a great deal of life insurance is sold to heads of young families, and since young families have many insurance needs in common, it is not surprising that the insurance industry has designed special policies to provide coverage for the entire family. The idea is to make available in a single life insurance contract a modest amount of protection on all members of the family. These policies usually concentrate most of the premium dollar on the father's life where it is most needed, provides insurance adequate to cover last expenses of other family members, and guarantees the insurability of present and future dependent children at the lowest possible cost.

#### Other Variations

An advantage that nonparticipating policies have over participating policies is a lower initial or "going-in" premium rate. Thus,

the amount of insurance coverage available per dollar of premium is greater at issue for nonparticipating policies. The primary advantage of participating policies over nonparticipating policies is the payment of policy dividends after a participating policy has been in force for one or more years.

Some companies have issued nonparticipating policies which provide annual payments to the insured that are guaranteed as to the amount and time of payment. These payments may be taken in cash, left with the company to accumulate at interest, or applied to purchase paid-up additional insurance. The option resembles those available for dividends on participating policies. A charge for this option is included in the premium. There is also available a nonparticipating policy which closely parallels a participating policy for which dividends are used to reduce premiums.

Most companies allow a policy owner to make a reasonable change in his plan of insurance after it has been issued. If the change is to a higher premium plan of insurance, the insurer will charge the policy owner for the change. If the change is to a lower premium plan of insurance, the insurer will grant the policy owner an allowance. Frequently a substantial sum of money must be charged in order to change to a higher premium plan of insurance. Sometimes the charge is amortized over the premium-paying period remaining after the change. The change of plan arrangement permitted is normally specified in the policy contract.

Some companies have available a policy that provides a death benefit equal to the face amount of insurance plus all premiums paid

to date, or equal to the face amount plus the cash surrender value at the time of death. Usually this policy requires an increasing amount of insurance. The premium for this type of policy necessarily reflects a charge for this additional protection.

Another innovation in the other variations category is the tailor-made term life insurance. This policy provides a pattern of death benefits and premium payments designed by the agent and the insured in light of the insured's anticipated needs and ability to pay. Tailor-made term policies may allow conversion options, renewal privileges, accidental death benefits, and waiver of premium benefits.

A joint life policy may be desirable in such cases as a partnership. This policy is usually paid when the first of two or more persons die. Such coverage is usually paid to the surviving partner so that he can buy the deceased partner's share of the business. There are several options available including the option of conversion under certain conditions. Some policies terminate all coverage when the first death occurs.

The premium on a joint life policy is usually greater than a single policy and slightly less than the premium for two single policies.



## CHAPTER V

### MARKETING LIFE INSURANCE

#### Company Level Marketing

More and more insurance executives and agents are becoming more familiar with the word "marketing."<sup>45</sup> The growing complexity of the insurance consumer has contributed significantly to the enhanced stature of marketing within the insurance industry. The contemporary marketing concept consists of three fundamental concepts. The first, and perhaps most important, component is the consumer. Marketing has the consumer as its primary focus. This customer orientation implies that every activity related to the creation, development and selling of insurance products must take into account the consumer's needs and wants. In other words, before making a decision, the marketing-oriented insurance professional attempts to view the intermediate and end results of the decisions from the consumer's perspective.

The second component of marketing is the marketing mix, which is used to bridge the gap between the insurance salesman and the customer. In building this bridge, the effective agent utilizes the mix ingredients of product, pipeline, pricing and promotion.

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<sup>45</sup>Dr. Stephen W. Brown, "Infusing the Marketing Concept in Professional Insurance Selling," Life Insurance Selling, November 1975, p. 43.

The effective tailoring of the elements of the marketing mix to the appropriate customer group enhances the level of probable sales and profits to the agent.

The final component of marketing is attitude. Marketing can be thought of as a philosophy of business or a way of thinking, and it should affect the agent's goals, decisions and behavior. It provides a consumer-oriented system within which the insurance agent can effectively plan, implement and control his way of doing business.

Implementing the marketing concept requires the professional to fully understand that all insurance consumers are not the same. A complete appreciation of the heterogeneity of buyers leads to the use of a key tool--market segmentation--in implementing the marketing concept. Segmentation consists of dividing the large and diverse market for insurance products into several submarkets, or segments. The members of each segment tend to be similar to each other in some significant aspect. Segmentation typically is designed to uncover a group or groups of buyers who have similar financial needs and wants.

Although there are numerous techniques for segmenting insurance markets, only demographic segmentation has been considered. Demographic segmentation consists of categorizing existing or potential clients according to various "people" characteristics, such as income and age. The grouping of consumers along these lines is probably one of the most frequently used segmentation procedures in most industries, including insurance. Some of the major demographic criteria that are used to segment insurance

markets are age, occupation, education, and geographical location. Demographic segmentation is practiced by professionals who orient their selling efforts to identifiable markets. Some such identifiable markets are young professionals, sole proprietors, and college students.

The value of identifying and concentrating on a specific segment of the total market comes in the recognition that the people who make up that market generally have similar insurance needs and wants. These similarities provide an opportunity for the agent to become an expert on the unique features of the consumer making up the market. The agent who consciously gathers and effectively uses data about his existing and potential buyers is likely to increase his sales. To fully implement the marketing concept, the agent must be able to bridge the gap between himself and his chosen market segments. The vehicle available for building relationships with clients is the agent's marketing mix. Product, pipeline, pricing, and promotion are often referred to as the "4 Ps" of marketing.

Life insurance products are often thought of as term, whole life, and annuity programs. A truly consumer-oriented agent would see the product, from the prospect's point of view, as security or investments. The agent must put together the product that will appeal to the potential buyer.

The pipeline element is the means of getting the product to the potential buyer--the sales process. The principle of marketing segmentation is applicable here. When the agent isolates the market

segment he can then determine the best manner of selling. The sale cycle, pre-approach, problem determination, solution, presentation, closing, delivery, and follow-through, must be tailored to suit the needs and wants of the customer. The success of the sale will depend on whether the salesman delivers the product at the right time, in the right place, and in the right way.

The price ingredient of the mix is very important. The marketing-oriented professional must adapt his product's premium (price) to the needs and financial capabilities of his market segment. For example, most members of the college market cannot afford a \$100,000 whole life plan. That plan, however, may well satisfy the financial needs and capabilities of most members of a young professional market.

The fourth element of the marketing mix, promotion, is also very important. Promotion is the communication that the agent has with his market. This communication may be advertising, public relations, and face-to-face selling. Agents profit from his company's advertising but he may also engage in personal advertising through television, newspapers, radio, brochures, and direct mail.

Public relations consists of the formal and informal relationships that an agent maintains with his community. The professional will choose to contribute his time and effort to the various business and civic organizations that also are of interest to members of his market segment. The face-to-face communication is probably the most important promotional tactic. Face-to-face communication often overshadows the other promotional forms

(advertising and public relations) and marketing mix ingredients.

Although each of the mix elements is distinct, they are also interrelated. The mix elements must be coordinated as well as tailored to the needs and wants of the market. For example, let us look at two market segments, young professionals and college students:

#### Tailoring the Marketing Mix

to

#### Selected Market Segments

##### Young Professional Segment

Products A, B, and D  
Pipeline C  
Pricing A  
Promotion B, D, and E

##### College-Student Segment

Products C and D  
Pipeline D  
Pricing C  
Promotion A and E

This illustrates that three products (A, B, and D) are likely to be attractive to the young professional market, while only two products (C and D) are likely to be received by the college market. The appropriate pipeline, pricing, and promotion strategies are developed in a similar fashion.

The increasing complexities of American life and business will require the insurance industry to expand its marketing efforts. The present agency system may not survive as the delivery vehicle for the insurance industry of the future. There are at least two reasons why this is true. First, the cost of developing an agent already exceeds his economic value. The monthly financing expenses alone usually run \$700 to \$1,000 per agent. Because the probability of agent survival is only five to twenty percent after three to five years, the ultimate cost to develop a mature agent is likely

to run to tens of thousands of dollars even in the most efficient companies.<sup>46</sup>

Second, there is increasing pressure from regulators to put a limit on commission income as a percentage of premium. Insurance companies are being forced to provide benefits in relation to premium income, with the result that the dollars available for agent compensation are diminishing. Many insurance companies may not be able to justify their existence.

#### Local Agency Activities

In an effort to learn about local small life insurance agencies, twenty such agencies were contacted in the Omaha, Nebraska area. Either the agency head or a licensed member of the agency was interviewed. The following three questions were asked:

1. What marketing campaigns do you as an agent or does your company use?
2. How do you get the names of prospective customers?
3. What type of life insurance policy do you favor?

In response to the first question, all twenty agencies had an advertisement in the telephone book's Yellow Pages, fourteen agencies represented companies that conduct national advertising campaigns on national television and in magazines. Sixteen of the agencies conducted direct mail campaigns and none of the agencies

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<sup>46</sup>Jay M. Jaffe, "Insurance Marketing in the Future," Best's Review, Life/Health Insurance Edition 75 (September 1974): 28.

conducted any "special deal" campaigns or introductory offers as might be used to market a new consumer product.

Ninety percent (eighteen) of the agents responded with the answer of referrals to the second question of where prospective customers' names were obtained. One agent used the city directory to obtain names of persons who live in "well to do" zip code zones. Another agent used strictly names obtained from real estate brokers. Of course, all had some walk-in customers, but very few.

The response to the third question as to what type of life insurance policy did the agent prefer varied to some extent. However, fourteen agents stated that they were unable to answer that question without knowing the family and financial situations of the customer. Two agents (ten percent) stated they preferred term life insurance and four agents suggested a combination of straight and term life insurance.

The sample size of the survey was limited; however, it is felt that even if the number of contacts were greatly increased only a similar small percentage of agencies would recommend term life insurance. The number of agencies that conduct direct mail campaigns was impressive as was the reluctance to suggest a type of life insurance without knowing more about the consumer.

#### Agent/Personnel Selling Approaches

Personal selling was the primary means of marketing life insurance. The life insurance market includes agents and other representatives. The life insurance agent is primarily a salesman equipped

with a rate book showing the rates, surrender value, and other features of policies issued by his company, as well as sample policies and application blanks. The agent's powers are limited to securing the application, delivering the policy, and collecting the premium. He cannot bind the company on the acceptance of risks or the settlement of losses.<sup>47</sup> But the consumer only knows what the agent tells him.

The insurance salesman through various means gets hold of a consumer's name and phone number, contacts him, and establishes an appointment. The consumer usually agrees to the interview not because he has any intention of buying more life insurance but because he has a few questions about his present life insurance policies. During the interview the insurance salesman raises in the consumer's mind some simple doubts. The salesman tries to convey to the consumer that he, the consumer, already knows as much as he needs to know about insurance and that the consumer need not know what insurance is but only what it does for the consumer's family. In short, life insurance is so simple that a man is born understanding the matter. At the same time, life insurance is so complicated that trying to explain it only interferes with getting people to buy it.

The consumer has been led to believe both in advertising and by the insurance salesman, who receives a much lesser commission

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<sup>47</sup>Albert H. Mowbray, Ralph H. Blanchard, and C. Arthur Williams, Jr., Insurance, Its Theory and Practice in the United States (New York: McGraw-Hill Book Company, 1969), p. 396.



than on ordinary life, that term insurance is something that should be avoided. The consumer is normally astonished and amazed at the life insurance variations and the "life insurance plans" that are just suited to his individual family. Terms like participating, endowments, dividends, limited-payments, and preferred-risk tend to confuse the consumer and drive the price of the policy up.

The primary purpose of a salesman is to make the consumer want to buy. A successful salesman knows that most people have one objection and only one objection to a product--they do not want to buy it. The other excuses--"I can't afford it," "I don't believe in it," "I have a friend who takes care of it for me"--can be circumvented, if the salesman can get past the first and main objection.<sup>48</sup>

Many techniques and approaches may be used by insurance salesmen. Some common approaches are:

"The brother-in-law." A novice who has the strength of ignorance, a belief in untruths and half-facts. He is sometimes ignorant of the consequences of his recommendations and convinced that the greater the amount of protection, the better it is for the consumer. He sells to his relatives, friends and acquaintances. By far the worst insurance deal a consumer can make is buying from a beginning salesman, especially if he is a relative.

"The knock on the door." The salesman who says that the consumer was recommended to him by his neighbors. He tells the consumer what a nice house the consumer has. He asks to come in.

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<sup>48</sup>Chernik, Consumer's Guide to Insurance Buying, p. 28.

He then states, "What I have to talk about may be the most important discussion of your whole life." This is the second-worst menace of the insurance salesman.<sup>49</sup> This is the two week professional who has found his job by reading the daily newspaper ad section. He usually does not know what he is selling and does not even care about his product. His motivation is the commission. His smile is usually wide and his shiny new leather briefcase contains the forms for the consumer to sign. The consumer will get very little expert guidance from this salesman.

"The researcher." This salesman does research on his prospects. He will know what the consumer has and what the consumer wants. The "researcher" leads the consumer into a discussion of the consumer's background and to the realization that the insurance program he has devised is intimately tailored to suit the consumer's needs. The problem here is that the salesman has made the need fit the product.

"The Forty-niner." He entices the consumer with the lure of gold. He tells the consumer that he is getting something for free. He tells the consumer that only a select few qualify for this bargain. The consumer qualifies and the salesman brings in "free" items which the consumer thinks are thrown in for nothing. The sucker for close-out sales and for items that are 50 percent off (which was in reality increased by 100 percent in the first place) is the sucker for the "Forty-niner."

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<sup>49</sup>Ibid., p. 29.

"The flatterer." He compliments the consumer on his suit, hair, table, lamp, child, dog cat--anything. If the consumer was just elected to the local PTA or joined a local club, the "flatterer" will send his congratulations. When recommending the most expensive plan of coverage he will preface it with, "You may not think you want to pay that much; however, this plan is uniquely suited for someone in your position." He flatters the consumer into the most expensive, exclusive, executive-only insurance program available.

"The wooer." This salesman showers the consumer with gifts, pens, memorandum pads, colorful calendars. His approach is similar to that of the "flatterer."

"The tough." This salesman uses no sweetness in spelling out the consumer's responsibilities. When the consumer decides to "think it over" he will insist on leaving an application blank. "Here's the application. It's in your hands now. I care too much about your family to have them on my conscience if anything should happen to you while you think it over."

"The shamer." When a consumer says that he is not interested, the shamer will reply: "Do you realize what you just said? You just said that you are not interested in the welfare of your family if you should die." He then illustrates his argument with a case of someone (preferably with whom the consumer is acquainted) who had to go to work as a waitress, all because her husband was not interested in insurance.

"The story-teller." Most insurance salesmen are great story tellers. He tells the story of a young man full of energy who died

quite unexpectedly. Fortunately this young man listened to the salesman only six months ago and the insurance policy turned out to be the young man's best investment. His stories are well rehearsed. The consumer is slowly convinced.

"The reverse psychologist." He is always a step ahead of the consumer. He volunteers all the information detrimental to a plan long before the consumer senses the loophole. He dwells upon the disadvantages of a specific proposal, hoping that the consumer will identify his weak argument. After a while the plan does not sound so bad to the consumer.

"The net cost artist." This salesman will show the consumer on paper how the annual premium, less the average dividend, paid for a given number of years, will yield a cash value of more than the consumer paid in premiums. The consumer can be made to believe that expensive policies cost next to nothing and life insurance programs are investments of great return.

"The planner." He leaves his own family budget with you, naturally showing some 15 percent or more marked for insurance. He projects, charts, analyzes, and prospects until the next twenty years are lines on the chart. The trouble is that he is the translator and the consumer does not understand, in all cases, his plan.

What should the insurance consumer do? He must start out with well drawn specifications when shopping for insurance. He should know approximately how much coverage his family needs and what sort of policy can provide it at a price within reach. He must recognize that his needs are unique and never mind what his neighbor does. He should

not set aside a fixed percentage of his income for insurance. It is much better to determine how much to spend the other way around.

First define the insurance need, then relate it to all of the factors that go into the overall family budget planning. The consumer must avoid lumping all of his insurance policies into a single item labelled "insurance" and entering it into the family budget that way. By listing each he will know exactly what he owes, what he is getting for his money, and where the gaps are in his protection picture. The consumer should avoid buying policies merely at the urging of someone else or because he feels the need for a particular kind of protection at a particular time. He should look at the entire situation, then buy if he needs and can afford the policy.

The consumer must be aware that the agent can cheat him. Agents sometimes lie about premiums. They quote the consumer a price for a man a few years younger, then when he delivers the policy, he admits his "mistake." For \$25.00 or \$50.00 more a year, most people go along with the "mistake."

Agents can lie about dividends and cash values. This makes the policy look considerably more attractive than it is. Some agents try to sell policies altogether different from the one the consumer wants. He tries to trade the consumer up to a bigger or costlier policy. The agent may try to sell the consumer a related product-- for example, shares in a mutual fund. He is hoping that because the consumer is in a mood to take out life insurance, something extra can be sold. An agent may try to do the consumer a favor if he becomes a customer. The agent will arrange a loan or find a new house, but as

a courtesy, the consumer must buy the insurance. Some agents offer rebates--some of his commission--to get the consumer to buy insurance. In most states this is a criminal offense. The agent can conceal the fact that for health or other reasons some consumers are charged extra. He pays the extra premium himself, in order to make the sale, and leaves the consumer to find out about the rated-up policy when the next premium falls due. Agents try to get the consumer to give up an old policy for the cash to buy his new one. In general, the consumer is better off keeping the old policy that was bought when the consumer was younger and the cost was lower. The new policy will almost certainly cost the consumer more than the old one did.<sup>50</sup>

When selecting an agent the consumer should pick one big enough to give thorough, complete service, yet small enough that his business would count. The agent should know his own business and be appreciative of the consumer's situation. The consumer should be aware of how the agent has treated others.

Let the insurance buyer beware! The insurance industry is powerful and most unresponsive to the public welfare. Insurance marketing is typical of the American-style waste and indifference to human values.

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<sup>50</sup>Gollin, Pay Now, Die Later, p. 245.

## CHAPTER VI

### OTHER CONSIDERATIONS

#### Direct Mail Advertising Used by Selected Life Insurance Companies

To learn the personal effect of the direct mail marketing technique on an average consumer, the author saved all direct mail for a year's period which solicited or advertised the sale of life insurance. These direct mail items cost the companies \$6.122 in postage alone.<sup>51</sup> A list of those letters, pamphlets, and other mailed items from one company is provided as Table 2. The postage cost for each mailed item is also listed. Some companies that mailed items were:

<u>Name</u>	(1 Jan 75) <sup>52</sup> <u>Rank</u>	(1 Jan 75) <u>Insurance in Force</u>
United Services	152	\$2,165,920,000 <sup>52</sup>
USAA Life	223	\$1,373,700,000 <sup>52</sup>
Ozark National Life	366	\$ 665,087,000 <sup>52</sup>
Fidelity Union Life	-	\$ 4,326,329 <sup>53</sup>

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<sup>51</sup>Figured at the 1 October 1976 U. S. Postal Rate for bulk mail of 8¢ for the first two ounces, and 4¢ for each additional ounce.

<sup>52</sup>Ranking of 450 life insurance companies as compiled by The National Underwriter, The Insurance Salesman (August 1975). Fidelity Union Life is not listed in the top 450.

<sup>53</sup>Fidelity Union Life, "Annual Report 1974," 25 February 1975.

The author was a policyholder with each of the above listed companies. These companies contributed the majority of the mailed items. USAA Life had 58,000 policyholders in effect on 1 January 1975.<sup>54</sup> Assuming that they mailed similar material to the other policyholders, the company would incur a cost of \$115,652.00 in mail fees for the direct mail marketing effort in a year's period. This does not include others on their mailing list who are not policyholders. If life insurance is such a good thing, why this massive direct mail approach? Why flood the United States Postal System with so-called junk mail? Perhaps life insurance is not as good a deal as the industry would have the consumer think. Perhaps the direct mail tactic is necessary to insure that the consumer is continually thinking--life insurance.

#### Considerations on the Death of the Wife

To this point this paper has concentrated on the death of the breadwinner, but what about the untimely death of his wife? What about the reorganization that will have to take place? What about a cleaning woman? A cook? A babysitter? What about nursery schools which may now become mandatory? There is no doubt that an economic burden would be placed on a family if the wife dies. But at the risk of sounding callous, there will also be a sizeable reduction in expenditures--no more expensive clothing, hair dressing, cosmetics, etc. There will be a drastic reduction in expensive social functions and even in the preparation of fancy meals. If the older children can assume some of the functions of the deceased mother, and if everyone reorients his activities and participates in the reorganized family unit, chances are that the cost of daily living will be reduced.

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<sup>54</sup>USAA Life, "1974 Annual Report," January 1975.



TABLE 2. DIRECT MAIL FROM USAA LIFE FOR A ONE-YEAR PERIOD

<u>Item</u>	<u>Postage</u>
USAA Annual Report - 1975	13¢
<u>AIDE The Insurance Magazine from USAA</u> , Spring, Summer, Fall and Winter Issues (16¢ per issue postage)	64¢
Letter, 23 February, with forms to request information on life insurance	8¢
Letter, 7 April, with forms to request information on life insurance	7.9¢
Letter, 6 May, with forms to request information on life insurance	6.3¢
Letter, 19 May, with forms to request information on life and household insurance	8¢
Letter, 15 June, comparing cost of life insurance	6.3¢
Booklet, "USAA Has Coverage for All Needs," 25 June	8¢
Statement, with booklets to request information on all types of insurance, 12 July	13¢
Letter, 14 July, decreasing term life insurance	7¢
Letter, requesting toll free call to learn about complete portfolio of life insurance, 5 August	6.3¢
Folding card, summary of four most popular life insurance plans, 25 August	8¢
Letter, 10 September, "We Can Tailor Life Insurance Programs to Fit You"	7.7¢
Letter, 5 October, rising cost of life insurance	6.3¢
Letter, 10 November, "Your Dynamic Estate"	7.9¢
Booklet, USAA Life insurance in force plus card to request information, 27 November	7.7¢
Letter, 15 December, "Life Insurance--What You Can Buy for \$50"	6.3¢
Letter, 7 December, "Homeowners Life Insurance"	<u>7.7¢</u>
TOTAL	\$1.994

## CHAPTER VII

### CONCLUSION

What, then, is the insurance consumer's best course of action? The American insurance consumer has and will continue in the near future to recognize that life insurance is a necessity for some measure of personal comfort.

Life-oriented goals must be considered when selecting a life insurance program. One must coldly and unemotionally consider what will happen in the event of the death of the family breadwinner. This contingency must be discussed with the family. It should be recognized that the one person who needs insurance most is the head of a young family--the breadwinner--and that not everyone needs a life insurance policy. One must consider when insurance needs are greater, and when they are lessened. For that reason, one must periodically review his financial and insurance situations in connection with his changing goals. The purchase of insurance can never be a static, once-in-a-lifetime operation. As life and ideas change, so do insurance needs.

The type of life insurance to buy will depend upon the life-oriented goals. If the purpose for buying life insurance is to obtain some degree of protection for the family and some feeling of personal comfort, then the life insurance consumer should select

term insurance as the basis for his life insurance program. More true protection for a given amount of expense can be purchased with term insurance. However, as term insurance provides only protection the consumer should realize that some type of savings program is necessary to provide an income source in the later years of life.

How much life insurance should the breadwinner buy? The amount of insurance to carry will always be a compromise between the amount necessary for the beneficiaries to lead a comfortable life after the death of the breadwinner and the need for money during his lifetime. The life insurance consumer must realize that he cannot provide totally or even satisfactorily for the well-being of his family after his death and that life insurance is only a partial solution to the economic problems facing any family after a death.

The individual must decide how much he wants to spend on life insurance. There are rules of thumb. Some will say the amount of your life insurance should be six times your annual income. Others will suggest that you earmark 10 to 20 percent of your earnings. Each agent may have his own formula.

One should be aware that life insurance is, or at least should be, an emergency fund. The amount of insurance needed to support a family and the amount affordable may not be close. Therefore a compromise will result in the fact that one will carry insufficient life insurance. This will enable the breadwinner to pay the premiums without unnecessary hardship, or reduction in the living standards, or risk of lapse or surrender that would destroy the primary reason for buying insurance.

Despite the glowing picture drawn by insurance companies, consider the fact that a \$20,000.00 policy would provide the widow at age 55 only \$90.00 per month for the rest of her life. This kind of sober realization should help provide a more realistic planning framework.

In assessing ones life insurance needs and determining a philosophy on such matters, one should constantly be reminded of the basic needs of the widow. More than any other factor, an estimate of the capability of ones spouse should help determine the correct amount of coverage. How well equipped is she to go to work, or to meet an economic crisis? How well can she manage finances?

Remember that at the death of the breadwinner, the lives of the survivors will have to be totally rearranged, and that \$20,000.00 will be of little help in relation to need to them. Instead of an insurance policy, the premium money might be better invested in the acquisition of a special skill or advanced education by the wife. This would enable her to earn a portion of her living expenses after the death of the husband.

This study has pointed out the importance of more Federal Government involvement in the regulation of life insurance companies. Effective state laws in the life insurance area should be made Federal regulations so as to provide protection for all American consumers. A Federal consumer protection agency should study the American consumer belief that a need exists for large

amounts of life insurance and what propaganda has caused this belief. If the American consumer has been falsely caused to believe that a need exists for life insurance, then appropriate regulation of the life insurance industry and a consumer education program must be developed.

The life insurance consumer should be provided some protection by requiring life insurance companies to provide each consumer with a Federal pamphlet which would explain the various types of life insurance coverage available and the advantages of each. A mandatory waiting period between the application and contract completion would provide time for the consumer to read the pamphlet and evaluate his life insurance need without pressure from the life insurance company or agent.

In summary then, this study of life insurance has led to the realization that some personal comfort is provided by owning life insurance. It has also been concluded that term insurance is the best and cheapest way to buy life insurance, and that only the breadwinner in a young family situation should be covered by life insurance.

APPENDIX I

UNFAIR METHODS OF COMPETITION AND UNFAIR OR DECEPTIVE ACTS OR PRACTICES  
IN THE  
BUSINESS OF INSURANCE  
STATUTES OF THE STATE OF NEBRASKA

1. Making, issuing, circulating, or causing to be made, issued or circulated, any estimate, illustration, circular, statement, sales presentation, omission, or comparison which:
  - a. Misrepresents the benefits, advantages, conditions, or terms of any insurance policy
  - b. Misrepresents the dividends or share of the surplus to be received on any insurance policy
  - c. Makes any false or misleading statements as to the dividends or share of the surplus previously paid on any insurance policy
  - d. Misleads or misrepresents the financial condition of any

person or the legal reserve system upon which any life insurer operates

e. Uses any name or title of any insurance policy of class of insurance policy which misrepresents the true nature thereof

f. Misrepresents for the purpose of inducing or tending to induce the lapse, forfeiture, exchange, conversion, or surrender of any insurance policy

g. Misrepresents for the purpose of effecting a pledge or assignment of or effecting a loan against any insurance policy

h. Misrepresents any insurance policy as being shares of stock

2. Making, publishing, disseminating, circulating or placing before the public, or causing, directly or indirectly, to be made, published, disseminated, circulated, or placed before the public, in a newspaper, magazine, or other publication, or in the form of a notice, pamphlet, letter, or poster, or over any radio or television station, or in any other way, an advertisement, announcement, or statement containing any assertion, representation, or statement with respect to the business of insurance or with respect to any person in the conduct of his insurance business which is untrue, deceptive, or misleading

3. Making, publishing, disseminating, or circulating, directly or indirectly, or aiding, abetting, or encouraging the making, publishing, disseminating, or circulating of any oral or written statement or any pamphlet, circular, article or literature which is false, or maliciously critical of or derogatory to the financial condition of any person and which is calculated to injure such person

4. Entering into any agreement to commit, or by any concerted action

committing any act of boycott, coercion, or intimidation resulting in or tending to result in unreasonable restraint of or monopoly in the business of insurance

5. a. Filing with any supervisory or other public official, or making, publishing, disseminating, circulating, or delivering to any person, or placing before the public, or causing, directly or indirectly, to be made, published, disseminated, circulated, delivered to any person, or placed before the public, any false material statement of fact as to the financial condition of a person

b. Making any false entry of a material fact in any book, report, or statement of any person or omitting to make a true entry of any material fact pertaining to the business of such a person in any book, report, or statement of such a person

6. Issuing or delivering or permitting agents, officers, or employees to issue or deliver agency company stock or other capital stock, or benefit certificates or shares in any common-law corporation, or securities or any special or advisory board contracts or other contracts of any kind promising returns and profits as an inducement to insurance

7. Making or permitting any unfair discrimination between individuals of the same class and equal expectation of life in the rates charged for any contract of life insurance.



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