



Consumer Federation of America

LOWER-INCOME HOUSEHOLDS AND THE LIFE INSURANCE MARKETPLACE: SHOULD WE BE CONCERNED ABOUT DECLINING PARTICIPATION?

Life Insurance Report Prepared by Stephen Brobeck, CFA Executive Director, for the Ford Foundation, October 2011

Introduction

Historically, life insurance has played an important role in helping protect household incomes and facilitate saving. Term insurance has helped ensure that, on the death of a wage-earner, his or her dependents had resources to cover living expenses for a period of time. And cash-value policies, especially whole life, have provided both an assurance that death benefits can continue until death at an old age and a tax-deferred way to save regularly for retirement.

However, household participation in the life insurance marketplace has declined for decades. According to the industry's 2010 Life Insurance Fact Book, the number of individual policies purchased fell fairly steadily from 22 million in 1955 to 10 million in 2009. To an extent this decline was offset by increasing sales of group insurance, which rose from two million in 1955 to 27 million in 1999. But the average coverage of these group policies was only about \$60,000, and their annual sales declined, between 1999 and 2009, to 19 million.¹ Furthermore, insurance coverage has increasingly been sold to wealthy Americans, with cash-value policies becoming "a tax shelter for the rich" according to one industry leader.² An analysis done for the Wall Street Journal found that high-end policies of at least \$2 million made up nearly two-fifths of the face value of new cash-value policies sold in 2007.³ Ten years earlier, that percentage was ten. Between 1989 and 2007, according to the Federal Reserve Board's Survey of Consumer Finances, the proportion of households with cash-value insurance declined from 36 percent to 23 percent.⁴

¹ American Council of Life Insurers, ACLI Life Insurers Fact Book 2010, pp. 66, 72.

² Mark Maremont and Leslie Scism, "Shift to Wealthier Clientele Puts Life Insurers in a Bind," The Wall Street Journal (Oct. 3, 2010).

³ Ibid.

⁴ Federal Reserve Board, Survey of Consumer Finances, 1989 and 2007.

This declining participation is reflected in the modest ownership of life insurance policies by low- and moderate-income (LMI) families. In 2007, according to the Survey of Consumer Finances, only 35 percent of low-income households (lowest quintile) and 54 percent of moderate-income households (second quintile) held a term and/or whole life insurance policy. Moreover, the coverage of these policies was not large enough to support dependents for very long. For low-income families, the median face value of the 24 percent with term insurance was \$16,000, and the median face value of the 13 percent with whole life was \$15,000. For moderate-income households, the face value of the 41 percent with term was \$30,000, and the face value of the 17 percent with whole life was \$22,000. Nor had the whole life policies accumulated much cash-value -- a median of \$2,500 for low-income households and \$5,000 for moderate-income households.⁵

The central questions this paper raises are how concerned we should be about this modest life insurance ownership and what steps, if any, we should take to increase LMI household participation in the life insurance marketplace.⁶ Answering these questions is complicated by a couple substantive factors: First, not all these households need the income protection afforded by life insurance. A number have no dependents. Also, the relatively generous survivor benefits offered by the Social Security System provide some income protection to dependents. Second, for decades most independent experts have urged low- and middle-income consumers to "buy term and invest the difference."⁷ This advice has unquestionably discouraged the purchase of whole life and other cash-value policies by these households, whose incomes are usually too low to use the policies as an effective tax shelter.

Addressing this issue is also complicated by limited knowledge of the extent to which life insurance products meet low- and moderate-income household needs. Sources do provide good information about LMI purchase and ownership of life insurance policies. Consumer Expenditure Surveys, published by the Bureau of Labor Statistics, provide data on average life insurance spending for all households in each of the two lowest income quintiles. As already noted, the Survey of Consumer Finances includes data on

⁵ Analysis of Survey of Consumer Finances data by Professor Catherine Montalto of Ohio State University for Consumer Federation of America, February 2011.

⁶ These and related questions were raised at a forum sponsored by the Federal Reserve Bank of Chicago, the Center for Financial Services, and the Annie E. Casey Foundation in May 2008. See Amy Brown, Insurance and Asset-Building for the Underbanked: A Convening Summary, for a summary of the meeting. See also research prepared for the conference: Rachel Schneider and Kimberly Gartner, The Insurance Industry and the Underbanked (The Center for Financial Services Innovation, March 2007). Robin Newberger and Michelle Coussens, Insurance and Wealth Building Among Lower-Income Households later published by the Chicago Fed Letter (Federal Reserve Bank of Chicago, June 2008). In analyzing 2004 Survey of Consumer Finances data, the latter showed how few low-income households held life insurance policies.

⁷ The value of this advice from financial journalists and financial advisers was supported by a 1977 Federal Trade Commission staff report which concluded that whole life policies often earned far lower yields than other savings and investment accounts.

household ownership of term and whole life policies for these two income groups. And LIMRA, the organization that researches the life insurance marketplace for its industry members, collects useful data on lower-income households that have been incorporated into reports which the group generously shared with us. Furthermore, there is a scholarly literature on various life insurance issues, including the extent to which different types of households need insurance protection.⁸ There are even a couple reports, conducted respectively by the Federal Reserve Bank of Chicago and the Tomas Institute, that are based on interviews with lower-income households.⁹ However, neither these reports nor other research carefully analyzes the life insurance needs of LMI households and the extent to which life insurance products meet these needs.

The paper includes the following sections and subsections:

- Life Insurance Marketplace
 - Types of Products
 - Household Purchase and Ownership
 - Life Insurers and Agents
 - Regulation
- Wealth Accumulation Through Whole Life Policies
 - Why Whole Life Policies Usually Offer Poor Value to LMI Households
 - Reforms Needed to Increase Product Value to LMI Households
- Financial Security for Dependents Through Term Policies
 - Term Life Offers Better Value Than Whole Life for LMI Households
 - Why LMI Households May Choose to Forego Coverage
 - Marketplace Barriers to LMI Household Access
 - Possible Strategies for Increasing Access
- Meeting LMI Household Funeral Needs with Industrial Life and Burial Insurance
- Protecting Surviving Dependents from Consumer Debt Through Credit Insurance
- Summary and Conclusions

The paper begins with an introduction to the life insurance marketplace. This section discusses life insurance companies, products, marketing, and product purchase and

⁸ This literature typically looks at the long-term income needs of middle and upper-middle class households. Particularly interesting is a fairly recent study by B. Douglas Bernheim and others that examined the relation between saving, life insurance coverage, and financial advice among a sample of Boston University employees. B. Douglas Bernheim, Solange Berstein, Jagadeesh Gokhale, and Laurence Kotlikoff, "Saving and Life Insurance Holdings at Boston University -- A Unique Case Study," *National Institute Economic Review*, No. 198 (October 2006), pp. 75-96.

⁹ Newberger, loc. cit. Jongho Lee, Celina Torres, and Yin Wang, *Living in the Present, Hoping for the Future: Latinos and Insurance, A Los Angeles Case Study* (The Tomas Rivera Policy Institute, August 2005). The latter represents the best starting point for research on Latino participation in the insurance marketplace. Using focus groups and survey research, it examines the purchase of auto, homeowners, and life insurance by Latinos and their attitudes toward and experience with these types of insurance.

ownership with a special focus on trends. In separate sections, the paper then examines LMI household need and use of whole life, term, industrial life/burial, and credit life policies. (Credit and industrial life/burial policies are purchased to address specific income needs -- repayment of consumer debt and payment of funeral and burial expenses respectively -- with face values usually under \$10,000. But because these policies may meet important LMI household needs and also have received severe criticism over the years from advocates and academics, they are included in this paper.) Each of these sections assesses the need of LMI households for this insurance, its availability, and when purchased, the value received. Each section also suggests ways to improve needed access and any consumer protections that would help ensure adequate value. And each section discusses potentially useful research.

Life Insurance Marketplace

Types of Products

The two most important types of life insurance products are term and cash-value policies. Term policies provide a death benefit to a beneficiary or beneficiaries as long as premium payments are up-to-date. In 2009, a large majority of these policies sold were "level term," where annual premiums do not increase for the length of the policy, most commonly, for 10, 15, 20, or 30 years.¹⁰

The most useful website for comparing term policies, Term4Sale, reveals how annual premiums vary among dozens of the largest companies. These costs are influenced not only by the amount of coverage purchased and gender, but also by one's use of tobacco and one's health. A typical policy might be purchased by a 36 year old male for twenty years to protect his children financially. If this father wanted \$400,000 of coverage, did not smoke, and had excellent health, his annual premiums would range from \$239 to \$366. If his health was only fair, premiums would range from \$476 to \$782. And if his health was fair and he smoked, premiums would range from \$1,060 to \$1,936. Since premiums rise with age, if this father had delayed the purchase, he would pay more. At age 56, if he did not smoke and was in excellent health, his premiums would range from \$1,235 to \$1,658, four to five times as high as those of the comparable 36 year old.¹¹ Being substantially overweight or underweight would also boost the premiums of many policies.¹²

¹⁰ Winston Hall, "Serving Up Life Insurance Products to the Middle Market," *Product Matters* (October 2010), p. 13.

¹¹ See Term4Sale website, www.term4sale.com, which permits variation of age, gender, residence, health, smoker/non-smoker, and death benefit to obtain quotes from dozens of life insurers.

¹² See discussion of influence of body mass index (BMI) on rates in article on "being overweight carries life insurance pains" on Insure.com website.

Cash-value policies, called "permanent insurance" by the industry, include a death benefit and a cash accumulation. For decades, the most common cash-value policies sold were whole life policies, and today these policies represent a large majority of those sold to low- and middle-income households.¹³ In whole life policies, a consumer makes level payments that, over the course of the policy, cover the cost of a guaranteed death benefit plus a "cash value" that accumulates and earns interest. Not surprisingly, then, for the same death benefit, whole life premiums are usually much higher than those of term, especially for young adults, the group most likely to be raising children.¹⁴

Over the past several decades, alternatives to whole life have emerged and been marketed aggressively, especially to households with substantial assets -- universal life (UL) and variable universal life (VUL). These cash-value policies allow greater flexibility in premium payment and insurance amounts with returns that, for VULs, vary depending on the performance of investment accounts. Thus, a VUL offers the possibility of greater rewards, if investments perform well, and also greater risks, if they perform poorly.¹⁵ In the last decade, two variations of UL have become popular -- equity-indexed UL and guaranteed premium UL. The former usually links returns to the S&P 500 with a lower-than-normal guaranteed interest rate and a downside floor of protection. The latter mimics term with guaranteed level premiums payable for any desired number of years, often to age 100. Guaranteed premium UL policies are heavily front-end loaded and must be carried to death to achieve reasonable value. VULs and the UL variations, targeted to upscale markets, are rarely sold in LMI markets.¹⁶

Two other types of life insurance sold are credit life and industrial life. Credit life is most often sold by lenders to borrowers, frequently to those purchasing cars, who want the loans paid off if they die. Depending on state-set maximum rates, annual charges on a \$10,000, 48-month loan might range from \$150 to \$700.¹⁷ Industrial life and burial insurance are typically sold by specialty insurers, often through funeral homes, to customers who want a death benefit to help cover funeral and burial expenses. At one insurer, a 32 year old non-smoker would pay premiums of \$219 a year for \$10,000 of coverage, and a 52 year old non-smoker would pay premiums of \$420 a year for the same coverage. Smoking would increase these premiums by one-third to one-half.¹⁸

¹³ ACLI Life Insurance Fact Book 2010, p. 68.

¹⁴ Elaine Tumicki, "The Product - Market Challenge," LIMRA's MarketFacts Quarterly, v. 24, n. 3 (Summer 2005), p. 27.

¹⁵ James H. Hunt, Variable Universal Life Insurance: Worth Buying Now? (Consumer Federation of America, December 2007).

¹⁶ Hunt, loc. cit. Article by insurance consultant and blogger Donald Yerke, "Selling Life Insurance Policies -- Selling Term vs. Whole Life Insurance Coverage Plans," found on ezinearticles.com.

¹⁷ James H. Hunt, table of credit life charges and costs on an "illustrative loan" released by the Consumer Federation of America in January 1997.

¹⁸ See article on "how much does funeral insurance cost" on Journey Insurance Agency website (journeyinsuranceagency.com).

Household Purchase and Ownership

In 2009, according to the Bureau of Labor Statistics Consumer Expenditure Survey, households spent an average of \$309 on life insurance products. That expenditure ranged from \$104 for the lowest-income quintile, to \$140 for the second-income quintile, to \$728 for the highest-income quintile. The total household expenditure of \$37 billion was substantial, slightly exceeding the \$34 billion spent on car financing, yet much less than the \$129 billion spent on auto insurance.¹⁹

Only about four in ten life insurance policies sold are term. In 2009, according to the American Council of Life Insurers, 41 percent of individual policies sold were term.²⁰ Yet, in part because most group policies are term, most policies held are term. Data from the Fed's 2007 Survey of Consumer Finances indicates that about twice as many households had a term policy (51%) as had a whole life policy (24%). Furthermore, the median face value of the term policies, \$100,000, was almost twice that of the median face value of the whole life policies, \$54,000.²¹

Life insurance protection is provided both by policies sold to individuals and by policies sold to organizations which then provide coverage to members or customers. In 2009, nearly twice as many individuals received coverage from groups, mainly employers, as from their own purchases. However, the average face value of the group policies per insured (\$60,800) was far less than the average face value of the individual policies (\$174,400).²²

Of the \$37 billion spent by consumers for life insurance in 2009, less than \$1 billion represented credit life insurance premiums. For this year, the American Council of Life Insurers reported that these premiums totaled \$842 million.²³ These premiums were paid on slightly fewer than 25 million policies, which meant that the average annual premium per policy was just \$34. There are no reliable estimates available of how much consumers spend each year on industrial life and burial insurance.

Life Insurers and Agents

A few large insurers dominate the life insurance marketplace. In 2009, Northwestern Mutual collected the most net life insurance premiums, \$10.4 billion. MetLife (\$9.6 billion), New York Life (\$8.7 billion), Prudential Financial (\$7.5 billion), and American

¹⁹ See line items on "life and other person insurance," "vehicle insurance," and "vehicle finance charges" in the table on average annual expenditures and characteristic from the 2009 Consumer Expenditure Survey, U.S. Bureau of Labor Statistics.

²⁰ ACLI Life Insurers Fact Book 2010, loc. cit., p. 64.

²¹ Montalto analysis of SCF data, loc. cit.

²² ACLI Life Insurers Fact Book 2010, loc. cit., p. 66.

²³ Ibid., p. 37.

International Group (\$6.8 billion) were not far behind. Only fourteen other insurers collected more than \$1.5 billion in annual premiums.²⁴

Yet, by standard measures the industry is not highly concentrated. In 2006, more than 1000 companies were registered by at least one state to sell life insurance.²⁵ And back in 1997 according to one study, concentration ratios fell far short of a 4-company 40 percent market share -- only 25 percent on average for state ordinary life premiums.²⁶ In 2006, according to another study, in the ordinary life insurance market, the ten largest sellers held 57 percent, with a Herfindahl-Hirschman Index of 498; in the credit life insurance market, the ten largest sellers held 73 percent, with a HHI of 779; but in the industrial life insurance market, the ten largest sellers held 93 percent, with a sky-high HHI of 2970.²⁷ Markets with indexes below 1000 are not considered highly concentrated.

The number of sellers, the effective standardization of a level premium products, and the existence of useful websites for comparing products has helped make the term life insurance marketplace a highly price-competitive one offering good value to consumers. By comparison, the complexity of products and the lack of effective cost and illustration disclosures have contributed to a cash-value life insurance marketplace that is opaque and confusing.

Because life insurance is "sold not bought," insurers must sell their products fairly aggressively. Traditionally, they have done this selling through the affiliated agency system with its career agents, home service agents, and multi-line exclusive agents.²⁸ In 1997, according to one report, 68 percent of total life premiums were written through agents or brokers.²⁹ This emphasis on personal sales is not surprising given the fact that personal communication generally represents the most effective way to sell complex products that are not as highly valued as many other products.

Nevertheless, direct selling of life insurance is increasing. In 2008, according to research involving LIMRA, 20 percent of the policies sold were through direct channels such as the Internet, direct mail, and telephone. And between 2006 and 2010, the number of consumers who purchased insurance online doubled.³⁰ This number is expected to grow rapidly not only because of an increasing number of consumers who make Internet

²⁴ *Ibid.*, p. 101.

²⁵ Martin F. Grace and Robert W. Klein, *The Future of Insurance Regulation in the United States* (Brookings Institution Press, 2009), p. 23.

²⁶ Martin F. Grace and Robert W. Klein, *The Industrial Organization of the U.S. Life Insurance Industry: Issues and Analysis in the Structure of the Industry* (Center for Risk Management and Insurance Research, Georgia State University, 2000), p. 35.

²⁷ Grace and Klein, *Future of Insurance Regulation*, loc. cit., p. 24.

²⁸ Grace and Klein, *Industrial Organization*, loc. cit., p. 2.

²⁹ Marianne Purushotham, "The Impact of Distribution on the Individual Life and Annuity Industry," *The Actuary Magazine* (June 2006), p. 2 of 4.

³⁰ March 8, 2010 news release by LIMRA posted on their website (www.limra.com/newscenter).

purchases, but also because of the erosion of the agency system. From 1989 to 2004, according to LIMRA estimates, the number of full-time life insurance agents declined 34 percent to 160,000.³¹ In 2005, the head of LIMRA reported that 40 percent of affiliated life insurance agents planned to retire in the coming decade.³²

Regulation

The need for regulation of U.S. life insurers was first evident in the early nineteenth-century, when relatively new life insurance companies "became notorious for high expenses, shaky finances, and abusive sales practices."³³ As a result of these abuses, and similar problems with property/casualty companies, state insurance commissions were created. In 1871, a national group, the National Association of Insurance Commissioners (NAIC), was established to coordinate and support state regulation.

The two important functions of state insurance commissions are to regulate solvency and to oversee market conduct. Solvency regulation is especially important because, like banks, life insurers hold funds that will be used to meet future obligations. The dependents of someone with a 20-year level term policy expect to receive a death benefit if that policyholder dies, say, in year 17. And someone who invests regularly in a whole life policy expects that their insurer will preserve, if not grow, their invested funds. During the past half-century, the life insurance industry has faced a couple serious financial challenges -- during the 1980s then again during the recent financial crisis. But with the aid of state guarantee funds and the recent federal bailout of AIG's non-life subsidiary, it has remained solvent.

Market conduct regulation is also important to consumers because the complexity of life insurance products, especially those with cash-values, creates consumer vulnerability to deceptive and unconscionable sales practices. That is why insurance commissers can review new products for suitability and monitor advertising and the use of policy illustrations. In the early 1990s, several large life insurers were fined and required to provide refunds to policyholders who had been misled by sales agents. During the high-interest era of the 1980s, using company-supplied illustrations, some agents told buyers of whole life policies they could pay premiums for a limited period of time, then allow policy values to cover all future premiums. But as interest rates declined, the time period before premiums "vanished" increased greatly. Some agents were also found to have sold life insurance, providing only a death benefit, as an investment. And for decades,

³¹ Purushotham, loc. cit., p. 2 of 4.

³² Ron Panko, "Motivating the Middle Market," *Best's Review*, v. 108, n. 11 (March 2008), p. 76.

³³ Grace and Klein, *Future of Insurance Regulation*, loc. cit., p. 32. This section draws heavily from this source and from Robert W. Klein, "Insurance Regulation in Transition," *the Journal of Risk and Insurance*, v. 62, n. 3 (Sept. 1995), pp. 363-404.

churning -- selling new whole life and other cash-value policies to existing policyholders in part to capture large first-year commissions -- has been of concern to regulators.³⁴

In the 1990s, state insurance regulators issued rules about sales illustrations that, together with the desire of large insurers to preserve their reputations, resulted in more disciplined and responsible marketing of cash value life policies, though illustrations still show policies to be made "paid-up" on a nonguaranteed basis. And replacement regulations also issued in the 1990s have had limited success in checking inappropriate replacements, with some characterizing them as "do-it-yourself kits" for agents. State insurance commissions do not regulate life insurance rates except for those of credit life insurance.³⁵

Wealth Accumulation Through Whole Life Policies

Whole life policies offer several attractive features to LMI households who wish to build savings. The policies allow those families with dependents both to accumulate cash and to receive death benefits. Especially if premiums are paid automatically each month from checking, they are convenient to make. At any time beyond an initial period, the cash accumulation can be used as security for a relatively inexpensive loan or can be withdrawn. And if policyholders pay premiums regularly for at least twenty years, even if gaining little or no tax benefit, they can receive a respectable return on their investment. In 1997, life insurance actuary James Hunt analyzed, for the Consumer Federation of America, 100 cash value policies that he had earlier evaluated for individual policyholders. After twenty years, the average annual rate of return on these policies ranged from three to more than seven percent. For the five Metropolitan Life policies analyzed, for example, the rates of return ranged between 5.2 percent and 7.1 percent.³⁶

Why Whole Life Policies Usually Offer Poor Value to LMI Households

Regardless of these potential benefits, independent experts usually recommend that most consumers "buy term and invest the difference." Popular financial advisor Dave Ramsey is particularly adamant on this point: "Do not invest money in life insurance; the returns are horrible."³⁷ The main basis for this advice is that front-loaded agent commissions usually produce a negative rate of return in the first several years, and a relatively low rate of return after that up to about fifteen years, yet many policies are terminated before then. Based on data from LIMRA, more than one-quarter (26%) of whole life policies

³⁴ James H. Hunt, *Miscellaneous Observations on Life Insurance* (Consumer Federation of America, Jan. 2011).

³⁵ *Ibid.*

³⁶ James H. Hunt, *Analysis of Cash Value Life Insurance Policies: A Report on CFA's Rate of Return Service* (Consumer Federation of America, July 1997).

³⁷ Dave Ramsey, "The Truth About Life Insurance" (October 25, 2010) from his website, www.daveramsey.com.

are terminated in the first three policy years, nearly one-half (46%) are terminated in the first ten years, and nearly three-fifths (58%) are terminated in the first twenty years.³⁸ Relatively high, front-loaded commissions ensure that early terminations substantially lower savings yields. Usually more than half a policyholders first year's premium, and sometimes even more than 100 percent of this premium, is paid to the policyholder's agent in commission. As a result, in the first several years policyholders who terminate typically lose some or most of their savings accumulation. For the 100 whole life policies Hunt analyzed in 1997, he found a -87.9 rate of return in year one, a -54.9 percent return in year two, a -18.9 percent return in year three, and a zero percent return in year four.³⁹

LMI households fare much worse than high-income households because their termination (also called "lapse") rates are higher. For whole life policies, both the median face value amount and the cash accumulation are strongly associated with income. Median face values rise steadily from \$15,000 for the lowest income quintile to \$130,000 for the highest quintile.⁴⁰ And median cash values increase from \$2,500 for the lowest income quintile to \$28,000 for the highest decile.⁴¹ Yet, as 2007 research by the Society of Actuaries and LIMRA reveals, there is a consistent inverse relationship between policy size and termination rates. In fact, for policies under \$5,000, the termination rate is more than 45 percent in year one, and for policies between \$5,000 and \$25,000, this rate is 15 percent in the first year. By comparison, for policies over \$200,000 lapse rates are below 10 percent in year one.⁴²

One reason for the higher termination rates among LMI whole life policyholders is that, because of lower and less secure incomes, these households are the least likely to afford continuous premium payments over a fifteen to twenty year period. And a reason for the high termination rates among all policyholders is that life insurance agents have little financial incentive to encourage them to make premium payments reliably over an extended time period. While first year commissions usually exceed 50 percent, commissions in years two to nine often range from five to eight percent, while in years ten and beyond, they drop to two percent or less.⁴³

Perversely from the consumer's perspective, this commission structure financially incentivizes agents to encourage policyholders to replace their current policies, not to continue making payments on existing ones. This churning, which dramatically lowers

³⁸ Hunt, *Miscellaneous Observations*, p. 4.

³⁹ Hunt, *Analysis of Cash Value Life Insurance*, loc. cit.

⁴⁰ Montalto analysis of SCF data, loc. cit.

⁴¹ Brian K. Bucks, Arthur B. Kennickell, Travi L. Mach, and Kevin B. Moore, "Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin* (February 2009), p. A18.

⁴² Marianne Purushotham, *U.S. Individual Life Persistency Update, A Joint Study Sponsored by LIMRA International and the Society of Actuaries* (2007), pp. 22-23.

⁴³ James H. Hunt and Stephen Brobeck, *Early Life Insurance Terminations and Wasted Consumer Expenditures* (Consumer Federation of America, July 1995).

policyholder rates of return, is a subject of concern not only for both consumer advocates and insurance regulators but also for some industry leaders. As one of these leaders recently wrote: "The problem of abusive replacement of in-force life insurance policies has been part of the insurance industry seemingly forever....Not all replacements are inappropriate....That said, the industry has a long and inglorious history of advisors, agencies, and companies that built their businesses on indiscriminate replacement predicated on deliberately incomplete and/or falsified comparisons."⁴⁴

Even those LMI households that pay whole life premiums on one policy for twenty years may not receive good value from their policies. One reason is that it is very difficult, if not impossible, for consumers to compare complex insurance products because of inadequate cost disclosures. To quote one expert, "some have called them black boxes...that are impossible for laypersons to penetrate."⁴⁵ The variation in 20-year rates of return from three percent to more than seven percent, found by Hunt in his analysis of 100 whole life policies, illustrates this point.⁴⁶ LMI consumers, who tend to have less education than higher-income individuals, may have particular difficulty understanding the terms and conditions of whole life policies.

Reforms Needed to Increase Product Value to LMI Households

Could whole life policies ever provide good value to many LMI households? The value of the policies to these households would undoubtedly increase if two important reforms were enacted into law. The first is adequate disclosure of commissions, as in the United Kingdom and Australia. This disclosure would help reveal the high cost of early terminations and provide more realistic illustrations of cash-value accumulations. The second reform is suitability laws to protect buyers against sellers who are promoting inappropriate policies, such as many replacements. This protection, loosely supervised by the Securities and Exchange Commission, now exists only for variable life purchases such as universal life.⁴⁷

Even then, whole life policies would probably not offer good value to most LMI households unless agent commissions were largely leveled for the term of the policies. Such leveling would give sellers a much greater incentive to seek continuous policyholder payments, thus increasing rates of return. The traditional front-loaded commission structure for whole life and other cash-value policies explains much, if not most, of current lapse rates.

The political prospects for these reforms, however, are not promising. In the 1970s and 80s, advocates and some policymakers attempted to persuade states to require better disclosures. But these efforts largely failed even though conditions were more conducive

⁴⁴ Alan Press, "The Evolution of the Life Insurance Industry," LIMRA's MarketFacts Quarterly, v. 29, n. 4 (2010), p. 4.

⁴⁵ Hunt, Miscellaneous Observations, loc. cit., p. 4.

⁴⁶ Hunt, Analysis of Cash Value Life Insurance, loc. cit.

⁴⁷ Hunt and Brobeck, Early Life Insurance Terminations, loc. cit.

to reforms than they are today. More individual cash-value policies were being sold, and sales abuses, such as the use of unrealistic illustrations, were much more widely discussed in the press and by regulators. After several large insurers were criticized and fined by regulators in the 1990s for deceptive sales practices noted above, the industry made a greater effort to eliminate egregious practices.⁴⁸ Moreover, any attempt to enact stronger suitability standards and require more level commissions is likely to be strongly resisted by the industry.

Accordingly, it seems more sensible to promote LMI savings through workplace retirement accounts and bank/credit union autosave accounts. These accounts are available to most LMI households. They are relatively transparent. After they are opened, payments are "automatic," foregoing the need for monthly reminders (though whole life payments could be made "automatically" out of checking). And unlike whole life insurance, there is no substantial penalty for closing an account after a few years.

Whole life policies, both currently and prospectively, offer such poor value to many LMI households that useful research on the subject is limited. Still, it would be interesting to learn more about the product experiences of the 13 percent of low-income households, and 17 percent of moderate-income households, that own whole life policies. Perhaps the first question that could be asked is why these two groups have such modest median cash-values -- \$2500 for the first, \$5000 for the second? One factor may be that many or most of these policies represent burial insurance, a variant type of whole life policy discussed in a later section. Another factor may be that most of these policies are relatively new, with little cash value buildup, which might partly reflect high termination rates. It would also be interesting to know what percentage of LMI households had ever purchased, but eventually terminated, a whole life policy, and the reasons for these terminations.

Financial Security for Dependents Through Term Policies

Term Life Offers Better Value Than Whole Life for LMI Households

Most independent experts believe that term insurance offers LMI households better value than whole life. Compared to whole life policies, the most popular term policies are standardized and relatively simple. A large majority of term policies sold recently are for ten to thirty years with equal annual premiums for a specified death benefit. If the policyholder dies and the policy is paid up, beneficiaries receive the death benefit. There are no surrender values or need for illustrations. This simplicity allows easier product comparisons, which can be made by consulting websites such as Term4Sale.com. These websites have made what is already a price-competitive product even more price competitive. At a relatively early date in the life of Internet price comparisons, a 2002

⁴⁸ Klein, "Insurance Regulation," loc. cit., pp. 374-375. That effort included the creation of the Insurance Marketplace Standards Association, an industry-funded organization to promote higher standards and ethics (recently dissolved).

study concluded that life insurance websites had already reduced prices by eight to fifteen percent.⁴⁹

Moreover, term premiums are much less expensive than are whole life premiums. For \$100,000 in coverage, annual premiums for a 40 year old non-smoking woman in good health are available at several companies for less than \$140 annually.⁵⁰ By comparison, if this woman paid \$150 a year in annual premiums on a typical whole life policy, her beneficiaries would receive only about \$10,000 in death benefits.

As well as offering better financial value to LMI households than whole life, term policies are preferred. To quote one expert: "The average consumer wants inexpensive, easy-to-understand insurance with a level premium and a guaranteed death benefit."⁵¹ That is a functional description of most level term policies.

Why LMI Households May Choose to Forego Coverage

Yet, as noted earlier in the paper, most LMI households have no term insurance, and most LMI policyholders have coverage so low that it could not provide significant extended financial support. In 2007, according to the Survey of Consumer Finances, only 24 percent of low-income families had a term policy, and the median face value of these policies was \$16,000. And while 41 percent of moderate-income households had a term policy, the median face value of these policies was only \$30,000.⁵²

There are many factors that help account for the low levels of term life coverage among LMI households. Several involve consumer needs and perceptions. Most obviously, LMI households without dependents -- for example, single persons, working couples each with an income, many retired persons -- may feel little or no need to purchase life insurance. The most important reason people purchase term insurance is to protect their children. Yet only one-third of low-income households (33%) and two-fifths of moderate-income households (40%) have children living at home. These households are less likely to have life insurance than those without children -- in 2007, 27 vs. 39 percent for low-income units, and 49 vs. 57 percent for moderate-income units, though the households with children tend to have greater coverage.⁵³

A second factor is that young adults with dependent children correctly perceive that they are less likely to die than decades ago so may feel less urgency to purchase insurance protection. In 2007, the annual death rate for men 25 to 34 years old and 35 to 44 years

⁴⁹ Jeffrey R. Brown and Austan Goolsbee, "Does the Internet Make Markets More Competitive? Evidence from the Life Insurance Industry," *The Journal of Political Economy*, v. 110, n. 3 (June 2002), pp. 481-507.

⁵⁰ Term4Sale website, loc. cit.

⁵¹ Karen R. Terry, "A New Whole Life: the Shift From Perm to Term Insurance," *LIMRA's MarketFacts Quarterly*, v. 24, n. 4 (Fall 2005), p. 36.

⁵² Montalto analysis of SCF data, loc. cit.

⁵³ *Ibid.*

old was a small fraction of one percent -- 144 and 232 per 100,000 respectively. From ages 25 to 44, then, men had, on average, less than a four percent chance of dying. And during the same twenty-year period of their lives, women had only about a two percent chance of dying. Since these death rates had declined by around 50 percent since 1950, they could well have contributed to declining demand for insurance protection.⁵⁴

In addition, surviving dependents can turn to other sources of support. LMI dependents do not have nearly the access to inherited family wealth, or financially supportive family and friends, as do higher-income dependents. But most would have access to Social Security survivor benefits. To illustrate how generous these benefits can be, Social Security Administration actuaries have estimated the net present value of this insurance for a young family with two children and average earnings to be equivalent to a life insurance policy with face value of \$433,000.⁵⁵ According to one study that links the rise of Social Security survivor benefits to the decline of life insurance sales, many parents are aware of these benefits.⁵⁶

When workers covered by Social Security die, their spouses and dependents usually qualify for survivor benefits. In 2007, 97 percent of covered workers age 20 to 49 qualified for these benefits. These workers are always fully insured if they have been working for at least ten years; if they die at a young age, the time period is less; and under a special rule, surviving children and spouse can receive benefits if the worker has been employed for only 18 months of the previous 36. In 2007, the federal government paid 6.5 million persons about \$70 billion in survivor benefits. (That sum exceeded the \$58 billion paid by life insurers in death benefits in that year.) And in the same year, annual survivor benefits averaged nearly \$13,000 per child.⁵⁷

While Social Security never pays survivor benefits in one lump sum, only a small death benefit of \$250, this practice can be seen as one of the program's advantages. These benefits are of greatest value to LMI households with little savings. But in general, these are the households with a surviving widow, widower, or guardian who is least prepared, or perhaps willing, to allocate a large death benefit effectively to cover living expenses for an extended period of time. The fact that Social Security provides surviving children with a steady stream of income until they are 18 or 19 years of age is one of the program's strengths.

⁵⁴ U.S. Census Bureau, *Statistical Abstract of the United States 2011*, p. 81.

⁵⁵ There are two especially valuable sources on this subject: Survivors Benefits section of the Social Security Administration website (www.socialsecurity.gov). Kathleen Romig and Scott Szymedera, *Social Security Survivors Benefits*, Congressional Research Service Report to Congress, Jan. 8, 2008. For context, see: Melissa M. Favreault, Frank J. Sammartino, and C. Eugene Steuerle, *Social Security and the Family: Addressing Unmet Needs in an Underfunded System* (Urban Institute Press, 2002).

⁵⁶ Frank D. Lewis, "Dependents and the Demand for Life Insurance," *The American Economic Review*, v. 79, n. 3 (June 1989), pp.452-467.

⁵⁷ See sources in note 53.

Low levels of term coverage for LMI households with dependents also reflect the attitudes of these families about life insurance, insurance agents and insurance companies. On the one hand, as surveys reveal, most LMI adults recognize the value of life insurance protection and wish they had greater coverage.⁵⁸ A 2005 survey by TM found that the lower one's income, the more highly life insurance protection was valued.⁵⁹ And a 2010 survey by LIMRA discovered that the lower one's income, the higher the perceived need for more life insurance. Nearly two-thirds (65%) of households with incomes under \$30,000 said they needed greater insurance protection.⁶⁰

On the other hand, few consumers for whom adequate life insurance is an unmet goal believe it to be a top priority. When LIMRA asked a sample of these consumers this question, only seven percent said that it was.⁶¹ Moreover, many consumers have negative views of agents, brokers, and insurers. In a recent article, LIMRA's senior research director summarized these concerns and apprehensions: "Almost two-thirds of consumers fear that agents and brokers are more interested in fees and commissions than in selling them the right product. And only one-third think that agents provide clear explanations of the policies they sell." Furthermore, "only four in ten consumers think companies are financially strong, and less than one-fourth think companies have trustworthy sales representatives or would pay claims with few hassles."⁶²

Considering all these factors, LMI households may choose to allocate limited resources to other uses than term insurance protection. That might especially be the case if they smoked, were overweight, or were in poor health because these factors can significantly increase annual premium expense. The 40-year old woman, who might pay less than \$150 in annual premiums if she did not smoke and was in good health, would have to pay at least \$200 if her health were only "average," more than \$500 if she smoked, and even more if she were also overweight.⁶³ The same woman, if she were supporting children, would also probably feel it was more important to pay the rent than pay for term protection. That may help explain why LMI households with children apparently are less likely to have life insurance than are LMI households without children -- 27 vs. 39 percent for low-income units and 49 vs. 57 percent for moderate-income units -- though the households with children tend to have more coverage.⁶⁴ In general, if their incomes

⁵⁸ A more realistic assessment of LMI household appetite for term coverage might be obtained by asking these households not only whether they value and need this coverage but also whether they value this coverage more highly than the purchase of other goods and services and what they would be prepared to pay for it.

⁵⁹ Business Wire from New York (June 13, 2005).

⁶⁰ LIMRA, *Household Trends in U.S. Life Insurance Ownership* (2010), p. 31.

⁶¹ Anne M. Katcher, "How to Reach and Teach the Middle Market," *Life Insurance Selling*, v. 86, n. 4 (April 2011), pp. 44-46.

⁶² Cheryl D. Retzliff, "A Daunting task," *LIMRA's MarketFacts Quarterly*, v. 29, n. 2 (Spring 2010), pp. 49-56.

⁶³ Term4Sale website, loc. cit.

⁶⁴ Montalto analysis of SCF data, loc. cit.

are identical, households with children tend to have less discretionary income than households without children.

Marketplace Barriers to LMI Household Access

Nevertheless, the welfare of many survivors would increase by receiving life insurance death benefits that supplement Social Security survivor benefits. Insurance coverage of \$100,000 paid out over ten years, for example, could double the annual income of a single surviving child who is also receiving Social Security survivor benefits. To provide this income supplement for the child, a healthy non-smoking policyholder between the ages of 25 and 40 could pay as little as \$100 to \$150 in annual premiums (though \$500 to \$700 a year if they smoked and were in poor health).⁶⁵

This term coverage should meet several criteria: It should be adequate to meet needs. It should be affordable. It should be continuous, providing coverage during the entire period of need. And it should be easily accessible. These last two criteria are especially difficult to meet and need discussion.

The industry and experts agree that life insurance is "sold not bought."⁶⁶ They believe that, to overcome resistance reflecting factors discussed above, and the limited incomes of LMI households, someone must explain the product, its benefits, its value, and its importance to consumers. For many decades, most of this education and sales has been by individual insurance agents and with good reason. As one industry leader put it: "Nothing can replace a loyal sales force of highly motivated, incentive-based advisors who can prospect and close."⁶⁷ Despite recent growth, direct sales through mass advertising, mail solicitations, and Internet solicitations remain a niche market. That is especially true for LMI households with fewer resources, less education, and less access to modern communications.

Life agents, however, are increasingly unwilling to sell term insurance to LMI households largely because this insurance is much less profitable to sell than other products. This relatively low profitability reflects both lower commissions and lower premiums. Agents selling and servicing policies are typically paid 15 to 20 percent less for term policies than for whole life policies.⁶⁸ In addition, per dollar of coverage, small term policies are much more expensive to write than large term policies. As one insurance actuary wrote, "the expenses that are generated from selling ten \$100,000 simplified-issue term policies may exceed the expenses from a single \$1,000,000 fully-

⁶⁵ See Term4Sale website.

⁶⁶ The comment of an editor of *Life Insurance Selling* is typical: "I advise agents never to forget that life insurance still is a product that is sold, not bought, and to recognize that there are no easy ways to prospect." Brian Baetz, "Term Insurance Sales Techniques," *Life Insurance Selling*, v. 79, n. 6 (June 2004), p. 31.

⁶⁷ Press, loc. cit.

⁶⁸ Life insurance section from CNN Money website (money.cnn.com).

underwritten term policy."⁶⁹ As a result, as one LIMRA researcher put it delicately, "producers may not be willing to spend the time necessary to help consumers through the process of deciding what and how much to buy, all for a relatively low term commission."⁷⁰ Or as a Conning & Company researcher put it more bluntly, "there are no agents calling to say, 'Let's sit down around your kitchen table so I can sell you a \$30,000 insurance policy'."⁷¹

LMI households here lack more than access; they also face potential risk. Because of the commission structure, an agent willing to visit a moderate-income family at their home may try to sell them a cash-value policy offering less value than a term policy. Or, an agent may try to sell a relatively new type of term policy with a relatively large first-year commission. In either case, the agent may not have sufficient financial incentive to help ensure that the policyholder continues to make premium payments during the time period of needed coverage.

In the 1980s, some consumer advocates believed that bank branches could provide consumers with expanded access to term insurance so supported legislation that would facilitate bank sale of insurance. Today, banks have this opportunity but do not take advantage of it. From 2000 to 2008, the bank share of life insurance sales declined from 2.3 percent to 1.6 percent.⁷² And most of these sales, especially recently, were very large, single-premium policies to wealthy persons. Two insurance experts recently explained the reason why: "The primary reason life insurance has not taken hold in the bank channel is that it defies the transactional nature of the typical financial consultant and platform rep working in a bank. Bank reps have become accustomed to the quick and easy sale based on pitching investments to bank clients listed on maturing CD lists. Life insurance, however, takes more of a relationship mind set. Delicate questions must be asked. The products are more difficult to understand. There are elements of financial guidance in the life insurance needs discussion. The instant gratification of a quick commission isn't inherent in the application and underwriting process. Clients can be rejected in underwriting."⁷³ However, million-dollar policies, with their relatively large commissions, are seen by some banks as worth this time and trouble.⁷⁴ But even if banks wanted to sell insurance to LMI households they might face resistance. Participants in four Chicago-area focus groups said "they did not trust bankers to give advice about insurance and that banks were not the right place to get information about insurance."⁷⁵

⁶⁹ Hall, loc. cit., p. 12.

⁷⁰ Tumicki, loc. cit.

⁷¹ Joseph B. Treaster, New York Times News Service, Journal Record (June 15, 1998), pp. 1ff.

⁷² Polly Painter-Eggers, LIMRA's MarketFacts Quarterly, v. 27, n. 4 (Fall 2008), pp. 64-70.

⁷³ Scott Stathis and Janet Cappelletti, "Signs of Life: Banks Making Inroads in Life Insurance Success," LIMRA's MarketFacts Quarterly, v. 29, n. 4 (2010), p. 73.

⁷⁴ Painter-Eggers, loc. cit.

⁷⁵ Newberger and Coussens, loc. cit.

The most practical way to extend term insurance coverage to LMI households may be through group insurance offered by one's employer, credit union, or some other non-profit group. This insurance is often limited to \$50,000 or less. But any member of the group, no matter how old or unhealthy, can obtain coverage. Because sales costs are low, the premiums can be relatively low.⁷⁶ And even \$50,000 would be very helpful to most surviving LMI dependents.

Most group insurance is provided by employers, who have typically offered this coverage as a free employee benefit often resulting from a collective bargaining agreement.⁷⁷ Many workers receive this free term coverage -- according to the U.S. Bureau of Labor Statistics, 56 percent of all private sector workers, 78 percent of all state and local government workers, and an even higher percentage of federal government workers in March 2010.⁷⁸

While helpful, employer-provided group insurance has limited or no value to many LMI workers. The typical (median) level of coverage is relatively low for all workers -- \$15,000 for private workers and \$20,000 for state and local government workers -- and is even lower for low-wage workers.⁷⁹ (The \$60,000 average coverage reported by the industry reflects much larger coverages for many professional and executive employees.) More importantly, low-wage workers are far less likely to receive term coverage than are higher-wage workers. In March 2010, according to the BLS, only 24 percent of private workers in the lowest wage quartile, and only 59 percent of government workers in this quartile, received this coverage.⁸⁰ The potential for extending this free coverage is also limited by the growing desire of many employers to cut costs by limiting or eliminating employee benefits and by the declining reach and influence of labor unions that had helped establish the free policies. That is probably the main reason for the 29 percent decline in group insurance policies (technically, "certificates") from 159 million in 1989 to 113 million in 2009.⁸¹

Possible Strategies for Increasing Access

The best long-term hope for providing LMI workers with more adequate term insurance at work may be for employers to contract for group coverage with insurers, give employees the option of purchasing this coverage during enrollment periods for their retirement savings programs, and deduct premiums from biweekly or monthly

⁷⁶ See also article on group term insurance on AXA Equitable website (www.axa-equitable.com/plan/business/group-term-life-insurance).

⁷⁷ Allan P. Blostin, "Is Employer-Sponsored Life Insurance Declining Relative to Other Benefits?" *Monthly Labor Review* (Sept. 1981), pp. 31-33.

⁷⁸ U.S. Bureau of Labor Statistics, "Life and Disability Insurance Benefits: How Extensive is the Employer-Provided Safety Net?" *Program Perspectives*, v. 2, n. 7 (Dec. 2010), p. 2.

⁷⁹ *Ibid.*, p. 3.

⁸⁰ *Ibid.*, p. 2.

⁸¹ ACLI Life Insurers Fact Book 2010, loc. cit., p. 66.

paychecks.⁸² Employers would have the ability to negotiate low-cost coverage, and employees would have the option to purchase more adequate coverages of \$100,000 or more. (Use of a default option would enroll more workers but also some who had no need for life insurance coverage.) Ideally, this coverage would be offered as a supplement to any free coverage. But in reality, employers would be greatly tempted to substitute employee-paid for employer-paid coverage. This risk might be minimized somewhat if the first large private employers to offer employee-paid coverage also continued to offer free limited coverage.

There are, however, other group life insurance options that, while much less popular than employer-provided insurance, may offer greater growth opportunities. These options involve affinity marketing by non-profit groups, which serve and interact personally with members, of term life policies offered by major insurers. For the sale of each policy, the non-profit is compensated. Credit unions, which currently have a relationship with nearly half of all U.S. households and can easily offer group term life insurance, have an unusual capacity to market group term policies. LifeRing, for example, offers a ten-year level premium group term life insurance plan exclusively to credit unions that is underwritten by New York Life. For a healthy person under 40, annual premiums for \$100,000 of coverage are almost always less than \$100.⁸³ However at present selling life insurance does not seem to be a priority for most credit unions. A 2006 survey by the Credit Union National Association of its members found that only 44 percent of credit unions (serving 64 percent of credit union members) even offered life insurance products.⁸⁴ And these products are not featured prominently -- some are even hard to locate -- on the websites of most large credit unions.

Some credit unions, as well as nonprofits like AARP, offer term policies to older persons. This coverage, however, is more expensive and often requires a medical exam.⁸⁵ For example, Patelco Credit Union, the largest California credit union, requires a medical exam for coverage more than \$30,000 and charges 60-64 year old members about \$1200 a year in premiums for \$50,000 in term coverage.)⁸⁶

Finally, there is reason to believe that some major life insurers would be willing to explore, with non-profit groups, more effective ways to provide LMI households with term coverage. Some insurers believe that selling life insurance policies to what they call the "middle market" -- defined variously as households with incomes as low as \$25,000, \$30,000, or \$35,000 -- not only could be profitable but also is politically necessary. As one industry member wrote recently: "With an \$11.4 billion annual premium potential,

⁸² Retzloff, loc. cit., p. 50.

⁸³ See LifeRing website (www.lifering.net/lifering/).

⁸⁴ Information supplied by CUNA in a June 27, 2011 email.

⁸⁵ See AARP Level Benefit Term Life Insurance website (www.nylaarp.com/Life-Insurance/Level-Benefit-Term).

⁸⁶ See Group Term Life Insurance page of Patelco Credit Union website (www.patelco.org/insurance/group).

the middle market is a virtually untapped source of new business for life insurers."⁸⁷ And as the head of LIMRA cautioned more than two decades ago: "In this scenario [ignoring lower-income markets] it's difficult to portray insurance as the protector of widows and children or to justify the continued tax advantages of investment-oriented life products to politicians."⁸⁸ Today, with Congress searching desparately for new sources of revenue, industry leaders are especially concerned about the possible loss of these tax advantages.⁸⁹

It should be noted that some major insurers have created programs that benefit lower-income families. The most noteworthy is the LifeBridge program of MassMutual, which since 2002 has provided free \$50,000 term policies to thousands of lower-income families to help secure the educations of their children. MassMutual effectively makes the premium payments for up to ten years. As of June 2009, the insurer had issued 9,800 policies and had a long-term goal of 20,000 policies. Since as of this date there had been only seven claims, the greatest cost of the program was rolling out and administering the program in local areas, often in partnership with nonprofits or government agencies.⁹⁰

Given the industry's current emphasis on selling large policies to upper-income individuals, awareness they are not adequately serving society's life insurance needs, and concern about their tax status, it would be useful for nonprofits collectively to engage large insurers in discussions about ways they can better serve the term life insurance needs of LMI households. This dialogue would help nonprofits better understand insurer plans to meet these needs and encourage insurers to more seriously address this issue. These discussions would also better inform nonprofit thinking about useful research and any needed public policies.

Meeting LMI Household Funeral Needs with Industrial Life and Burial Insurance

There are several related products that have been purchased by LMI consumers to help cover their funeral expenses. Industrial life insurance and burial insurance are small life insurance policies that are structured like whole life policies but are almost always purchased just for their death benefits. In the first half of the twentieth-century, most policies sold were called industrial life, had face amounts limited to \$1,000 or \$2,000 depending on state regulation, and had premiums collected by agents at the homes of

⁸⁷ Hall, loc. cit., p. 14.

⁸⁸ John C. Scully, "Has the Life Industry Forgotten Its Mission?" *Best's Review*, v. 94, n. 10 (Feb. 1994), p. 46.

⁸⁹ Maremont and Scism, loc. cit.

⁹⁰ See: Trevor Thomas, "MassMutual Will Offer \$1 Billion in Free Life Insurance to Poor Parents," *National Underwriter, Life & Health*, v. 106, n. 38 (Sept. 23, 2002), p. 81. Jordan Carleo-Evangelist, "Insurer's Policies Free to Eligible Families," *McClatchy-Tribune Business News* (June 4, 2009).

policyholders on a weekly, bi-weekly, or monthly basis.⁹¹ Thirteen of the largest sellers of industrial life insurance reported to the National Association of Insurance Commissioners that, in 1995, they had 12.7 million policies in force representing \$12 billion of insurance, but only three companies indicated that they were still writing these policies.⁹²

Recently, however, most policies sold are marketed as burial or funeral insurance -- though known in the industry as monthly account ordinary or monthly debit ordinary life insurance -- usually have coverage of less than \$10,000, and increasingly have premiums paid monthly by mail.⁹³ According to the NAIC survey, eleven of the largest sellers of monthly ordinary life insurance reported, for 1995, 16 million policies in force representing \$110 billion of insurance.⁹⁴ All these insurance policies have been, and still are, sold by insurance agents who specialize in selling a variety of small policies mainly to LMI households. Today, these "pre-need" policies also are increasingly sold by funeral homes, though some homes prefer to sell mimicking "trust accounts" that are not regulated by state insurance departments (and, as such, will not be discussed in this paper).⁹⁵

There are no reliable data available on how many industrial and burial policies are currently sold annually and remain in force. In 2001, Consumer Reports estimated that 9 to 11 million persons have \$21 billion of coverage.⁹⁶ Throughout most of the last century, industrial life policies were sold disproportionately to African-American families in the South. While that is less true today, most burial insurance apparently is still sold to

⁹¹ Joseph M. Belth and E.J. Leverett, Jr., "Industrial Life Insurance Prices," *Journal of Risk and Insurance*, v. 32, n. 3 (Sept. 1965), pp. 367ff. James R. Young, "Consumer Problems with industrial Life Insurance," *Journal of Consumer Affairs*, v. 10, n. 2 (Winter 1976), pp. 255ff. Joan Koonce Lewis, "Home Service Distribution System: A Method of Marketing Life Insurance to the Poor," *Financial Counseling and Planning*, v. 9, n. 1 (1998), pp. 35-39.

⁹² National Association of Insurance Commissioners, *The Sales and Marketing Practices, Auditing and Accounting Procedures and Products of Insurers Utilizing the Home Service System* report (Dec. 6, 1997), Appendix D, p. 1.

⁹³ Lewis, loc. cit. NAIC, *Sales and Marketing Practices*, loc. cit., p. 4.

⁹⁴ NAIC, *Sales and Marketing Practices*, loc. cit., Appendix D, p. 3.

⁹⁵ See: Susan Souder, "Exploring Trends in the Funeral Industry," *Business People*, v. 21, n. 12 (Jan. 2009), p. 38. See also an updated version of Jessica Mitford's classic, *The American Way of Death* (Alfred A. Knopf, 1998), ch. 19. The trust accounts sometimes offer good financial value if they remain solvent, but they are not backed by the state's insurance guarantee fund, increasing consumer risk. See: Jennifer Huffman, "State Alleges Millions of Dollars Mismanaged in Funeral Trust," *Napa Valley Register* (April 23, 2011).

⁹⁶ "Final Arrangements," *Consumer Reports* (May 1, 2001).

LMI households.⁹⁷ In Florida, according to state regulators, there are about one million policies outstanding.⁹⁸

The popularity of these policies with African-American families is easy to understand. For many African-Americans, funerals have special importance. As slaves whose deaths were typically treated by owners just as either an economic loss (productive workers) or gain (the ill and aged), they began forming cooperative societies to ensure a decent burial for their own. As one researcher put it, "the ritual formality and spectacle of black funerals and burials were clearly deliberate attempts to make the 'home-going' ceremonies of African Americans underscore or encourage a view of each life as important or noble."⁹⁹ These traditions, especially among LMI households, have largely continued to the present.¹⁰⁰

Such funerals, however, are not cheap. In 2009, all funerals cost an average of \$6,560, up from only \$708 in 1960, and LMI African American families tended to purchase more funeral services than many higher-income households who were increasingly substituting cremation for services such as embalming, viewing, a funeral procession, and burial.¹⁰¹ But these LMI families often lacked sufficient savings to cover this expense. In 2007, according to the Survey of Consumer Finances, the 79 percent of low-income households with any financial assets held a median amount of \$1700, the 93 percent of moderate-income households with these assets held a median amount of \$7000, and these figures would be much lower if consumer debts had been subtracted.¹⁰²

Industrial and burial insurance policies would not have become popular without a sales force that sold policies and collected premiums door-to-door. In 1995, according to the industry's trade association, the "home service insurance industry" included 80 companies, 32,000 agents, and 27,000 other employees.¹⁰³ The sales techniques of one agent were revealed recently in a trade association magazine: Show up at the door unannounced. Target people 55-75 with incomes between \$15,000 and \$50,000. Be prepared to market to "seniors who live in shabby trailer parks, old homes with a lonely widow and her 19 cats, or a forgotten widower who became a pack rat after his caring wife passed away."¹⁰⁴ These agents succeed for some of the same reasons many door-to-

⁹⁷ Koonce Lewis, loc. cit., p. 35. Erik Eckholm, "Burial Insurance, at \$2 Per Week, Survives Skeptics," *New York Times* (December 3, 2006).

⁹⁸ Page on industrial life insurance on the Florida Department of Financial Services website, MyFloridaCFO.com.

⁹⁹ Karla F.C. Holloway, *Passed On: African American Mourning Stories* (Duke Univ. Press, 2002), p. 184.

¹⁰⁰ Eckholm, loc. cit.

¹⁰¹ See National Funeral Directors Association website (www.nfda.org/media-center/statisticsreports).

¹⁰² Bucks, loc. cit., pp. A 18-19.

¹⁰³ Koonce Lewis, loc. cit., p. 35.

¹⁰⁴ Alan Benedict, "Insider Secrets of a Final Expense Specialist," *Life Insurance Selling*, v. 85, n. 3 (March 2010), pp. 45-46,48.

door salespersons are successful. Customers appreciate the personal attention and also have difficulty getting sales agents out of their house without signing a contract. Also, they are offered policies that they think they can afford. A 60 year old might pay only \$20 to \$30 a month for \$5000 of coverage, while a 40 year old would pay less.¹⁰⁵ Lastly, the policies are easy to purchase. They do not require a medical exam.

In the past several decades, those selling industrial life insurance policies have received much criticism from investigative journalists, consumer advocates, and regulators. The most widely publicized criticism is based on reports that large insurers including Met Life and Prudential had, up until the 1960s, been charging African American customers higher rates than other customers. In this decade, the two companies stopped selling the policies and, in the 1980s, stopped collecting premiums on policies in force. In 2002, Met Life settled lawsuits by agreeing to pay up to \$160 million to 1.8 million policyholders.¹⁰⁶ And since then, other insurers have agreed to settlements. As recently as 2010, the Citizens National Life Insurance Company agreed to add 23 percent to the face amount of policies purchased before 1960 by African Americans in Texas.¹⁰⁷

In the late 1990s, sellers were also criticized for collecting more in premiums than they would pay out at death. This was often the case for customers who had reliably paid premiums for decades. Sellers were also faulted for high termination rates.¹⁰⁸ These and other questionable industry practices led regulators in states such as Florida and Georgia to investigate and try to reform the industry. It appears, however, that their efforts have had limited success. In Florida, the two reforms proposed by the insurance commissioner -- banning the sale of new burial policies and requiring disclosure to existing customers of past payments and future benefits -- were not approved by the legislature.¹⁰⁹ Today, only Georgia, which prohibits the collection of premiums exceeding 150 percent of the face values of small policies, provides any constraint on premium collection. Several other states -- including Iowa, Nevada, North Carolina, Oregon, and Washington -- require some disclosure of the relation between premium payments and the face value of policies.¹¹⁰

Industrial life and burial insurance need more intense scrutiny from regulators and researchers because there is continuing demand from LMI households, especially African American families, for a financial product that allows them to easily make small monthly payments that will eventually help cover funeral expenses. It would be helpful for state

¹⁰⁵ See Journal Insurance Agency website, loc. cit.

¹⁰⁶ See articles by Scott Paltrow in Wall Street Journal (April 27, 2000), (July 13, 2000), (Feb. 7, 2002).

¹⁰⁷ News release issued by the Texas Department of Insurance, Sept. 14, 2010.

¹⁰⁸ See articles by Eckholm and Paltrow, loc. cit.

¹⁰⁹ Scott Paltrow, "Georgia Regulator to Lead Investigation Into Insurer's Rates for Black Customers," Wall Street Journal (Dec. 15, 2000), p. C13. Edwards Staples, "Florida Probes Industrial Life Practices," Advisor Today, v. 95, n. 4 (April 2000), p. 36.

¹¹⁰ Model Regulation Service section of National Association of Insurance Commissioners website, January 2011.

regulators to update their 1997 report on the home service industry, with a special focus on burial insurance. That update should include information on agent compensation structures. These regulators would benefit greatly from, and certainly welcome, more research on the subject. Of particular value might be intensive investigations of one or more lower-income African American communities in the South to learn how funeral homes and insurance agents are selling small policies and how these policies are viewed, purchased, and used by area residents. Questions to research include: How many households are still making payments on decades-old industrial life policies? Are most small life insurance policies still sold door-to-door? Has the shift from home collection of premium payments to payments by mail or directly debited increased termination rates? Do policyholders believe they are receiving good value from product purchases?

Protecting Surviving Dependents from Consumer Debt Through Credit Life Insurance

When someone dies, there are almost always funeral expenses that must be covered. In some cases, there are also consumer debts. Credit life insurance pays off the balances on individual consumer loans, mainly car loans. While less important to LMI households than other forms of life insurance, credit life has received a great deal of scrutiny over the years.¹¹¹ Most of that scrutiny has been critical, with one consumer group calling it, in the early 1990s, the "nation's worst insurance rip-off."¹¹² For these reasons it is discussed by this paper.

Credit life insurance has received much attention in part because relatively good information exists about this relatively highly regulated product. All states regulate the price of credit life and report statistics annually on its sale and claims. These data reveal low loss ratios -- the portion of premium dollars paid out in claims -- for the product. For decades nationwide, these loss ratios have been under 50 percent. In some states, they have even been less than 20 percent.¹¹³ Critics have also charged that products were often sold deceptively by loan officers who implied or stated that a loan would not be approved unless the insurance was purchased and/or that terms would be more favorable if it were purchased. One 1995 study of a sample of credit life insurance purchasers found that 11 percent said they were pressured to sign up for a policy, 12 percent said they felt that buying a policy would increase their chances of getting a loan,

¹¹¹ Credit life is less important mainly because all consumers spend relatively little money on its premiums -- less than \$1 billion annually -- and because only a minority of LMI households hold car loans -- about one-fifth of low-income households and one-third of moderate-income households -- that represent a large majority of credit insurance sales. Bucks, *loc. cit.*, pp. A40 and A45.

¹¹² Robert A. Rosenblatt, "Consumer Group Claims Credit Life Policies Are Worst Insurance Rip-Offs," *Los Angeles Times* (June 5, 1990). The group was the Consumer Federation of America.

¹¹³ Recent figures on loss ratios were compiled by Birny Birnbaum, Center for Economic Justice, and submitted, with other groups to congressional leaders on July 29, 2009 and to the Federal Reserve Board in October of that year.

and six percent said they believed buying a policy would improve the terms of the loan, though the study also concluded that only 3.4 percent were "subject to coercion."¹¹⁴

Most critics, however, have also recognized that credit life insurance can provide adequate or good value to some consumers.¹¹⁵ These groups include:

- members of credit unions whose policies collectively have a loss ratio of just below 60 percent, the National Association of Insurance Commissioners' standard;
- residents of states such as New York, Vermont, and Maine whose strictly regulated credit life policies have loss ratios of around 60 percent;
- older borrowers whose policies, since they are not age-rated, have above-average loss ratios; and
- those who are willing to pay what is in most states a very high price for peace-of-mind they highly value.

Recently critics have shifted some of their attention from traditional credit life insurance products -- and related insurance for disability, unemployment, and family leave -- to newer debt cancellation contracts (DCCs) and debt suspension agreements (DSAs). Historically, most credit life insurance has been sold by car dealers, banks, and credit unions on car loans, but these insurance sales have declined sharply since the 1990s. In 1999, more than 20 million policies were sold; by 2009, that number had declined to under 11 million. In 1999, there were more than 45 million credit life policies in force; by 2009, that number had fallen to less than 24 million policies generating less than one billion in annual revenues.¹¹⁶ This decline reflects in part the views of car dealers who see the product as less profitable than other products such as service contracts and GAP insurance. As a result, according to one industry estimate, sales of credit life on car loans have declined from over 70 percent to under five percent.¹¹⁷ This estimate, however, may fail to take into account the sale of credit life by insurance companies that have been set up and are controlled by car dealers.

Banks were encouraged to promote DCCs and DSAs by 1992 regulations issued by the Office of the Comptroller of the Currency that asserted the OCC's authority to be the sole regulator of these products. This authority was later upheld by the courts. Today, banks and credit unions collect far more in premiums on DCCs and DSAs than insurers collect on credit life policies. According to a recent Government Accountability Office report, in 2009 the nine largest credit card issuers collected \$2.4 billion in premiums on these products, and paid out only 21 percent of this revenue in claims. Moreover, the GAO found, most of these issuers would not provide detailed information about the product

¹¹⁴ John M. Barron and Michael E. Staten, "Coercion in the Selling of Credit Life Insurance," *Psychology & Marketing*, v. 12, n. 8 (Dec 1995), pp. 765-787.

¹¹⁵ News release issued by the Consumer Federation of America on Jan. 29, 1997.

¹¹⁶ ACLI's Life Insurance Fact Book 2010, pp. 55, 66.

¹¹⁷ Amy Wilson, *Automotive News*, v. 84 (May 3, 2010, p. 24).

until it was purchased.¹¹⁸ Consumer advocates now hope that the new Consumer Financial Protection Bureau will take steps to improve the value of this product to consumers and will encourage the Bureau to do so. But this product is not life insurance so will not receive further attention in this paper.

Summary and Conclusions

There are two related questions this paper seeks to answer, should we be concerned about limited and declining participation of LMI households in the life insurance marketplace, and if so, what steps should be taken to increase participation? These questions are important because life insurance products can potentially help these households accumulate savings and provide financial security for dependents. In brief, our answer to the first question, if given the options of "very concerned," "somewhat concerned," and "not at all concerned," is "somewhat concerned."

In regard to saving: Whole life policies may appear to offer great potential to help LMI households accumulate savings. But in reality this potential is greatly limited. There is a compelling explanation as to why these policies are held by only 13 percent of low-income households and 17 percent of moderate-income households, with median cash-values of only \$2,000 and \$5,000 respectively. For most consumers, whole life policies offer poorer value than other savings alternatives, and that is especially true for LMI households. The heavily front-loaded commission structure for cash-value policies not only requires consumers to hold policies for fifteen to twenty years to receive competitive yields, but also incentivizes agents to persuade consumers to replace these policies, sometimes incurring losses. LMI consumers with low or non-existent discretionary incomes, which are often highly variable over time, may find it difficult to make continuous payments over a twenty-year period. They may also have great difficulty understanding relatively complex, opaque products that are poorly understood by consumers with higher incomes and more education. It might be worthwhile taking on the enormously difficult challenge of developing appealing whole life policy options that were accessible to many LMI households if there were not other more attractive savings options. But such options already exist. Workplace retirement savings and bank credit/union autosave accounts, for all their limitations, are more accessible, probably more reliable, and far less risky than cash-value insurance policies.

In regard to financial security for dependents: The existence of Social Security survivor benefits for which nearly all surviving dependents qualify reduces the need of LMI households for term insurance protection. The Social Security Administration estimates

¹¹⁸ U.S. Government Accountability Office Report to Congressional Committee, Credit Cards: Consumer Costs for Debt Protection Products Can Be Substantial Relative to Benefits But Are Not a Focus of Regulatory Oversight (March 2011). See also: Center for Economic Justice, the Impact of Debt Cancellation Contracts on State Insurance Regulation (July 2003) and also CEJ data submitted, with other consumer groups, to Congress and the Federal Reserve Board in 2009, loc. cit.

that the net present value of these benefits for a young family with two children and average earnings is the equivalent of a life insurance policy with a face value of \$433,000. While this coverage is lower for LMI households, their surviving children can receive annual benefits, averaging \$13,000 for all households, until the age of 18 or 19. In any "reform" of Social Security, it is important that these benefits be preserved and, if possible, restored for college-age survivors.

Nevertheless, LMI surviving dependents receiving Social Security payments would find helpful the additional income of term insurance death benefits. And most term insurance policies offer adequate to good value because they are price competitive and premiums are relatively low -- perhaps only \$150 a year for \$100,000 of coverage for a healthy, nonsmoking young parent (though much more for those who smoke, are overweight, and/or are in poor health). The challenge here is to greatly increase LMI household access to these products, but there are demand- and supply-side barriers blocking this access. Consumers themselves, especially young adults with low mortality rates, often see purchasing life insurance protection as a lower priority than meeting other financial needs. And many, while recognizing the importance of life insurance protection, have negative views of the life insurance industry. On the seller side, few life insurance agents are interested in marketing term policies of \$100,000 or less because agents can earn much more selling whole life and other cash-value policies. That is also true of most bank units offering life insurance products, which have also found these products more difficult to sell than other savings and investment products.

Expanding access to group term policies seems more promising than trying to persuade life insurance agents to focus more attention on meeting the life insurance needs of LMI households. Employers and large nonprofit organizations who wish to provide life insurance to their employees or members can reduce marketing costs, negotiate low rates from insurers, cover employees who are in poor health, offer the convenience and reliability of payroll deduction, and reduce skepticism about the credibility of the product. However, efforts to expand group term coverage face their own challenges. Employers have higher priorities than providing life insurance protection to employees who are more interested in pay raises and adequate health insurance. Nevertheless, there may be opportunities to persuade some large employers who are currently providing modest term coverages of \$15,000 or \$20,000 to substitute, or ideally add, much larger coverage options which could be offered during retirement savings enrollment periods and paid by employees through payroll deduction. One risk here is that employers offering these new options would eliminate the free policies but make an insufficient effort to persuade employees to purchase the new policies, causing many to lose coverage. Another difficult challenge is figuring out how departing employees can easily retain their insurance policies.

Nonprofit groups also can help meet LMI life insurance needs. Many credit unions currently offer term coverage up to \$100,000 at an affordable price. Many groups with large memberships, such as the NAACP, make available this coverage to members. AARP markets to its members, for a somewhat higher price because of their age, term coverage up to \$50,000 that can be useful to LMI couples who worry about the financial

consequences of the death of a spouse. It would be useful to more carefully consider the potential of all nonprofits to provide LMI employees, members, and clients with low-cost term options. One challenge here is identifying large non-profits that serve many LMI households and have experience successfully selling financial products to them.

It would also be useful to initiate discussions with large life insurers about ways to meet LMI life insurance needs. Insurers may welcome these discussions because of their growing interest in serving "middle markets," belief that many households lack adequate insurance protection, and concern that not meeting these needs jeopardizes the favorable tax status of their products.

Perhaps the greatest research need is to learn more about the life insurance policies currently or formerly held by LMI households. Many of these policies could well be terminated whole life policies. Many others probably are industrial life or burial insurance policies. It would be useful to learn more about how these and other policies were purchased, maintained, or terminated, and their perceived and actual financial value. This knowledge may help us to better identify unmet needs, discover any abuses, and develop needed policy reforms. Interviewing dozens of residents of selected LMI communities, and examining their policies, may be especially informative. Given the traditional popularity of industrial life and burial insurance among African American families in the South, it would be important to include one of their communities.