TEXAS DEPARTMENT OF INSURANCE

REPORT

Of The

PROCEEDINGS

Of The

SMALL FACE AMOUNT LIFE INSURANCE ADVISORY COMMITTEE

Appointed to Advise the Commissioner of Insurance With Respect to His Study of the Small Face Amount Life Insurance Market in Texas

Austin, Texas

December 30, 2002

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HB 2415 Mandates

HB 2415, which was passed in regular session by the 77th Legislature and signed into law by Governor Perry on June 11, 2001, requires the Commissioner of Insurance to conduct a study of the Texas marketplace for small face amount life insurance (SALI) and report his findings to the legislature on or before January 1, 2003. In undertaking the study of small face policies, the legislature mandated that the Commissioner evaluate whether:

- the relationship between the pricing of these policies and the value received by insureds is reasonable.
- actuarial and expense experience supports the pricing of these policies.
- adequate disclosure is made to consumers regarding the relationship of price to benefits received.
- the sale of multiple polices to one insured is appropriate and suitable.
- statutory changes are needed or desirable.

The Commissioner was also directed to study any other matter relating to the small face marketplace that he deemed appropriate. The legislation required the Commissioner to appoint an advisory committee made up of representatives from life insurers, life insurance agents, consumers, the Office of Public Insurance Counsel and other groups to assist him in conducting the study and to obtain comments from interested parties.

Appointment of Advisory Committee

Commissioner José Montemayor appointed ten members to the Advisory Committee:

Agents

- Mike Myers, President, Texas Association of Insurance and Financial Advisors (TAIFA) (replacing Paul Herrera who resigned).

Consumers

- Rob Schneider, Consumers Union.
- Jermaine Thomas, Barnes & Turner Law Firm.

Insurers

- Mark France, Texas Association of Life and Health Insurers (TALHI).
- David Hawkins, Texas Association of Insurance Officials (TAIO).
- Brenda Nation, American Council of Life Insurers (ACLI).

OPIC

- Rod Bordelon, Public Counsel, the Office of Public Insurance Counsel.

Other Groups

- Dain Eric Moran, LULAC.
- Cynthia Postell, Singing Hill Funeral Home.
- William-Paul Thomas, Rainbow/PUSH Coalition.

The author of HB 2415, Representative Helen Giddings, and the Senate Sponsor, Senator Rodney Ellis, served as *ex officio* members of the Committee and participated in its proceedings as did the Commissioner of Insurance, José Montemayor.

TDI Staff

Texas Department of Insurance (TDI) staff assisted the Committee and was responsible for drafting survey documents, recording and analyzing survey results and developing meeting agenda items. Mike Boerner, Managing Actuary, Actuarial Division, served as staff lead and was assisted by: David Durden, Associate Commissioner, Government Relations; Ana Smith-Daley, Deputy Commissioner, Life/Health Division; Jackie Robinson, Director, Life Annuities and Credit Section, Life/Health Division; Kenneth Elliott, Financial Program; and William O. Goodman, Special Litigation Counsel, Legal and Compliance Division.

Overview

The Advisory Committee held four public meetings over the course of eight months: February 1, 2002, Austin; April 17, 2002, Houston; August 2, 2002, Dallas; and October 8, 2002, Austin. The meetings generally followed the agenda items set out in **Exhibit 1**. Morning sessions were devoted to discussion of these items, while afternoon sessions were generally reserved for public testimony.

Although the issues of multiple policies and unclaimed benefits were examined and considered, most of the attention and work of the Committee and TDI staff was focused on the issue of whether the relationship between the pricing of small face amount life insurance policies and the value received is reasonable; whether actuarial and expense experience supports the pricing of these policies; and whether limitations, if any, should be placed on the sale of these policies. These issues were examined and debated in depth based on data obtained from two TDI surveys of life insurance companies writing SALI policies in Texas. Data supplied by the industry and consumer representatives also informed the debate on these issues.

Except for general agreement about the need for greater disclosure and a "free look" right to cancel, there was very little committee consensus regarding the existence or extent of problems in the small face marketplace or the need or appropriateness for legislative change. Generally, consumers, consumer representatives, TDI staff, Representative Giddings, and Senator Ellis were of the opinion that some SALI policies operated to produce extremely unfair results from the insured's perspective and that in addition to disclosure, legislation placing certain restrictions on the sale of these policies is warranted.

Industry representatives, while acknowledging the need for improved disclosure and a right to a "free look", were nearly unanimous in the view that the insured's longevity and *not* policy design, expense loads or pricing was the single most important factor behind premiums exceeding the death benefit (i.e. high policy multiples). They argued that the theory of large numbers dictates that those who live longer will subsidize those who suffer premature death. Insurers also questioned the significance of the survey results and argued emphatically that they were not representative of the SALI marketplace as a whole. For this reason, the industry believes that restrictions on the sale of SALI policies are neither needed nor advisable since restrictions will deprive certain Texas citizens, primarily the poor and the elderly, of the ability to purchase insurance to cover the risk of premature death or final expenses.

Study Methodology

In requiring a study of the SALI marketplace, the legislature, among other things, mandated that the Commissioner with the assistance of the Advisory Committee evaluate whether:

- the relationship between the pricing of these policies and the value received by insureds is reasonable.
- actuarial and expense experience supports the pricing of these policies.

To that end, TDI staff recommended and the Advisory Committee "agreed"[1] to conduct two surveys. The first was

[1] Your reporter has sought to be true to the record throughout this report. In this regard it should be carefully noted that none of the decisions of the Committee were subject to formal vote. To say that the Committee "agreed" to any one thing is to simply say that the process went forward, probably with majority consensus.

designed to identify a sample of policy forms currently marketed in Texas where the reasonableness of the relationship of price to value could be questioned. TDI staff and the Committee settled on a screening threshold designed to identify policy forms where premiums could either (1) exceed the death benefit by 1.5 times or more or (2) exceed the death benefit in ten years or less. Policy forms which exceed the thresholds are identified here as "outliers." In the vernacular, they are also known as "upside down" policies. By adopting these thresholds, various Committee members made clear they were not passing judgment on its reasonableness, but were simply marking a beginning point from which to start the survey. The first survey, in order to restrain insurer costs, was not designed to identify all policy forms in a particular company's portfolio that might meet or exceed these thresholds; rather, companies were directed to identify a representative sample of policy forms that most exceeded the threshold and which had significant numbers of policies in force.

The second survey was designed to obtain pricing, profit margin and experience detail from a selected sample of outliers identified in the first survey. The objective of the second survey was to answer the Legislature's mandated question of "whether actuarial and expense experience supports the pricing of life insurance policies with a small face amount."

The sample chosen for further scrutiny generally consisted of those first survey outliers that deviated the most from the threshold and which had significant numbers of in-force policies.[2] If an analysis of the outliers in the second survey found the experience and pricing to be reasonable, then lesser outliers would be considered reasonable as well.

The Committee confronted a number of issues involving survey design. First among them was the meaning of "small face." The legislature did not define this term, but left the definition to the Department and the Committee. TDI staff and members of the Committee, after considerable debate, settled on $15,000 or less. There was general agreement that the number was not based on a precise analytical assessment, but that it was nonetheless reasonable and supported by some historical precedent.[3] At least one commenter, however, questioned the

[2] "Department staff used both objective criteria and judgement to select companies for the second survey.

"The objective criteria consisted of the multiple of premiums paid [compared] to death benefits, which varied by issue age. The multiples used were 2.0 for issue age 0; 3.0 for issue age 35; 3.5 for issue age 55; and, 4.5 for issue age 75. Policy form examples with reported multiples in excess of these multiples were candidates to be selected. Department staff also used objective criteria of the first duration at which premiums paid could exceed the death benefit. The first duration used also varied by issue age. For issue ages 25 and 35 the first duration used was 10. For issue ages 55 and 75 the first duration used was 7 years and 5 years, respectively. Policy form examples with a reported first duration less than the applicable first duration criterion used were candidates for selection.

"Department staff established the criteria for multiples based on calculations of multiples for various mortality tables as provided in Table C of **Exhibit 3**.

"Department staff tried to chose (sic) policy form examples with a significant number of policies in force to get information based on a larger body of experience. In some cases Department staff exercised judgement such as in situations where multiples reported were very high but the number of policies in force were small. In these situations a policy form may have been selected even though the information related to experience may not be based on very many policies." SECOND SURVEY REPORT, October 8, 2002. **Exhibit 4.**

[3] For example, stipulated premium life insurance companies are restricted by statute to issuing policies of $15,000 or less. Also, the NAIC Small Face Working Group, in their study of the subject, limited their focus to policies of $15,000 or less.

wisdom of this choice and argued for a much higher threshold.[4]

Another design issue that generated debate concerned what kind of small face policies should be included in the survey. Over the objections of one member,[5] it was decided to exclude interest sensitive and participating policies.[6] There was consensus that although these types of policies can be issued in small face amounts, they have not generated the kind of regulatory concern historically associated with non-participating forms. Subsequent consumer testimony lends some support to this judgment call, since nearly all of the complaints aired were based on non-participating policies. Considerable discussion was also directed to the issue of what product categories should be selected within the non-participating policy form universe. Staff's recommendation to include "Home Service" as a product category drew sharp industry criticism. Industry representatives argued that the term describes a method of distribution, not a product type. "Home Service" products are sold, serviced and premiums are collected at the insured's home or workplace. Since "Industrial" and "Debit Ordinary" can be serviced in this same manner, inclusion of "Home Service" as a distinct product category would cause data overlap. Staff acknowledged the possibility of overlap, but argued that such an overlap would simply produce additional policy form examples that would prove helpful to the analysis at minimal cost to the insurers. In any event, the term remained in the First Survey's product categories, joined by: Industrial, Debit Ordinary, Pre-Need, Term, and Whole Life.

Another major design issue was how to recognize differences in underwriting for the product categories ultimately selected for study. After extensive discussion, it was agreed that for each product category individual data would be reported for: guaranteed issue; limited underwriting; and expanded underwriting. This produced a total of 18 possible data subsets.[7]

The Committee also addressed a number of other, less significant design issues, which are set out in the footnote below.[8]

First Survey

After a thorough vetting by the Committee and TDI staff, TDI on February

[4] "If the public policy issue is that premiums may exceed the death benefit then it is difficult to understand [w]hy it would be acceptable if the death benefit, and the premiums were higher? Our understanding is that there are whole life policies in the marketplace at much higher limits with the same potential. Why shouldn't you find out if that is true?" B. BURNER, Comments, 02-14-2002.

[5] "If you are going to exclude interest sensitive and universal life [policies], then you should also exclude participating [policies] and policies with non-guaranteed face amount adjustments in order to be consistent. Therefore, if you want the survey to be comprehensive, you need to include interest sensitive and universal life. There is nothing magic about these product types if issued in a small face amount." M. FRANCE, Comments, 02-20-2002.

[6] These policy types have benefits or other values that can increase in the future. Increases can be through interest or other credits which may be based on company performance.

[7] (6 product categories) x (3 underwriting categories).

[8] Such issues included: (1) inclusion/exclusion of riders; (2) definition of terms and instructions; (3) extent of experience detail to be provided in Form 2; (4) level of detail in light of survey report deadlines generally, and especially during Annual Statement Reporting periods; (5) reporting methods that promote accuracy and expedite analysis. After two successive rounds of comments these issues were resolved by: (1) excluding riders so as to focus on the basic policy and premium; (2) providing a glossary of terms and publishing a Q & A on the TDI web site to assist with completion of the survey; (3) and (4) requiring examples based on readily accessible data and allowing for use of estimates; and (5) permitting automated and electronic reporting of survey responses.

28, 2002, distributed the first survey to 758 foreign and domestic life insurers, including stipulated premium companies, doing business in Texas. **Exhibit 2**. Fraternal Benefit Societies (fraternals) were excluded because of their unique characteristics, including the ability to assess members and their non-profit status. The survey sought examples of currently marketed policy forms where premiums could either (1) exceed the death benefit by 1.5 times or more or (2) exceed the death benefit in ten years or less for issue ages 85, 75, 55, 35, 25, and 0. The survey also sought, for each policy form identified, the number of policies in force. Finally, the survey sought from each company responding with examples the total number of small face policies in force, with corresponding experience data.

Approximately 25% of the 758 companies surveyed identified policy forms that triggered the first survey criteria.

Type	Number Surveyed	Number Triggered	Number Not Triggered
Domestic	133	35	98
Stips	40	29	11
Foreign	585	127	458
Total	**758**	**191**	**567**

After tabulating the survey data, Staff presented a Draft First Survey Report at the April 17, 2002, Advisory Committee Meeting in Houston and a FINAL FIRST SURVEY REPORT at the Dallas meeting on August 2, 2002, **Exhibit 3**.

The report generated considerable discussion during the Houston meeting, with several members expressing confusion regarding the meaning or significance of the data presented. Survey data regarding premium multiples to death benefit were summarized and attached to the report as *Table A* which is set out on page 9. Survey data regarding the first duration (in years) where premiums can equal or exceed the death benefit were summarized and attached to the Report as *Table D* as shown on page 10.

In reviewing *Table A* and *Table D* it is important to note that the data does not represent the entire universe of policies currently marketed in Texas that could exceed the threshold. The selection criteria for the first survey directed companies to provide only examples of policy forms that most exceeded the threshold and had significant numbers of policies in force. Therefore, the number of policy forms that could exceed the threshold is almost certainly understated.

Moreover, the data should not be interpreted to mean that the number of policies identified with a particular form will all exceed the threshold. They will not.

Table A summarizes, by issue age, the number of policy forms whose premiums, if paid over the life of the policy, will exceed the death benefit by the multiples shown.

Similarly, *Table D* summarizes, by issue age, the number of policy forms whose premiums could exceed the death benefit within ten years or less, by the durations shown.

The data shows there are small face policy forms marketed in Texas whose rate schedules demonstrate that insureds can pay significantly more in premium than the death benefit. For example, Table A shows seven policy forms in Texas where an insured surviving for the life of the policy would pay 5 to 5.9 times the death benefit in premiums if the policy was purchased at age 55.[9] Of course, very few insureds will survive the life of one of

[9] See *Table A*, row for "Issue Age" 55 and column for "Multiple Range" 5.0 to 5.9.

these policies but a significant number of insureds are expected to survive over half the life of these policies. Therefore, a number of insureds in this example could be expected to pay more than 2.5 to 3 times the death benefit in premiums.[10]

Each table also sets out the number of policies associated with the policy forms that are identified as outliers. The purpose of providing the number of policies was to demonstrate that they are significant for the policy forms shown, even though it is not known at which issue age the policies were issued.

Based on a review of the first survey data, TDI staff is of the opinion that many small face insureds will ultimately pay premiums significantly in excess of the death benefit. Industry members vigorously dispute that the data supports this conclusion, and argue that at best the data shows only how a small fraction of policies in the SALI marketplace might perform.[11] ACLI takes the point further and argues that because it is not known at which issue age the policies were issued, no conclusions can be drawn regarding whether any Texas consumers who purchased these policies paid more in premium than death benefit.

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[10] "2.5" equals half of 5.0; "3" equals half of 5.9 rounded near.

[11] TDI staff has difficulty reconciling this argument with industry's adamant opposition to caps on multiples. If in fact only a small fraction of SALI policies perform in this manner, it would seem that the imposition of such caps would have very little impact on the overall SALI marketplace.

Table A

Forms - The number of examples provided of approved policy forms in Texas whose rate schedules can require premiums paid over the life of the policy to be a multiple of the death benefit as indicated in the table for the specified "Issue Age" and "Multiple Range".

Policies - The total number of policies issued and still in force as of 12-31-01 in Texas for the corresponding number of approved policy forms in Texas. It is not known how many of these policies are issued at any particular issue age. The purpose of providing the number of policies issued is just to show how many policies are still in force for all issue ages for the corresponding number of approved policy forms. (emphasis in the original)

Issue Age		Less Than 1.5	Multiple Range 1.5 - 1.9	2.0 - 2.4	2.5 - 2.9	3.0 - 3.4	3.5 - 3.9	4.0 - 4.4	4.5 - 4.9	5.0 - 5.9	6.0 - 6.9	Greater or Equal to 7.0
85	# Forms	3	0	1	1	4	7	10	14	8	4	5
	# Policies	21,110	0	104	2,534	15,438	5,557	16,109	30,545	38,918	1,019	1,816
75	# Forms	17	11	10	9	24	35	25	21	18	7	7
	# Policies	28,626	16,565	5,141	18,522	53,897	139,120	52,834	51,616	162,680	62,074	61,364
55	# Forms	41	30	46	46	24	9	2	5	7	1	1
	# Policies	78,806	26,763	76,474	306,300	70,082	15,699	517	10,701	94,264	12,523	441
35	# Forms	90	29	25	6	7	4	2	1	1	3	1
	# Policies	183,453	186,492	55,782	20,349	49,224	14,372	1,111	39,474	393	1,129	441
25	# Forms	100	27	9	4	6	3	3	1	1	4	1
	# Policies	206,574	171,345	33,492	14,612	58,282	1,303	2,443	39,474	393	2,023	441
0	# Forms	91	12	7	4	0	2	4	2	1	0	4
	# Policies	196,407	154,538	14,453	12,921	0	1,418	12,320	687	39,474	0	1,522

Note: One use of this table is to see what multiple of premiums to death benefits you may be required to pay over the life of the policy if your age is one of the issue ages specified in the table.

Table D

The information on this table was taken from examples provided in response to the first survey for approved policy forms in Texas which had at least 100 policies still in force in Texas as of 12-31-01. *This table reflects samples only and does not include all forms and policies in Texas which would meet the survey criteria.* (emphasis in the original)

Forms - The number of examples provided of approved policy forms in Texas whose cumulative premiums paid can equal or exceed the death benefit in the number of years indicated in the table for the specified "Issue Age" and "First Duration".

Policies - The total number of policies issued and still in force as of 12-31-01 in Texas for the corresponding number of approved policy forms in Texas. It is not known how many of these policies are issued at any particular issue age. The purpose of providing the number of policies issued is just to show how many policies are still in force for all issue ages for the corresponding number of approved policy forms. (emphasis in the original)

Issue Age		Less Than or Equal To 1.0	First Duration (In Years) Where Premiums Can Equal or Exceed Death Benefit									Greater Than 10.0
			1.1 - 2.0	2.1 - 3.0	3.1 - 4.0	4.1 - 5.0	5.1 - 6.0	6.1 - 7.0	7.1 - 8.0	8.1 - 9.0	9.1 - 10.0	
85	# Forms	1	5	17	25	3	1	0	1	0	0	0
	# Policies	20,130	1,816	38,545	48,022	2,828	11,031	0	104	0	0	0
75	# Forms	5	1	5	13	29	47	43	17	11	1	1
	# Policies	21,003	580	2,337	111,893	184,437	118,057	146,381	30,395	4,542	7,389	104
55	# Forms	5	0	2	1	2	1	7	5	10	6	147
	# Policies	34,895	0	1,185	580	2,448	129	12,321	4,060	96,424	26,122	467,686
35	# Forms	3	0	2	0	0	0	0	6	3	1	113
	# Policies	20,402	0	1,185	0	0	0	0	5,985	8,648	580	443,605
25	# Forms	3	0	2	0	0	0	0	5	1	2	89
	# Policies	20,402	0	1,185	0	0	0	0	5,499	119	8,886	401,570
0	# Forms	3	0	2	0	0	0	0	5	1	1	62
	# Policies	20,402	0	1,185	0	0	0	0	5,499	486	8,400	282,058

Note: One use of this table is to see how quickly cumulative premiums paid may equal or exceed the death benefit if your age is one of the issue ages specified in the table.

Second Survey

The objective of the Second Survey was to answer the legislature's question "whether actuarial and expense experience supports the pricing of" SALI policies. The survey required insurers to provide detailed actuarial data in connection with outliers previously identified. Because much of this information consisted of sensitive pricing statistics and therefore qualified for protection as a "trade secret," the data was sought through a Subpoena Duces Tecum. The Second Survey is contained in **Exhibit 4**.

To minimize costs of compliance, insurers were required to produce this data for only the "worst" offending outliers they had previously identified in the first survey.[12] The Committee discussed elements of the second survey in the second advisory meeting held in Houston on April 17th, 2002. Prior to issuing the subpoenas on June 4, 2002 and July 1, 2002, TDI staff adopted many of the suggested changes based on Committee input received in Houston and written comments received from members after two rounds of exposure drafts.[13]

The second survey gathered usable data[14] on 72 policy forms issued by 60 life insurance companies doing business in Texas, both foreign and domestic. Experience data was collected on approximately 240,000 Texas policies as of year-end 1997 and more than 500,000 policies as of year-end 2001. After tabulating and reviewing the experience data, TDI staff delivered the FINAL SECOND SURVEY REPORT at the October 8, 2002, Advisory Committee Meeting in Austin. **Exhibit 4**.

The report summarized the data in four tables. Three of the four tables grouped data from newer business to older business in order to compare their performance.[15] This comparison gives insight to the life cycle of this business. *Table 4* summarizes the entire experience data and is set out below.

[12] The selection criteria were previously set out in footnote 2.

[13] Changes included: focusing on "current" advertising materials and "current" pricing methodology, replacing the term "nonforfeiture benefits" with "cash surrender benefits", clarifying instructions related to the use of national experience vs. Texas experience, providing allowances for the use of estimates, and replacing one question with a question to invite rationale which supports the reasonableness of premiums to benefits.

[14] Some responses were not usable because of missing or unclear data.

[15] Table 1, Newer Blocks of Business (new issues greater than 50% of in force in 1997); Table 2, Other Blocks with Active Sales (new issues less than 50% of in force in 1997); and Table 3, Blocks with Few or No Sales (new issues less than 4% of in force).

TABLE 4 - Summary Of All Experience (Excluding Non-Usable Experience)					
SUBPOENA ITEM #7	1997	1998	1999	2000	2001
Premiums paid	$52,355,364	$88,972,823	$104,823,692	$116,707,012	$127,802,242
Death benefits paid	$14,610,342	$25,662,876	$30,194,655	$35,614,592	$41,680,459
Number of death claims	6,337	10,983	12,668	14,044	14,967
Cash surrender benefits paid	$631,057	$1,314,485	$1,513,106	$2,102,262	$2,272,905
Number of terminations	11,750	46,290	51,727	55,668	47,432
Total other benefits paid	$2,593,600	$2,975,159	$3,657,284	$3,442,579	$5,138,404
Total other expenses paid (including commissions)	$32,733,366	$51,777,473	$62,308,480	$67,068,651	$69,174,580
Number of new issues	80,360	111,256	118,661	110,830	107,743
Total other income (such as investment income)	$6,021,137	$9,975,312	$11,761,295	$14,358,501	$16,393,823
Charge assumed (primarily reserve change)	$10,904,422	$17,765,554	$19,685,748	$21,019,127	$23,705,136
Net gain/ (loss)	-$3,096,286	-$547,412	-$774,286	$1,818,302	$2,224,581
Number of policies in force at year end	240,515	392,724	439,130	478,014	514,619
Total face amount in force at year end	$845,835,165	$1,501,286,997	$1,784,584,664	$2,048,134,428	$2,363,877,195
Death benefits as percent of premiums	27.91%	28.84%	28.81%	30.52%	32.61%
Total other expenses as percent of premiums	**62.52%**	**58.19%**	**59.44%**	**57.47%**	**54.13%**
Charge assumed as percent of premiums	20.83%	19.97%	18.78%	18.01%	18.55%
Cash surrender benefits as percent of premiums	1.21%	1.48%	1.44%	1.80%	1.78%
Total other benefits as percent of premiums	4.95%	3.34%	3.49%	2.95%	4.02%
Total other income as percent of premiums	11.50%	11.21%	11.22%	12.30%	12.83%
Net gain / (loss) as percent of premiums	-5.91%	-0.62%	-0.74%	1.56%	1.74%
Estimate of aggregate lapse rate	5.70%	12.85%	12.75%	12.36%	9.79%
Average face amount at year end	3,517	3,823	4,064	4,285	4,593
Average death claim paid	2,306	2,337	2,384	2,536	2,785

TDI staff drew a number of conclusions from the data. Two are significant in light of the legislature's charge: (1) expenses, lapse rates and mortality are significant (high) in relation to premium and, with one caveat, (2) pricing assumptions appear to be plausible based on experience provided. These observations pleased neither industry nor consumer representatives. Industry, while happy with the finding that the pricing of these products was reasonable, took strong issue with the characterization of expenses as "significant", while consumer representatives found it hard to reconcile reasonable pricing with high multiples or short durations.

Specifically, TDI staff made the following observations regarding the data:

• "Expenses are very significant relative to premiums for the small face policies in the second survey. Experience showed that expenses could equal or exceed premiums for the first two to three years which results in large losses during this period of time. For blocks of business with few or no sales (i.e. – closed blocks), experience showed expenses to range from 40% to 46% of premiums paid during the five year experience period. First year commissions, some in excess of 100% of first year premiums, account for much of the early years' expenses where a combination of continuing commissions, fixed and some percent of premium costs account for later years' expenses.

• "Lapse rates contribute significantly to initial years' costs given the relatively high costs of putting business on the books. First year lapse rates can range from 20% to 45%.

• "Death benefits are significant in relation to premiums paid. For newer blocks of business (both start-up and fairly new business), experience showed death benefits to be 12% to 17% of premiums paid during the five year experience period. Start-up blocks of business appeared to have somewhat lower death benefits during the first two years of issue. For blocks of business with few or no sales (i.e. – closed blocks), experience showed death benefits to be approximately 70% to 87% of premiums paid. Note that for older closed blocks of business death benefits can easily exceed premiums paid. Unlike expenses, however, death benefits in later years will have a reserve accumulation to help support these benefits.

• "In general pricing assumptions appear to be plausible based on experience and reasonable consistency in use. It is noted, however, *that a number of companies did not have or could not provide pricing assumptions to support their product*.

• "The analysis provided indicated that generally, companies' actual experience was worse than that found in pricing assumptions.

• "Newer blocks of business showed losses of approximately 30% of premiums, which graded down to approximately 3% of premiums over a five-year period. Business somewhat older with active sales showed gains of approximately 2% to 6% of premiums. Business with low or no sales (closed blocks) showed gains of 5% to 15% over a five-year experience period.

• "Some direct marketed experience was provided (mostly mail solicitation). These products appeared to have lower expenses in the early years (approximately 30-40% of premiums). Such products have no commissions. Initial years' expenses for these products are heavily dependent on how many mailers are needed before a sale is secured.

• "Most products were whole life with level premiums and level death benefits. However, a number of products, especially guaranteed issue products, provided a death benefit that would grade up to an ultimate level amount over 3 to 4 years." SECOND SURVEY REPORT, October 8, 2002. **Exhibit 4.**

Comments Received Regarding the Survey and TDI Staff Response

As indicated earlier in this Report, there was very little consensus between the industry representatives on the one hand, and consumer representatives, legislative sponsors and TDI staff, on the other, regarding the existence or extent of problems in the SALI marketplace. Much of the industry attention and comment in this area was directed to the two surveys.

Because the surveys formed such a large part of the Committee's and TDI staff's work, a thorough exposure of the various points of view is in order.

The Results Are More Theoretical Than Real; The Need to Quantify

At least one industry representative, in hindsight, argued that the survey should have been designed to *quantify* how many people have survived long enough to have experienced the multiples:

> The results generated are the theoretical worst cases for each policy form. Not only is there no evidence that a single Texan actually fits this worst case, the odds are none ever will. How many folks continue to pay on their life insurance until age 100? A more useful analysis would have been to examine the companies' actual books of business to see what happens. [16]

TDI Staff Response:

The Committee, in developing the first survey, made no recommendations to quantify how many insureds have actually experienced multiples of premiums to death benefits. To the contrary, industry Committee members advised against asking companies for "too much detail" given the enormous burden and expense in providing data which is not readily available. Also, since the first survey focused on currently marketed policy forms this business generally would not have been on the books long enough to have experienced a significant portion of the multiples provided. However, based on expected mortality and lapse experience, it is reasonable to expect that a significant percentage of the total number of insureds identified in *Table A* will survive for over half the life of their policy. For this reason, it is also reasonable to assume that a significant number of this population will experience multiples at least half as great or more as those identified in *Table A*. In this regard it should be noted that in connection with the Department's recent settlement with American General Life and Accident Company, restitution was paid to more than 168,000 Texans whose premiums exceeded their death benefits.[17]

TDI staff agrees that in an ideal world it would have been desirable to "examine the companies' actual books of business to see what happens," but as noted above, it was not likely that the 758 companies surveyed would have been amenable to extracting this level of detail.

Scope of the Survey

A number of industry commenters expressed the opinion that the Surveys, especially the Second Survey, were too restricted in scope, and thus any observations drawn from the data do not represent the Texas SALI marketplace as a whole. Brenda Nation, a Committee Member representing the ACLI, noted:

> Given that the two surveys conducted by the Department were the "means to justify the end" in that the surveys were designed to focus on the most egregious examples of small face amount life insurance products in the Texas marketplace,[18] the Department's point of view gives the appearance of being well founded. However, what is lacking in the Department's analysis is the fact that the results of these two surveys do not represent

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[16] B. BURNER, Comments, 10-7-2002.

[17] *In Re American General Life and Accident Insurance Company*, 00-0727 (06- 21- 2000)

[18] In the First Survey, Table A states: "This table reflects samples only and does not include all forms and policies in Texas which would meet the survey criteria." In the Second Survey, the selection criteria used "consisted of multiple of premiums paid to death benefits, which varied by issue age. The multiples used were 2.0 for issue age 0; 3.0 for issue age 35; 3.5 for issue age 55; and 4.5 for issue age 75. Policy form examples with reported multiples *in excess* of these multiples were candidates to be selected." See also Staff's response to Comments from Brian Forman, which states in part: "The study was for small face policies with high multiples which is only a portion of the entire small face market."

the Texas marketplace. Because of this, they must only be given the weight of the percentage of the Texas small face amount life insurance industry that they represent. ACLI contends that the Second Survey results account for less than a fourth of the Texas small face amount life insurance marketplace [footnote omitted] (which itself is only a fraction of the entire Texas life insurance marketplace) and are not indicative of the practices of the small face amount life insurance industry as a whole. ACLI recommends that any references to these surveys or their results in the proposed summary report should be prefaced with clear and concise language describing the limited marketplace that the surveys and results do represent.[19]

Similarly, Mike Pollard, Executive Director, TALHI, argued that the study conducted by the Committee fell short of the legislative mandate "to conduct a study of the marketplace in the State for life insurance issued with a small face amount. . . ." In his view: "This requirement seems to indicate that the Committee is to study the entire marketplace and should not limit its information, data, or finding on a particular segment of that marketplace." Echoing Ms. Nation's comments, he concluded: "Thus, the observations and conclusions drawn by the TDI staff and the Committee may leave one to wonder about the observations and information of all other policies not surveyed or studied."

TDI Staff Response:

The industry was given every opportunity to assist in the design of the surveys. Not once did the industry suggest that it desired the entire SALI marketplace to be surveyed nor that it was the industry's view that HB 2415 required such a result. In fact, the industry, citing previous work done by the NAIC, went so far as to suggest that a survey might not be necessary.[20]

Perhaps more instructive of what the legislature intended with respect to the scope of the study is revealed by the active participation and continuous support given to the project by the House bill's author, Representative Helen Giddings, and Senate sponsor, Senator Rodney Ellis. Had they been unhappy with the scope of the surveys' design, they surely would have expressed their discomfort to TDI staff and the Committee. It is significant to note that they did not do so.

The study methodology obtained the greatest detail on those policies that were of the greatest concern to the legislature and the public. Given the limited resources available to TDI staff and the enormous reporting and expense burdens that a larger survey necessarily would have imposed on the industry, the surveys' design, in staff's judgment, strikes a fair balance between the need to obtain useful information and the cost of obtaining that information. Staff therefore believes that the surveys represent a fair and reasonable implementation of the legislature's intent.

Should the survey results be extrapolated or characterized to mean that all individuals who enter the small face marketplace can expect their policies to perform as badly as those identified in the surveys? Certainly not; and TDI staff has never claimed that the data supports such a characterization. If this is the point of the comments advanced by the industry, then it is well taken.

[19] B. NATION, Comments, 10-25-2002.

[20] "While we appreciate the legislative mandate placed on the advisory committee to study the small face amount life insurance market in Texas, we nevertheless feel it is important to point out that much of the information sought in the advisory committee's First Survey draft is the same type of information already considered and examined by the NAIC Small Face Amount Working Group." B. NATION, Comments, 02-13-2002.

These comments seem to urge more than just the need for a disclaimer with respect to the data. They implicitly argue that absent a survey of the entire SALI marketplace, the data obtained by these surveys is of little or questionable value. In other words, before the legislature can make an informed judgment on the subject, it must know the precise calibration or ratio between policies that may perform badly and those that will not.

TDI staff disagrees with this construct. Suffice it to say, the surveys encompass experience data on more than 500,000 Texas policyholders and from this data it is reasonable to assume that significant numbers of this population will experience policy performance in excess of the threshold multiples. Ultimately, the weight accorded this data is a matter of legislative judgment.

Reasonableness of Premium to Value

TALHI and other industry commentators also make a closely related point. They argue that since the surveys do not reach the issue of how the SALI marketplace functions as a whole (the precise number of policies that may exceed the threshold as opposed to those that will not), "no reasonable conclusions" can be made regarding whether "the value received by insureds is not reasonable."[21]

TDI Staff Response:

Again, staff respectfully disagrees. Implicit in this argument is the assumption that unless a majority or some predetermined percentage of the products in this marketplace can be shown to produce "upside down" results, the value received by insureds as a whole is reasonable in relationship to the aggregate pricing found in the marketplace. Staff does not believe, based on the legislative history, that this was the legislature's intent. The surveys demonstrate that sizeable numbers of policies can be expected to exceed the threshold, and that actuarial and expense experience, while high, generally supports the pricing of these policies. However, these results in and of themselves do not resolve the question of reasonableness of price to value. This is so because, in the final analysis, the resolution of the issue more than anything else depends upon a combination of moral and political judgment which should and can only be exercised by the legislature. The question is akin to asking at what rate the charging of interest becomes usurious.

While the survey results should prove useful if the legislature decides to address the issues raised in HB 2415, the survey was never intended to be dispositive of these issues.

Other HB 2415 Matters

Adequate Disclosure

The Committee was able to answer at least one question posed by the legislature with one voice: the need for better disclosure to consumers "regarding the relationship between the pricing of life insurance polices with a small face amount and the benefits received."

Although there was virtual unanimity regarding the need for disclosure, coupled with a "free look" right to cancel, consensus broke down over the substance and timing of disclosure. Further, while consumer representatives, other groups, and OPIC strongly supported disclosure, they nonetheless made clear their opinion that disclosure alone was not sufficient to solve the problem.[22] Committee Member

[21] M. POLLARD, Comments, 11-13-2002.

[22] ". . . laws or rules to address the situation must go beyond mere disclosures. . . ." R. BORDELON, Comments, 10-25-2002; "I strongly believe that disclosure alone will

Dain Eric Moran was particularly emphatic on this point:

> LULAC is of the opinion that reform in the Small Face Life Insurance market is well overdue and despite what the industry suggests, increased disclosure is not the solution. . . . Yet the Small Face Industry argues that more disclosure is the solution to this problem, (which by the way, they have a difficult time acknowledging a problem exists). I emphatically denounce that belief since the majority of purchasers of these policies are the poor, elderly and uneducated. If they would argue this, I would challenge them to tell me how many middle to upper class households have purchased policies of this type.[23]

The substance or level of detail that a small face policy disclosure could provide ranges from the generic to the specific with variations in between. The NAIC Small Face Working Group endorsed generic disclosure in their model regulation: "The premiums you'll pay for your policy may be more than the amount of your coverage. You can find both the face amount and the annual premium in your policy. Look for the page labeled ___." [24] The disclosure then directs the insured how to do the math to determine when premiums exceed face: "Usually, you can figure out how many years it will take until the premiums paid will be greater than the face amount. For an estimate, divide the face amount by the annual premium." *See*, **Exhibit 6**.

At the other end of the spectrum is specific disclosure: "If you continue to pay your $25.00 monthly premium when due, you will pay more in premiums than your policy's $1,500 death benefit on or after March 1, 2006." Committee Member Jermaine Thomas supported this approach.[25]

Mark France, an industry Committee Member, recommended a disclosure form that displays the relevant policy data and identifies the year premiums will exceed the death benefit:

> Your policy's guaranteed face amount is $A.
>
> Each year you will pay premiums totaling $B.
>
> After 10 years, you will have paid $C.
>
> After 20 years, you will have paid $D.
>
> If you keep your insurance until it runs out and pay all the premiums, you will have paid $E.
>
> The premiums you pay will exceed the guaranteed death benefit after ___ full years.
>
> Your policy ___does ___ does not develop cash surrender values over time.
>
> Your policy ___ does ___ does not have a non-guaranteed benefit feature which can act to increase the death benefit or reduce the premiums you pay.
>
> You have 30 days from the date you receive this information in which you may cancel your policy and receive a refund of the premium you paid.

Attorney Wade Caldwell submitted another example of a specific or customized disclosure for the Committee's consideration. While the form does not identify the date a policy's premiums may exceed the death benefit, it sets out the death benefit together with the total amount of premiums paid for 10 years and if paid to age 75. Tom Munson, President of Landmark Life Insurance Company,

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not protect consumers." J. THOMAS, Comments, 11-19-2002; "For industry members and witnesses, the solutions proposed to address problems in the small face value life market are essentially limited to enhanced disclosure. While improving disclosure could be beneficial, disclosure alone falls far short of real reform and will do very little to end the kinds of the problems the task force has heard about." R. SCHNEIDER, Comments, 10-25-2002.

[23] D.E. MORAN, Comments, 10-25-2002.

[24] NAIC, DISCLOSURE FOR SMALL FACE AMOUNT LIFE INSURANCE POLICIES MODEL ACT. (April 2002). The complete disclosure, together with the Model Act is attached as **Exhibit 6**.

[25] J. THOMAS, Comments, 11-19-2002.

also suggested a similar disclosure. He recommended setting out preset time periods "such as for 10 years, or for the life of the policy," and suggested that the cost of this type of format "would also be relatively low."[26] The Caldwell proposal also required disclosure of the total amount that would accumulate at an interest rate of 6% if the premiums were placed into an IRA account. Committee Member Jermaine Thomas endorsed the saving account comparison as well. The Caldwell disclosure is set out in **Exhibit 7**.

Attorney Burnie Burner, who represents several insurers in this market, offered a middle ground approach. Unlike the NAIC Model which requires the insured to dig out the data and then perform a series of calculations, the Burner proposal sets out the death benefit and calculates the annual premium. The insured is then advised: "At some point in time, you may pay premiums that exceed the guaranteed minimum death benefit. You should calculate your total premium obligation to determine if this insurance is suitable for you." The Burner disclosure is set out in **Exhibit 8**.

The ACLI expressed opposition to specific disclosure, citing variables unknowable at the time of policy delivery that could materially affect the crossover date, rendering its disclosure misleading at best.[27] Although ACLI early on in the proceedings went on record as favoring the NAIC Model Act, in its October 25, 2002, comment to the Committee, it indicated that it was prepared to support "enhanced disclosure" such as the Burner proposal.[28] TALHI expressed support for the NAIC Model Act.[29]

Issues of timing and the frequency of disclosure also elicited divergent views. Committee Member Rod Bordelon, OPIC's representative, supports "disclosure at the time of application, upon policy issuance and annually thereafter."[30] Consumer's Union Committee Member, Rob Schneider, expressed the view that "disclosure must be made at the time of application, not at the time the policy is delivered." Delaying disclosure until the time of policy delivery, he reasoned, "puts the burden on the consumer to quickly review and go through what may be complicated procedures for getting a refund." Schneider also supports annual statements that provide disclosure:

> These statements will help remind consumers of the costs of the policies as well as how many policies they have in force, require companies to make sure their bookkeeping is accurate and that they can locate the policyholder, warn a policyholder if an agent has failed to properly remit premiums to the company[31].

Requiring annual statements was also supported by several public commentators, including Wade Caldwell.

Insurer members were divided on the timing of disclosure. David Hawkins was

[26] T. MUNSON, Comments, 10-25-2002.

[27] "As we have previously stated in our February 13 comment letter, many variables can affect whether the premiums on a life insurance policy will exceed the face amount and, if so, when the premiums will exceed the face amount. Factors such as paying premiums on time, paying the same amount each time the premium is due, skipping payments, doubling up on payments, paying partial payments, or taking a loan against the policy can individually or in combination affect whether or when the premiums will exceed the face amount of a life insurance policy." B. NATION, Comments, 10-25-2002.

[28] "Although ACLI continues to support the NAIC Model Disclosure document for the reasons described above, it has been made clear to us by Senator Ellis from the outset of this study that something more is needed in Texas to inform consumers of the choices available to them in the Texas marketplace. We have reviewed the disclosure form that Burnie Burner presented to the Advisory Committee at the October 8 meeting and can agree with a recommendation for some type of an enhanced disclosure document." B. NATION, Comments, 10-25-2002.

[29] M. POLLARD, Comments, 11-13-2002.

[30] R. BORDELON, Comments, 10-25-2002.

[31] R. SCHNEIDER, Comments, 10-25-2002.

of the opinion that disclosure should be made twice, "preferably at [the] time of application, with confirmation upon issue."[32] Brenda Nation favored disclosure at the time of policy delivery, but not before, arguing that "the amount of premium can change from the time of application to the time the policy is issued."[33]

Industry members and representatives opposed annual statements, citing "increased expenses on products that already have high expense rates."[34] Given the cost, the introduction of annual statements "could force companies to withdraw products generating marginal profits from the Texas marketplace, resulting in fewer choices. . . ."[35] Increased costs cited by another industry representative included significant computer programming and mailing (approximately $1.00 for each statement). He estimated that for his company mailing costs alone increase maintenance expenses by 8.3%.

Although the Committee could not agree on the substance or timing of disclosure, the members nonetheless were unanimous that disclosure was necessary and to be effective must be coupled with a right to cancel. Unfortunately, Texas is one of only a handful of states that have not enacted a "free look" or right to cancel statute regarding ordinary life insurance.[36] Most states grant insureds 10 days in which to cancel a policy after delivery. A few states provide for up to 20 or 30 days. Although not required by law, many insurers doing business in the state provide a right to cancel by contract. It is unknown how many in the Texas SALI market do so, however. Texas does require a 30-day right to cancel for long-term care policies which could serve as a model here:

> Notice of free examination. Each long-term care insurance policy or certificate must have a notice prominently printed on the first page of or attached to the policy or certificate stating in substance that the applicant has the right to return the policy or certificate within 30 days of the date of its delivery and to have the premium refunded if, after examination of the policy or certificate, the applicant is not satisfied for any reason. The entity issuing the policy or certificate shall pay in a timely manner a refund made under this section directly to the person or entity that remitted the premium. TEX. INS. CODE, art. 3.70-12.

Multiple Policies

Representative Giddings expressed particular concern over the appropriateness or suitability of the sale of multiple policies to one insured, citing the experience of her own mother, who at one time had more than a dozen policies. She argued that a consumer generally saves money by purchasing one large policy instead of several smaller ones; for example, one $2,000 policy versus four $500 policies.

The concerns expressed by Representative Giddings are reflected by the actions of several states which by statute or rule have attempted to address the problem of multiple policies.

Prior to the legislature prohibiting the sale of industrial life policies entirely, the New York Department of Insurance restricted the sale of multiple industrial life policies by setting the maximum aggregate amount of coverage that may be sold to an individual in any six month period, unless the consumer receives an explicit disclosure setting out the savings that

32 D. HAWKINS, Comments, 10-25-2002.
33 B. NATION, Comments, 10-25-2002.
34 *Id.*
35 *Id.*
36 By rule, The Department requires a 10 day right to cancel with respect to variable life products. 28 TEX. ADMIN. CODE. § 3.804(3)(A)(v).

could be had by buying one ordinary policy.[37] In adopting the regulation, the New York Department found that the "issuance of an ordinary policy instead of two or more monthly industrial policies is in the best interests of the insured, because it is less expensive."[38]

Similarly, Georgia restricts the aggregate face amount of industrial insurance on one life to $2,000.[39] Florida has adopted a slightly different approach to this problem. By statute it grants to insureds the right to convert multiple industrial policies into one ordinary whole life policy without evidence of insurability:

> Each industrial life insurance policy delivered or issued for delivery on or after January 1, 1981, shall provide that if, upon the sale of any new industrial life insurance policy, the combined face value of all industrial life insurance policies, including the new policy, issued by any one insurer, insuring any one life and owned by any one person, would exceed $3,000, then the owner shall have the option of merging and converting such industrial life insurance policies into one regularly offered ordinary life insurance policy with the same insurer with no further evidence of insurability required.[40]

Consumers also voiced concerns over multiple policies. Angela Reeves, in public testimony, provided examples about Mr. Clem Ellis, age 85, who had 17 active policies in 1996. Mr. Ellis paid $1,920.65 for a $2,000 whole life policy (taken out at age 81) which he cancelled for zero cash value after four years. Mr. Ellis also paid $3,061.56 for a $1,000 whole life policy (taken out at age 75) which he surrendered for a $428.00 cash value after 10 years. This policy would have been paid up after 15 years for a total premium of $4,444.20. Ms. Reeves observed that: "Insurance agents should only sell policies that are suitable to an individual's need; they should not apply any pressure or try to entice consumers into purchasing a policy just to make a sale for themselves. I believe this often happens with door to door selling of insurance."[41]

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[37] "1. The maximum aggregate amount of monthly industrial life insurance which an authorized life insurance company shall be permitted to issue in any six months period on any life shall not exceed $999, after deducting industrial life insurance (weekly or monthly) in force on such life and issued during the preceding six months by all other authorized life insurers, except as provided in Rule 2 which follows. No agent shall solicit or accept applications for a weekly or monthly industrial policy and receive commissions thereon with knowledge of prior weekly or monthly industrial life insurance beyond the limits set forth in this Rule, unless the exceptions in Rule 2 are complied with.

2. (a) The agent shall sign a statement that he has informed the applicant that in lieu of two or more industrial policies (weekly or monthly) for an aggregate amount exceeding $999, a single monthly debit ordinary policy of corresponding amount is available at a lower premium rate. Such statement shall also show the actual premiums and the amount of savings available to the applicant.

(b) The applicant shall acknowledge in writing that such information has been given to him by the agent but nevertheless requests the simultaneous issuance of two or more monthly industrial policies. The applicant shall state the reasons for such request." Circular Ltt'r 1966-8, Monthly premium debit life insurance. (1966).

[38] "In the marketing of monthly premium debit life insurance, the inferior bargaining position of the applicants or the failure by the agent to inform applicants of the existence and character of monthly debit ordinary insurance and the charges therefore may result in the more or less simultaneous issuance of two or more monthly industrial policies in the same company, notwithstanding that the applicant could qualify for monthly debit ordinary insurance for the same amount at lower costs. In the absence of appropriate regulation of monthly premium debit life insurance, the foregoing situation has resulted in insurance charges to policyholders which were unreasonable in relation to the benefits thereby provided to them. Issuance of an ordinary policy instead of two or more monthly industrial policies is in the best interests of the insured, because it is less expensive and is supported by the provisions . . . the New York Insurance Law." *Id.*

[39] "No insurer shall knowingly issue an industrial life insurance policy insuring the life of a person if the issuance of such policy would cause the aggregate face amount of industrial life insurance payable on the life of such person under any and all such policies issues by such insurer to exceed the sum of $2,000.00, exclusive of additional benefits in the event of death from accidental means." GA. STAT. § 33-26-6.1

[40] FL. STATS § 627.517

[41] A. REEVES, Comments, 10-25-2002.

Committee Consumer Members echoed similar concerns. Jermaine Thomas recommended more agent guidance and added that multiple policies should automatically convert to a single policy in instances where there is a marked savings to the consumer.[42] Rod Bordelon, OPIC, expressed the concern that "mere disclosure [of the disadvantage of multiple policies] may do more harm than good because it may encourage a consumer to move from several policies to one policy, incurring penalties that exceed the benefits of switching. Instead, the company or agent should be required to analyze the financial benefits of each option."[43]

Committee Industry Members took a different view. Brenda Nation said the "appropriateness of a consumer's decision to purchase several small policies or one larger policy lies with that particular consumer, not with the insurer." She added that "an enhanced disclosure document containing a provision addressing multiple policies at the time the policy is issued will allow the consumer to make an informed decision regarding his or her life insurance needs."[44] Mark France, while acknowledging that multiple policies presented a "difficult issue," cautioned that "in some cases, multiple policies are entirely appropriate and a good thing . . . . Often, the birth of a child, taking on a mortgage or other life changes will cause someone to increase their life insurance coverage."[45] He suggested that perhaps a simple disclosure statement along the following lines might be appropriate: "If you have more than one insurance policy, it may be to your benefit to investigate one new policy to replace all your existing policies." However, he shared OPIC's concern that replacing current multiple policies with one policy might not be economically wise, and concluded that "unfortunately, there is no right or wrong on this issue. Again, it's back to the individual situation."[46]

In sum, the Committee was unable to reach any consensus on an appropriate resolution of this issue, including disclosure.

Unclaimed Benefits

The Commissioner, pursuant to the Legislature's grant of discretion "to study any other matter relating to the small face marketplace that he deemed appropriate", added the issue of "unclaimed benefits" to the Committee's agenda. The phrase describes a situation where a deceased insured has multiple policies issued by a single insurer, but a claim has been filed and paid on only one. Given the fact that the sale of multiple policies is quite common in the SALI marketplace, the issue of unpaid claims has attracted considerable regulatory attention and was added as an agenda item by the NAIC's Small Face Working Group. Current law places no obligation upon an insurer to investigate for the possibility of multiple policies when it receives a claim on a single policy.

The Second Survey inquired about companies' procedures with regard to this matter; the results of that inquiry are compiled at **Exhibit 4**. The survey results show that there is no standard or industry norm regarding the procedures for identifying additional policies, and that practices vary significantly from company to company.

Staff brought to the Committee's attention a regulation that the Illinois Department of

42 J. THOMAS, Comments, 11-19-2002.

43 R. BORDELON, Comments, 10-25-2002.

44 B. NATION, Comments, 10-25-2002.

45 M. FRANCE, Comments, 09-10-2002.

46 *Id.*

Insurance adopted in an effort to establish minimum standards in this area. In general, the industry did not provide much in the way of recommendations. David Hawkins, TAIO, commented: "In considering possible regulations for locating additional policies at claim time, consideration should be given to the wide variety of technological capabilities among companies in this marketplace."[47] However, Consumer Committee Members had more to say on this issue. Rod Bordelon, OPIC, recommended: "A requirement similar to the Illinois regulation should be implemented to ensure that all available death benefits are paid."[48] Rob Schneider, Consumers Union, also supported requiring minimum standards for searching for multiple policies which he argued should also include locating beneficiaries. He also made the point that requiring annual statements would help ameliorate this problem: "These statements will help remind consumers of the costs of the policies as well as how many policies they have in force, require companies to make sure their bookkeeping is accurate and that they can locate the policyholder . . . . "[49]

The Committee was unable to make any specific recommendation on this issue, but to be fair it should be pointed out that very little time was devoted to it.

Beyond Disclosure: Other Possible Legislative Changes

Restrictions and Alternative Distribution

Throughout this process, TDI staff has sought to keep committee members apprised of what other states have either done or proposed with respect to the problems, either perceived or real, in the SALI marketplace. For over a century various state insurance regulators, state legislatures and Congress have wrestled with the difficult issues that the Texas Legislature has impressed on this Committee and the Commissioner. As early as 1906, a Joint Committee of the New York State Legislature, famously known as the "Armstrong Committee," issued a lengthy report regarding the conduct of seventeen large New York life insurers. Among many other findings, it expressed concern regarding high expense and lapse rates associated with "industrial life insurance,"[50] a sub-species and increasingly insignificant component, premium wise, of the present small face marketplace.

Some 73 years later, the United States Senate Judiciary Committee held hearings on the issue of whether to federalize the regulation of the SALI marketplace because of its concern that states were not doing enough to protect insureds from abuses it perceived to exist there, including upside down policies, multiple policies and high lapses.[51]

[47] D. HAWKINS, Comments, 10-25-2002.

[48] R. BORDELON, Comments, 10-25-2002.

[49] R. SCHNEIDER, Comments, 10-25-2002.

[50] ASSEMBLY DOC. NO. 41, N.Y. State Legislature, Jt. Comm.on Insurance 318 (1906).

[51] Senator Howard Metzenbaum, Chairman of the Subcommittee undertaking the hearings, outlined staff findings which echo many of the consumer comments made before the Advisory Committee:

"They have found that by targeting sales to the poor and the uneducated, many insurance companies have been able to sell policies at prices 3 to 5 times the going rate for comparable coverage.

The staff found that the poor and the uneducated are often deceived by agents into lapsing their policies before cash values can accumulate.

They found that it is a common practice to offer to the vulnerable and the uninformed a large number of small policies rather than a single package that could be had at a lower cost.

They found that it is also a common practice to persuade the elderly to take out insurance on their children and grandchildren in order, the agents say, to someday send these youngsters to college.

They found examples of poor families that have been talked into buying as many as 20 to 30 separate life insurance policies.

Remedies that go beyond disclosure include: prohibition; restrictions on multiples; durational net amount of risk requirements; and alternative methods of distribution. Few states have chosen to debate these matters, and fewer still have enacted, either by statute or rule, substantive regulation in this area. What follows is a brief summary of proposed or enacted regulation to date, by category.

Prohibition

The New York Legislature prohibited the sale of "industrial" life insurance in that state after June 1, 1981.[52] "Industrial" is defined to be any form of life insurance where either the premiums are collected weekly or where the premiums are payable monthly or oftener, but less often than weekly and where the face amount is less than $1,000. Prior to prohibiting its sale altogether, the New York Legislature imposed numerous restrictions on the sale of industrial policies.[53] The state of Arkansas has also banned the sale of industrial policies.[54]

Rob Schneider of Consumers Union urged that the Commissioner at least consider prohibiting the sale of life policies with a face amount of $10,000 or less, although he advocated less restrictive changes as well. Other than Mr. Schneider, no committee member advanced prohibition as a recommendation, although Senator Ellis indicated that he considered it a possible option for smaller policies. One public commenter advocated prohibiting the sale of policies insuring children for amounts less than $15,000 while another, citing policies sold to an individual in his seventies and eighties, advocated banning the sale of life insurance to those aged 65 years and older.[55]

Caps and Other Limitations

Various proposals have been advanced over the years (some adopted, others rejected) to restrict the sale of small face policies which fail to meet certain performance thresholds.[56] These restrictions fall into two general categories. One type limits the ratio of aggregate premium to death benefit (caps on multiples) while the other takes the reverse approach and prescribes a minimum period of time, expressed in years, where aggregate premium is *not* permitted to exceed the death benefit (minimum duration).

An example of the former is legislation recently enacted by the state of Georgia which provides:

> No insurer shall issue a policy which allows for the collection or payment of premium which in the aggregate will be greater than 150 percent of the face amount of the policy.[57]

The restriction is limited to industrial whole life polices which are defined as contracts where the death benefit cannot exceed $2,000 on a single life and where the premiums are collected monthly or more frequently.[58]

They interviewed a 64-year old woman who has paid as much as $105 a month in industrial life insurance out of a social security and disability pension of $184. She has already paid in $15,145 for $11,500 coverage with one company and $2,561 for $2,650 coverage with another." *Debit Life Insurance, Hearings Before the Subcomm. On Antitrust, Monopoly and Business Rights of the Senate Comm. On the Judiciary*, 96th Cong., 1st Sess. 3 (1979).

[52] N.Y. INS. LAW, art., 154(b)(5).

[53] They included: grading maximum amount of insurance by age issuable on children up to age 14½ from $100 to $1500; prohibiting the writing of a weekly premium industrial life insurance policy on the life of a person 10 years or older with the knowledge that the amount of the policy, together with the amount of all other premium paying weekly policies on such person's life, exceeds $1000; and limitations on expenses.

[54] Arkansas defines "industrial policies" as contracts with a face amount of $2,000 or less in which premiums are payable monthly or more often. ARK.INS.CODE §23-82-104.

[55] A. REEVES, Comments, 10-25-2002.

[56] The complete text of many of the bills, rules and statutes discussed herein can be found in **Exhibit 10**.

[57] Act of May 3, 2002, HB 1078, to be codified at 33-26-6.2.

[58] GA. CODE, § 33-26-6.2.

A bill (SB 2147) drafted by the Illinois Department of Insurance and introduced in the most recent session of that state's legislature proposed a 250 percent cap on aggregate premium (premiums less dividends paid in cash), to the face amount on all policies with a death benefit of $20,000 or less. On a tie vote, the bill failed to be reported favorably out of committee and died in the Senate.

The Washington Department of Insurance, by rule, adopted durational restrictions. Under the rule, which is limited to life insurance policies of $24,999 or less, it is declared to be an unfair trade practice:

> for any insurer or fraternal benefit society to provide life insurance coverage on any person through a policy or certificate of coverage delivered on or after July 1, 1989, to or on behalf of such person in this state, unless the benefit payable at death under such policy or certificate will equal or exceed the cumulative premiums . . . paid for the policy or certificate, plus interest thereon at the rate of five percent per annum compounded annually to the tenth anniversary of the effective date of coverage.[59]

Although challenged on a number of different legal grounds, the Washington Supreme Court upheld the rule as constitutional. The Court found the Commissioner had a rational basis for finding that the sale of these policies is inherently unfair and that the rule was a reasonable implementation of those findings.[60]

New Jersey, by regulation, imposes staggered durational minimums for "funeral" insurance policies. A funeral policy is defined as any insurance policy or annuity contract, regardless of face amount, that is intended at the time of issue to fund a prepaid funeral agreement.

The rule requires that the death benefit be at least as great as accumulated premiums over the first two years from issue. For policy years three through seven, the regulation requires a minimum death benefit equal to the "insurance adjusted premium fund." This fund is essentially the accumulation of premiums with interest, less appropriate charges such as mortality. The death benefit after the first seven policy years must not be less than the fund as of the seventh policy year.

The Florida legislature over the years has considered and rejected several proposals that would place restrictions on the sale of small face amount policies. The most recent bill which failed to win legislative approval is SB 1786. It would have required that the death benefit be increased by 50 cents for every premium dollar paid in excess of 250% of the death benefit. It would have further required that the death benefit be increased by $1.50 for every premium dollar paid in excess of 500% of the death benefit. The proposal was limited to life insurance policies with a death benefit of less than $15,000.

TDI staff provided one additional consideration for comment designed to

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[59] 284 WASH.ADMIN.CODE §23-550.

[60] The Court, in finding a rational basis for the rule cited the testimony of the Chief Deputy Commissioner that "[a]t some point, adequate premiums required by the actuarial realities of old age and small policy size combine to produce a policy that, at best, produces only a minimal benefit and, for the vast majority of policyholders, a significant depletion of small estates." *Omega Nat. Ins Co. v. Marquardt*, 799 P.2d 235, 241 (Wash. 1990). The Court also rejected insurers' arguments that there was "no rational basis for the distinction drawn by the rule between policies where the death benefit is over $25,000 and those where it is under $25,000." "Several persuasive reasons are advanced for the rule's classification of smaller and larger life insurance policies. The Commissioner argues that in policies under the purview of his new rule, it is the combination of high mortality rates together with heavy expense loading that produces the unfair results and that because the unit expense costs on larger policies are less than on smaller policies, the relationship between premiums and benefits in larger policies tend to be more favorable to the consumer." *Id* at 243.

reduce premium multiples by providing shorter premium paying options to the consumer and disclosing such options. Just as a single premium would reduce the maximum multiple to less than one, shorter premium paying options decrease the maximum multiple with a relatively small increase in premiums.

As previously indicated, the Committee was unable to agree on the need or desirability for imposing restrictions on the sale of small face policies. Consumer and other group members supported restrictions, while the industry members opposed them.

Dain Eric Moran supported legislation that would incorporate the Washington rule. Failing that, he would support imposing a 1.5 multiple limitation on policies of $10,000 or less. Rod Bordelon of OPIC endorsed both the Illinois and Florida proposals characterizing them as "simple, yet effective solutions." Rob Schneider from Consumers Union favored the Washington rule and noted that the Illinois proposal imposing a 250% cap may be "too weak." He also observed that "Other alternatives, such as varying restriction on multiples based on issue age, might be an appropriate alternative."[61]

Beyond questioning their empirical need, industry members expressed a variety of objections to the adoption of any of the restrictions discussed by the Committee. In general, industry opposed any restrictions, characterizing them as unnecessary and unworkable and arguing that, if adopted, they would force products from the marketplace. Brenda Nation observed:

> Data from the Second Survey support the fact that no company surveyed is making huge profits from the sale of these products, and in many cases, the data show that little or no profits are being realized from those companies. It is conceivable that some products, particularly those marketed to older people, might have to be removed from the marketplace should a rate cap proposal become law.[62]

Mark France expressed similar concerns and stated:

> Premium caps are not workable. The concept isn't bad, but just doesn't work in practice because of the myriad of insurance types and payment periods.[63]

David Hawkins also thought caps on multiples would bring unnecessary complexity:

> Premium caps would introduce a level of complexity, and thus confusion and costs, which does not now exist. To be fair, caps would need to vary based upon age and the type of product (i.e. whole life, term, paid-up life, etc.). In addition, a cap would not address any of the complaints brought before the committee in public testimony. Witnesses complained of premiums in excess of benefits, a situation for which there is no remedy unless certain age groups are denied access to insurance. The problem revealed in testimony is more appropriately addressed by disclosure than premium caps.[64]

In general, industry commenters defended high multiples as being a characteristic of insurance, since those who die or terminate early must be supported by those who survive longer.

In this regard, Greg Hooser stressed:

> . . . it is absolutely critical that public policymakers fully understand the concept of "pooling of risk" in order that, unlike most of the public witnesses, may understand that the presence of "winners" (those that die soon after purchasing a policy and collect the fully face amount of the

[61] R. SCHNEIDER, Comments, 10-25-2002.

[62] B. NATION, Comments, 10-25-2002.

[63] M. FRANCE, Comments, 09-10-2002.

[64] D. HAWKINS, Comments, 10-25-2002.

> policy) and "losers" (those who don't die as soon as the calculations predict they will die) are inherent in insurance.[65]

Industry representatives also noted that no one complains when death occurs soon after issuance of the policy. In this vein, these commenters compared the situation of a SALI insured who pays several multiples of the face amount to insureds who pay premiums for auto insurance for many years without ever collecting on a claim.

Except for one year term life insurance, TDI staff believes this comparison is inapposite. The premiums for auto insurance support a coverage period of one year or less. The premiums for all life insurance other than term support lifetime coverage. For example, twenty years of auto premiums have nothing to do with the next year's coverage, but twenty years of whole life premiums accumulate funding for that one eventual certainty: death. How many times an individual should reasonably be expected to fund this one risk is the ultimate question.

Industry Committee members had different views on providing shorter premium paying options. Brenda Nation opposed shorter premium paying options based on re-pricing and re-filing costs to companies to incorporate these options in SALI products that do not currently provide for them, stating:

> The concept of offering a limited pay product to consumers in this market is a costly prospect to those companies who do not already offer such a product, especially to those who do not have the legal authority to sell such a product.[66]

Ms. Nation also noted that the proposal would impose an especially difficult burden on direct response insurers by requiring them to offer alternative products through successive mailings to the same consumer.

Burnie Burner expressed a different view:

> Mike Boerner suggested that we consider offering limited pay options as an alternative to caps on multiples. His calculations showed that such option greatly reduced the multiples without significant increases in premium. We have done the research and believe that these options offer an opportunity to directly address the multiples issue without adversely and arbitrarily limiting the market.[67]

Alternative Distribution

Early in his long legal career, Supreme Court Justice Louis Brandeis mounted a campaign to bring "cheap insurance to the wage earner." The object of his attention or ire was industrial insurance which he felt was a bad bargain for the working man because of its "extraordinarily heavy expense."[68] Over a period of several years he lobbied tirelessly for the adoption of legislation in Massachusetts that would enable savings banks, quasi-public institutions at the time, to underwrite and market small face life insurance policies. Brandeis believed that products sold by savings banks, free of commissions and other expenses associated with traditional methods of distribution, would offer better value for the policyholder.

[65] G. HOOSER, Comments, 10-25-2002.

[66] B. NATION, Comments, 10-25-2002.

[67] B. BURNER, Comments, 10-25-2002

[68] "I am convinced that the greatest wrong committed in connection with the present conduct of life insurance is through industrial insurance, and mainly on account of the extraordinary heavy expense attendant upon the methods employed. . . . In casting about for some other means of providing cheap insurance to the wage-earner, it has occurred to me that there might be an insurance adjunct to our savings banks. . . . My idea is that the savings banks could do this business at a very small expense; that they would advertise only to a slight extent other than by slips put on the deposit books; and that they would not undertake to make house-to-house collections. It seems to me that accordingly there ought to be very little expense in conducting that portion of the insurance business . . . ." A. MASON, THE BRANDEIS WAY 123-124 (1938).

Massachusetts enacted his vision in 1907 and was followed by New York and Connecticut.

Although submitted for discussion by TDI staff, the concept of exploring alternative methods of distribution (savings bank life, internet, credit card companies) drew little Committee interest or comment. Member Brenda Nation while lauding the "intent behind these suggestions" was not sanguine about their feasibility since "many of the consumers in this market do not possess the financial resources to make these suggestions a viable option."[69] Burnie Burner, after doing an informal survey of internet life insurance web sites, found that few small face policies were offered and those that were available represented poor values. Mirroring Ms. Nation's comments, he observed:

> Of course, access to the Internet requires a computer, a modem and some level of skill. How many folks in this market have access to those resources? If they do not, are they denied the opportunity to buy life insurance? [70]

Rod Bordelon expressed similar skepticism, but for different reasons:

> [U]nless the other issues regarding premiums are addressed, I do not believe additional emphasis should be placed on marketing these products through channels such as credit card billing and direct marketing. The opportunity for abuse through high interest charges and selling additional insurance products such as credit insurance is great.[71]

Committee Member Comments/Recommendations

Below is a summary of Committee Member comments and/or recommendations made during the course of the Committee's work.

Rod Bordelon, OPIC - Consumer Representative:

- Recommends that a premium cap be used as a mechanism to prohibit the sale of certain policies; favors a simple solution such as that proposed in the Florida and Illinois bills over a more complicated method. Alternatively, a loss ratio requirement could be imposed similar to the credit life loss ratio.
- Recommends an approach similar to the Washington rule for products where premiums can exceed the death benefit in a short time from issue (such as pre-need products).
- Supports efforts to reduce expenses that drive up costs of small face policies.
- Favors disclosure at time of application, at time of issue, and annually thereafter with respect to premiums in relation to benefits. Also, favors 30-day "free look" provision.
- Recommends requiring agents or companies selling guaranteed issue policies to determine if the applicant is healthy and if so, to disclose more favorable coverages.
- Recommends requiring either the agent or company to analyze the financial impact to the insured of retaining multiple policies or replacing them with one large policy.
- Recommends a requirement similar to the Illinois regulation to identify other policies upon notice of death.

David Hawkins, TAIO - Industry Representative:

69 B. NATION, Comments, 10-25-2002.

70 B. BURNER, Comments, 10-07-2002.

71 R. BORDELON, Comments, 10-25-2002.

- Opposes any changes that would increase the costs of doing business, as this would decrease profits and lead to market withdrawals and ultimately, less consumer choice.
- Supports disclosure at time of application and issuance that premium payments under certain circumstances could exceed the face amount. Also recommends a 10-day "free look" period to augment the usefulness of this disclosure.
- Supports some level of disclosure regarding multiple policies or the effect of health on premiums.
- Believes premium caps would introduce a level of complexity, confusion, and costs which do not currently exist. Further believes, that premiums caps, if imposed, would need to vary by age and type of product.
- Cautions against pre-qualification of health on guaranteed issue products given that a reasonable spreading of risks is needed for guaranteed issue products to hold down premiums.
- Recommends that consideration be given to the differing technological capabilities of companies in this market.

Dain Eric Moran, LULAC – Other Group Representative:

- Recommends legislation implementing the Washington Department of Insurance rule or failing that supports premium caps not greater than 1.5 times with policy minimums of $10,000.
- Urges reform of the Small Face Life Insurance Market and stresses that increased disclosure alone is not the solution.
- Recommends that annual policy statements be provided.

Brenda Nation, ACLI - Insurer Representative:

- Opposes any restrictions on multiples of premium and notes that life insurance rates have never before been regulated.
- Opposes requiring shorter premium paying periods as this would be too costly for some companies to implement and is not viable for direct marketed products.
- Believes alternative distribution systems (e.g. internet, saving bank, credit card billing) may reduce expenses to the consumer but may never reach consumers served by this market.
- Favors NAIC disclosure model, but will support with certain changes, the disclosure proposed by Burnie Burner at the October 8, 2002, meeting.
- Recommends disclosure when policy is issued rather than at application due to complications in calculating premium because of various riders and premium payment options.
- Opposes any requirements for annual disclosure.
- Recommends enhanced disclosure at the time of issue of the policy to address multiple policies.

Mark France, Committee Member on behalf of TALHI. Following comments are qualified to be his own and not necessarily those of TALHI:

- Recommends disclosure at the time the individual receives the policy provided they are given a 30 day right to cancel the policy and receive all their money back.

- Believes any disclosure regarding the effect of health on premiums should be general in nature.
- Opposes premium caps, as well as other restrictions such as the Washington regulation, as he believes that these proposals might destroy the market for prepaid funeral insurance in Texas.
- Believes restricting guaranteed issue policies to only "unhealthy" people would cause premiums to skyrocket; also expresses concerns over determining criteria for "healthy people".
- Supports disclosure at time of application and at time of receipt of the policy, but opposed to annual disclosures.
- Supports offering of a limited pay option, if certain premium multiples are considered "unfair".

Rob Schneider, Consumers Union - Consumer Representative:

- Supports disclosures at the time of application and in annual statements, but cautions that disclosure alone will not solve the problems in the SALI marketplace.
- Endorses the Washington Regulation which addresses the reasonableness of premiums to benefits.
- Recommends that pre-need contracts should allow transferability - including growth - to any funeral home of the person's choosing and that refunds should be at least equivalent to those available through a trust-backed pre-need contract if the consumer cancels the contract.
- Recommends that TDI develop minimum requirements for companies to search for other policies and for locating beneficiaries when notified of death.
- Recommends TDI consider minimum policy levels (suggests $10,000) with slightly higher premium amounts in exchange for assurances that consumers will receive a better value.

Mike Myers, TAIFA – Agent Representative:

- Supports the need for policies in the marketplace under $1,000.
- Recommends that fully paid up policies be offered rather than the implementation of a premium cap.
- Suggests that insureds be granted the option to convert current policies to extended term or paid up coverage if they desire to cease premium payments.
- Recommends that choices be maintained with regard to distribution systems (i.e. that the agency system be preserved). Notes that compliance may be a problem for direct writers and other distribution methods that do not use agents.

Cynthia Postell, Singing Hill Funeral Home – Other Groups Representative:

- Supports restrictions on multiples (premium caps).
- Recommends disclosure to each customer with a signature required to acknowledge receipt and understanding.
- Recommends that consumer be provided with the option of increasing coverage of existing policy rather than the issuance of multiple small policies.

Jermaine Thomas, attorney, Barnes & Turner Law Firm – Consumer Representative:

- Favors the approach of the Florida bill (SB 1786) which requires increases to death benefit when premiums paid exceeds specified multiples.
- Recommends disclosure, but notes that disclosure alone is not sufficient to protect consumers.
- Recognizes that multiple policies are advantageous to the consumer in some instances, but recommends that multiple policies be automatically converted into a single policy where such would provide marked savings to the consumer. Also recommends that the consumer be required to sign a waiver (and the agent a statement that he disclosed the savings) if the consumer is opposed to such conversion.

Exhibit 5 contains copies of the comments from Committee members which includes their recommendations as summarized above.

Interested Party Comments/Recommendations

Below is a summary of Interested Party comments and/or recommendations made during the course of the Committee's work.[72]

Burnie Burner, attorney, Long, Burner, Parks & DeLargy, representing a coalition of insurers offering small face policies:

- Recommends disclosure as set out in his comments dated October 7, 2002, and attached as **Exhibit 8**.
- Supports requirement that insurers offering whole life policies of $25,000 or less offer a limited pay option as well. Also, recommends that any legislation provide the Commissioner with the authority to adopt rules defining the policies subject to the limited pay option, as well as the nature and extent of the offer.
- Supports a 30 day "free look" period.

Wade Caldwell, attorney, Martin, Drought & Torres Inc.:

- Recommends disclosure as set out in his comments dated May 22, 2002, and included in **Exhibit 7**.
- Recommends prohibiting collection of premiums for child or spouse riders after coverage technically ends.
- Recommends detailed annual statements be provided to policyholders which reflect the policy's cash value, annual earnings, and earnings rate.
- Recommends a ban on the sale of cash value life insurance on children in amounts less than $15,000.
- Recommends a minimum face value of $10,000.

Brian Forman, Vice President, Actuarial, Pan American Life Insurance Company:

- Opposes any restrictions on multiples; if changes are made, they should be exclusively limited to providing disclosure.

[72] A copy of written comments and audio tapes of the advisory committee meetings, are available upon request to the Texas Department of Insurance.

Greg Hooser, attorney, Sneed, Vine and Perry. Mr. Hooser provided comments on behalf of TAIO:

- Recommends that stronger disclosure requirements would best resolve most of the concerns expressed.
- Opposes any requirements that would increase the price or eliminate products such as the Washington regulation.
- Opposes to any requirements which increase the cost of small face amount policies.
- Recommends that pros and cons of any proposals be prepared along with their fiscal impact.

Paul Mills, Catholic Family Fraternal of Texas – Insurer:

- Recommends that fraternals be excluded from any small face proposals being considered, given the differences between fraternals and commercial insurers.
- Opposes the application of any fixed multiple or premium cap to fraternals.
- Opposes the application of any policy minimum to fraternals.

Tom Munson, Landmark Life Insurance Company – Insurer:

- Opposes premium caps, annual notices, and a mandated minimum policy size.
- Supports offering alternative products which would contain a lower multiple.
- Favors NAIC disclosure model.
- Supports a customized notice or disclosure to the consumer which would include premiums versus benefits, given it is presented correctly.

Mike Pollard, TALHI - Insurer Representative:

- Favors NAIC disclosure model.
- Supports a complete disclosure of all the premium and face amount terms of a policy, along with a cancellation ("free look") period.
- Recommends that any decision regarding multiple policies be left up to the consumer.

Angela Reeves – Consumer:

- Recommends that life insurance policies not be sold to individuals over the age of 65.
- Recommends that life insurance policies covering children not be sold.
- Supports disclosure at time of sale.

Summary of Consumer Testimony

A summary of consumer testimony can be found in **Exhibit 9**.

Many consumers expressed concern and dismay over the amount of premium paid relative to the death benefit:

- Mr. Lawrence Sherman gave examples of policies his father, Claude Sherman, was issued. For four policies with a total death benefit of $4,500 (three policies for $1,000 and one policy for $1,500) Mr. Sherman paid $13,361. The three $1,000 policies were purchased at ages 63, 68, and 77. The $1,500 policy was purchased at age 72.
- Ms. Ana Myatt discussed an example where $3,232 was paid for a $750 death benefit.

- Ms. Angela Reeves related the experience of Mr. Clem Ellis, age 85. Mr. Ellis had 17 active policies in 1996. Mr. Ellis paid $1,920.65 for a $2,000 whole life policy (taken out at age 81) which he cancelled for zero cash value after four years. Mr. Ellis also paid $3,061.56 over a 10 year period for a $1,000 whole life policy (taken out at age 75). He surrendered this policy after 10 years for a $428.00 cash value. Had Mr. Ellis continued to pay on this policy until maturity (5 more years), he would have paid a total premium of $4,444.20 or 4.4 times the face value.
- Mr. Jerry Brown testified about 21 policies purchased by his mother, father, nephew and brother.
- Wade Caldwell on behalf of his clients, Adrian and Quinnie Allen, provided a copy of a small face family policy issued in 1935. The policy had a total $1,000 face value split among 9 insureds. The death benefit for Adrian and Quinnie is $300 each. Premiums are still being collected on this policy. Attorney Caldwell estimates that at least $2,000 in premiums have been collected from Adrian Allen to date. **Exhibit 11.**
- Other consumers, with varying degree of specificity, offered testimony about their experience or that of their loved ones, with "upside down" policies.

Post-Draft Comments

Staff received three comments from Advisory Committee members regarding the draft *Report of the Proceedings of the Small Face Amount Life Insurance Advisory Committee*. These comments are attached as **Exhibit 12**.

AN ACT

relating to an interim study of the marketplace in the state for life insurance issued with a small face amount.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

SECTION 1. (a) The commissioner of insurance shall conduct a study of the marketplace in the state for life insurance issued with a small face amount and report the commissioner's findings to the legislature on or before January 1, 2003.

(b) In conducting the study, the commissioner shall:

(1) evaluate whether:

(A) the relationship between the pricing of life insurance policies with a small face amount and the value received by insureds is reasonable;

(B) actuarial and expense experience supports the pricing of life insurance policies with a small face amount;

(C) adequate disclosure is made to consumers regarding the relationship between the pricing of life insurance policies with a small face amount and the benefits received;

(D) the sale of multiple policies to one insured is appropriate or suitable; and

(E) statutory changes are needed or desirable; and

(2) consider any other matter relating to the marketplace for life insurance issued with a small face amount that the commissioner determines is appropriate.

(c) The commissioner of insurance shall appoint an advisory committee to assist in conducting the study required by this section and to obtain comments from interested parties. The committee shall include members who represent:

(1) life insurance agents;

(2) life insurers, including stipulated premium insurance companies;

(3) the office of public insurance counsel;

(4) consumers; and

(5) any other group the commissioner determines could contribute to the study.

(d) The advisory committee appointed under Subsection (c) of this section is abolished and this section expires September 1, 2003.

SECTION 2. This Act takes effect September 1, 2001.

______________________________ ______________________________

President of the Senate Speaker of the House

I certify that H.B. No. 2415 was passed by the House on May 4, 2001, by a non-record vote.

____

Chief Clerk of the House

I certify that H.B. No. 2415 was passed by the Senate on May 22, 2001, by the following vote: Yeas 30, Nays 0, 1 present, not voting.

____

Secretary of the Senate

APPROVED: ______________________________

Date

____

Governor