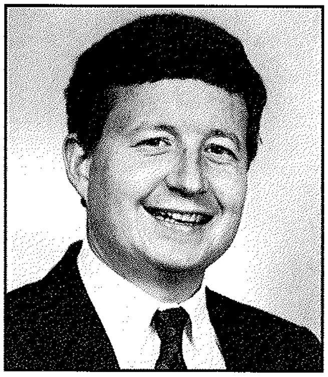
THE RHA REVIEW

ROUTE TO:

Vol. 2, No. 4, Third Quarter 1996

A publication of Robert Hughes Associates, Inc., an international insurance consulting, actuarial, litigation support and risk management company.



The Era of Life Insurance Disillusionment

By Robert Puelz, Ph.D., Ch.F.C., CLU

In the early 1980s I had the opportunity to learn about the sale of life insurance from reputable marketing people at a respected mutual life insurance company. After a few years, however, I chose to follow my academic yearnings, leaving the sale of life insurance to others. In hindsight, I now realize that I was witness to significant change within the life insurance marketplace, notably the widespread sale of universal life insurance under implausible long-term interest-rate assumptions, and the sales tactic of vanishing premium life insurance.

Problems raised by life insurance products not easily understood by the consuming public have surfaced in a series of lawsuits pertaining to deceptive sales practices by insurance representatives. Recent major cases have alleged wrongdoing by the representatives of some significant life insurers, including the Prudential and New York Life. In Texas, Crown Life recently agreed to an out-of-court settlement associated with the sales of vanishing premium policies during 1987. Some policyholders who bought the vanishing premium concept are having their premiums reappear. Moreover, some life insurance consumers have begun to experience actual cash value accumulations and death benefits lower in comparison to the original projections. Indeed, the forecast by Joseph Belth, associated with the sale of interest-sensitive products, predicting a "backlash when consumers eventually discover – the hard way – the magnitude of interest-rate risk they assumed," has come to fruition.[1]

So what types of disclosures should be made by a life insurance agent and a life insurance company that are selling a policy of life insurance? Disclosing information to prospective customers so that they can make in-

(**Disillusionment**, continued on following page)

THE LONDON LINE

An Offer You Can Refuse

By Michael D. Jackson

There is good news and bad news from London. The bad news is that the Lloyds' Names can reject the current offer being made to them. The good news for Lloyds is that it is very likely that the Names will accept this latest offer for reconstruction and renewal.

More good news is that one of the underwriters who fled from England after a multi-million-pound Lloyds' fraud in the early eighties has had an arrest warrant issued against him in the United States. This follows Peter Cameron-Webb's failure to observe a court order against him for recovery of Names' funds under his control in Switzerland. This does bring about the thought of a Pandora's box of legal possibilities being opened up against other "fraudsters" in the London insurance market. It has always been the view of outsiders that the bigger the fraud, the more likely you are to get away with it.

(**LONDON**, continued inside)

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(Disillusionment, continued from cover)

formed purchasing decisions is important and has been the subject of considerable attention in the life insurance trade press over the past 20 years. I have a few suggestions for the industry which are in addition to the required reporting of the surrender cost and net payment indices mandated by the National Association of Insurance Commissioners' Life Insurance Disclosure Model Regulation.

First, an agent and the company should report the yearly price of insurance per $1,000 of protection across a reasonable range of dividend crediting rates. The yearly price calculation is simple and provides a useful benchmark by which both term and cash value products can be compared in terms of their protection costs.[2]

Second, for cash value policies, the yearly rate of return on the savings component of the policy should be reported across a reasonable range of dividend crediting rates. As stated, both the yearly price and return calculations are impacted by projected dividends. Reasonable disclosure about prospective dividend performance entails projections at current payout levels, and projections above and below current levels. In this respect "reasonableness" ought to be company-specific and related to feasible ranges of the company's projected mortality, projected expenses and net investment income.

Third, typical cases involving a life insurance need should include a discussion about buying term insurance. It is well known among life agents and the industry in general that this purchasing strategy is a viable alternative. It is equally well known, however, that there is a larger financial incentive for agents and companies to sell a product with a cash value component rather than to sell term insurance.

Fourth, sales proposals stating that premiums will vanish are misleading. When a non-expert insurance consumer is told that premiums will vanish, despite standard bottom-of-the-page caveats such as "The dividends illustrated are neither guaranteed nor estimates of future dividends," the customer will expect to pay premiums for only the period of years illustrated until the premium "vanishes." Moreover, even if current and reserved dividends are sufficient to pay premiums during the later policy periods under this method of premium payment, there is a true economic opportunity cost to the policyholder who uses these dividends for this purpose. It is my view that vanishing premium sales illustrations imply to the prospective customer a "get something for nothing" sales approach as an inducement to buy the policy.

Finally, across all appropriate policy comparisons, the agent should reveal his or her compensation to the prospective customer. The commission an agent is paid will have a direct impact on the ability of the policy to perform, since the commission is an important expense component of the premium structure. Prospective customers need to know the amount an agent is compensated so as to properly value his or her service.

If life insurance agents clearly place importance upon client needs and maintain up-to-date knowledge of the industry and its products, then agents will go a long way in showing the due care owed to their customers. RHA

[1] *Insurance Forum*, October 1985.

[2] See Joseph M. Belth, *Life Insurance: A Consumer's Handbook*, 2nd ed. (Bloomington, IN: Indiana University Press, 1985).

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FROM NEAR AND FAR

When Hurricane Bertha blew through the Mid-Atlantic states in early July, insurance estimators couldn't agree on the amount of insured losses and/or the amount of total losses. Somewhere between $200 and $500 million was about as close as the various estimates got.

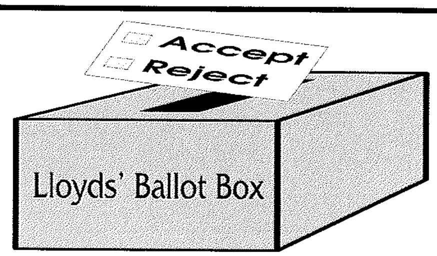
Prior to Hurricane Bertha, weather-related claims for the first half of 1996 had passed the $3 billion mark. This includes claims related to winter storms in the early part of the year, tornadoes in the spring and the drought that affected the Southern states in early summer.

At the end of May a ferry licensed to carry about 450 passengers sank on Lake Victoria in Tanzania while carrying a reported 800 passengers. Apparently the ferries that service routes on Lake Victoria are so old and badly maintained that they are usually uninsurable. The 16-year-old *Bukoba* was owned by the state-owned Tanzanian Railways Corporation and was thought to be uninsured.

(LONDON, continued from cover)

Other city figures involved in alleged fraudulent activities that are or have been investigated by the Department of Trade and Industry (DTI) and Serious Fraud Office (SFO) may now be having sleepless nights similar to those that they caused others.

The 34,000 Names around the world have until August 28, 1996, to accept or reject the "offer" of reconstruction and renewal terms designed to draw a line under and put closure on the huge losses "incurred" in recent years through a series of man-made and natural disasters and the large number of long-term environmental pollution claims.



"The 34,000 Names around the world have until August 28, 1996, to accept or reject the 'offer' of reconstruction and renewal terms designed to draw a line under and put closure on the huge losses 'incurred' in recent years."

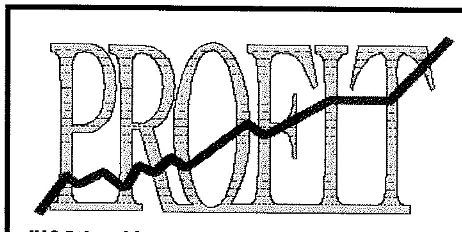
It should be remembered that this is the second such rescue mission that has been launched. The first was attempted in 1994, when approximately £900 million ($1.3 billion) was thrown into the pot. This second offer is worth £3.2 billion ($4.6 billion), making this pot a little more attractive. How will this rescue package be divided? The deal is roughly this: about £2.1 billion ($3 billion) of debt owed on all Names' involvement will be written off. The remaining £1.1 billion ($1.6 billion) will go toward mitigating the losses of the 13,600 Names who have sued Lloyds.

All Names who have funds at Lloyds will allow those funds to be surrendered. The system will then "transfer" £14 billion ($20 billion) of Names' assets into the newly formed Equitas, which has been formed to take over all Names' liabilities. This will supposedly allow them to sleep at night. On top of these figures, a further £900 million ($1.3 billion) will be required from Lloyds to ensure that Equitas is properly funded.

Accountants participating in the funding of this rescue bid are to be indemnified on a limited basis. Ernst & Young, Arthur Andersen, Coopers & Lybrand, Littlejohn Fraser, and Neville Russell are expected to contribute £116 million ($167 million). The reason for these contributions is that some accounting firms are being held somewhat responsible for failure to properly audit Lloyds' books in the past.

Names who accept the offer waive their legal right to sue the companies and related firms involved. Despite all of the efforts to end all litigation in this £3.2 billion ($4.6 billion) rescue bid, there is still a rebel action group, representing Names, that has established that accountants and auditors who have not contributed to the "offer" will not be protected by the waiver. Names therefore can accept the "offer" and still litigate against non-contributing auditors. This then places some high-ranking auditors like Pannel Kerr Forster at risk of litigation.

The majority of Names have approved the acceptance of a £440 million ($634 million) payment from current and future profit toward the rescue plan. Despite this, fears still exist that a minority will not accept the terms.



"If [the Names vote to accept,] Lloyds will survive and continue into the future. A return to profit has already begun, and there is expected profit in the future underwriting years."

All in all, a package has been placed before the Names to vote upon. If they vote for it, Lloyds will survive and continue into the future. A return to profit has already begun, and there is expected profit in the future underwriting years. A rejection of the "offer" has been declared by senior officials at Lloyds to be "too dire to contemplate." In September the DTI, which regulates the insurance industry in the United Kingdom, will make its annual assessment of the financial capabilities of Lloyds. So if the vote is for a rejection of the "offer," the DTI could be in a position to consider that Lloyds is not in a financial condition to continue.

I am convinced that Lloyds will survive, but there are a number of land mines left on this battlefield that need to be defused before the people in the City of London can tread safely around this battlefield again. Also, there are some who say that a number of people need to be tried for war crimes before everyone is finally satisfied. RHA

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PARDON OUR MESS

If you have called or visited us recently, you may have had your conversation interrupted by the din of construction underway.

The reason for all of the noise is that we have once again expanded. We have added two more offices, including a large work area that will be utilized by our staff for research projects and for the organization and operation of our insurance programs business.

Since our move to this building in April of last year, we have almost doubled the amount of space that we occupied at our previous location. As always, we extend a special thank-you to all of our loyal clients who have made this growth possible.

THE RHA REVIEW

Publisher .... Robert N. Hughes
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The RHA Review is published quarterly by Robert Hughes Associates, Inc. — an independent international insurance consulting, actuarial, litigation support and risk management company based in Dallas, Texas, with offices in Houston, Texas, and London, England. The purpose of this publication is to offer insurance-related information and critical comment pertinent to the clients, friends and fellow professionals of Robert Hughes Associates, Inc. This publication is available free to interested parties. The information contained in this publication is intended to be general in nature; readers should obtain professional counsel before taking any action on the basis of this material.

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