

# The NAIC Model Life Insurance Solicitation Regulation: Measuring the Consumer Impact in New Jersey

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## ABSTRACT

This paper examines, via consumer interviews, the impact of the National Association of Insurance Commissioner's Model Life Insurance Solicitation Regulation as implemented in New Jersey. A substantial portion of the insurance buyers sampled did not become aware of the provisions of the regulation aimed to improve their buying ability. Further, many life insurance buyers were not well informed concerning the nature and operation of life insurance contracts, and in particular, the life insurance policies that they had purchased.

The market for life insurance is characterized by some, but not all of the features of a perfectly competitive market. Clearly, there are many buyers and sellers.<sup>1</sup> Furthermore, the product, consisting of the life insurance contract and the associated service, is relatively homogeneous among the competing firms.<sup>2</sup> Also, although there are minimum capitalization/surplus laws in each state, entry to and exit from the marketplace are not severely restricted. The fourth and final characteristic of the ideal competitive marketplace is that complete information should be available to all consumers without charge. This aspect of the life insurance marketplace has become the focus of much regulatory interest and is the subject matter of the present report. The lack of this perfect knowledge attribute, and the associated market place symptoms, have piqued regulatory interest in general information disclosure, cost disclo-

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<sup>1</sup> There were approximately 1,900 life insurance companies and 30 million policies sold in 1979. Source: *Life Insurance Fact Book, 1980*. American Council of Life Insurance.

<sup>2</sup> Some of the homogeneity among policies is mandated by statute or administrative rules.

sure specifically, and consumer education programs for the life insurance buyer.

Evidence has been presented to indicate that substantial cost-to-purchaser differences exist between similar life insurance policies [1, 3]. Although these differences exist, some consumer surveys have found that insurance buyers do not perceive that significant cost disparities are prevalent.<sup>3</sup> This gap between reality and perceived reality can survive only if buyers are sufficiently unaware of the life insurance product and inter-insurer cost relationships.

Realization that information, particularly cost information, was not readily available or comparable in life insurance markets without external influence began with Professor Joseph Belth's study, *The Retail Price Structure in American Life Insurance* [1]. Since that time, industry and some public interest have been attracted to life insurance cost disclosure and consumer education as a regulatory issue. Although some state insurance commissioners took unilateral action, e.g., Pennsylvania, 1970<sup>4</sup>; the National Association of Insurance Commissioners (NAIC) did not adopt its model life insurance solicitation regulation until June, 1976.

The NAIC model regulation is the focus of the current study. In adopting this regulation, the NAIC recognized (1) a lack of consumer understanding of the life insurance product and (2) the difficulty encountered by a life insurance buyer in accessing usable cost comparison information. The purpose of the present analysis is to evaluate the impact of the NAIC regulation on consumers of ordinary life insurance subject to that regulation in New Jersey.

### The New Jersey Legislation

The consumer education and cost disclosure plan adopted by the State of New Jersey is the model disclosure bill developed by the National Association of Insurance Commissioners. The stated objectives of the regulation are to improve the buyer's ability to (1) select the most appropriate insurance plan, (2) understand the features of the policy chosen, and (3) evaluate the relative costs of similar plans of insurance. These goals are met by requiring insurers to deliver certain informational items to the buyer whenever individual life insurance is sold.

The informational items to be delivered are (1) a Buyer's Guide and (2) a Policy Summary Sheet. The Buyer's Guide describes the process that the consumer should use in evaluating insurance information concerning policy types, payment plans, dividends, and cash values. A large portion of the text is concerned with defining the cost of life insurance policies and describing

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<sup>3</sup>For example, Institute of Life Insurance and Life Insurance Marketing and Research Association, *Life Insurance Consumers* 11 (1975), and Institute of Life Insurance, *Monitoring Attitudes of the Public*, 1975 Survey 55 (1975).

<sup>4</sup>Commissioner Herbert Denenberg issued his first "Shoppers' Guide to Life Insurance" in 1970.

the use of cost indices that are part of the Policy Summary Sheet the consumer receives with the policy purchased.

The second mandated portion of the information disclosure is the Policy Summary Sheet. This sheet provides the buyer with basic information regarding the policy purchased. Included in the summary are: name and address of the insurer and agent, generic name of the policy, annual premium, death benefits, cash values, dividend projections, policy loan interest rate, life insurance cost indices, and equivalent annual dividend. This summary must be a clearly presented separate document.

Unless there is an unconditional ten day refund provision included in the policy, insurers and/or their agents are required to provide the prospective buyer with the Buyer's Guide and Policy Summary prior to accepting the purchaser's application and initial premium. If such a refund is available, the disclosure information must be delivered, at the latest, with the policy.<sup>5</sup>

Finally, the law prohibits certain behavior in life insurance sales presentations. These rules prohibit, for example, cost presentations without recognition of the time value of money,<sup>6</sup> display of guaranteed and nonguaranteed benefits as a single sum, and reference to dividends without the caveat that these dividends are not guaranteed.

### Study Development and Research Design

The objectives of this research were to measure and evaluate the impact on consumers of the NAIC Model Solicitation Regulation as adopted by the State of New Jersey. The focal point of the investigation was consumers who had purchased ordinary (not industrial or group) life insurance policies subsequent to the implementation of the New Jersey law. By detailing the purchase process those buyers used and by measuring their attitudes, knowledge, and perceptions, the research effort attempted to detect the effects of the solicitation regulation.

The sampling and research procedure ultimately adopted by this study involved a number of simplifications that were necessitated by economic considerations, constraints imposed by insurers, or traditional consumer survey methodology. In sum, the data collection process included the following:

1. Although other insurers supplied a small number of purchaser names, the names of the life insurance buyers utilized in this study were supplied by either the Prudential Life Insurance Company of America or Metropolitan Life Insurance Company.<sup>7</sup>

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<sup>5</sup>The NAIC Model Regulation mandates no continuing, periodic post sale disclosure.

<sup>6</sup>Typical life insurance ledger sheets or cash flow presentations are not prohibited.

<sup>7</sup>These insurers wrote to each potential respondent informing them of the study and giving the policyholder an opportunity to be eliminated from consideration. This rejection rate approximated 25 percent. According to the 1976 *Annual Report of the Commissioner of Insurance*, Prudential issued 23 percent of the ordinary life insurance policies sold in New Jersey, Metropolitan 15 percent.

2. The geographical area sampled was an eight county section of northeastern New Jersey. The counties represented were: Bergen, Passaic, Morris, Hudson, Middlesex, Essex, Union, and Somerset.
3. Personal interviews of 30 minutes duration were utilized to collect the data necessary. Appointments with potential respondents were made by telephone for those with listed telephone numbers. Those policyholders without available telephone numbers were approached on a door-to-door basis. (The final sample included 32 percent without listed telephone numbers.)

A disconcerting problem that arose because of unavoidable time delays in processing interviews was the time lag between the policy purchase date and the interview date. Optimally, the interview should have been conducted immediately after the purchase. This speedy response to the life insurance sale was impossible due to a variety of causes including: winter weather, the volume of interviews, and the process utilized to generate the names. Interviewing did not begin in earnest until January of 1979, while many of the respondents purchased their policies in September of 1978. This resulted in a time lag measured in months rather than weeks.

Some aspects of the typical life insurance purchase may greatly offset the possible detrimental effects of such a long time lag. First, a life insurance purchase is not a frequent event. For example, nearly ninety percent of the respondents owned three policies or less, and for 45 percent of the sample, the policy discussed in the interview was the first policy purchased. This infrequency of purchase may contribute to a lasting memory of the sale and the product. Second, the purchase of life insurance is an important purchase. In fact, in responding to the purchase of an automobile, a dental check-up and life insurance, the subjects of this survey rated, on average, life insurance higher in importance than either cars or dental check-ups. Third, life insurance is typically sold by an agent. Associating a person with the product may contribute to increased recall of the purchase.

Taken altogether, the infrequency, personal nature, and importance of the life insurance purchase probably tend to make the decision a vivid and meaningful one for the individual. Thus, the time lag from purchase to interview date may not have been critical.

As a test of possible recall differences associated with the time lag to interview date, the sub-sample for whom Policy Summary Sheets became available<sup>8</sup> was split according to which side of the median time lag of seven months the individual was associated. Both groups were tested for information recall accuracy. Table 1 contrasts the results for the two groups. The results indicate that accuracy between the groups was approximately the same. Certainly there is no evidence that the later interviews led to substantially more inaccuracy in reported information. The overall magnitude of recall accuracy may have been low because of the time lag. The point in time

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<sup>8</sup>One hundred forty-eight respondents are included in this category.

Table 1

## Effect of Time Lag on Reported Accuracy of Policy Information

Policy Type	Percent of Group Reporting Accurate Information	
	Purchase to interview dates less than seven months. n = 88	Purchase to interview dates greater or equal to seven months. n = 60
Whole Life	19.2	18.7
Term	18.4	22.1
Cash Values		
Yes	41.6	47.4
No	9.8	10.4
Dividends	62.9	69.4

that the interviews would have had to be conducted to increase the level of reporting accuracy, if possible at all,<sup>9</sup> is unknown.

Furthermore, the NAIC Model Solicitation Regulation attempts to educate consumers of life insurance. Presumably, those buying policies subject to the provisions of the legislation become part of the diffusion of that education. The extent that those interviewed were in a position to pass on the basic disclosure information should be independent of the date of purchase. Thus, although the author would have preferred interviews conducted closer in time to the purchase date, the responses to the interviews should provide previously unobserved insights regarding consumer attitudes, knowledge, behavior, and perceptions of life insurance.

Data collection also included getting copies of the Policy Summary Sheet associated with the life insurance policy of interest from the appropriate insurer. At the completion of the interview, respondents were asked to sign an authorization for release of the policy summary to the author. Ultimately, 89.7 percent of the respondents agreed to the release of this information.

The interviews were conducted by Stewart Surveys, Inc., of Ridgewood, New Jersey. The process began in January of 1979 and was concluded June 1, 1979.

<sup>9</sup>Reporting accuracy levels may be low because of misunderstanding and ignorance and, therefore, unrelated to the time lag.

### Characteristics of the Sample

The names and addresses of 662 people were forwarded to the interview firm. Of those names, 409 were provided by the Prudential Insurance Company of America and 253 by the Metropolitan Life Insurance Company. Of the total 662 individuals, 494 recent purchaser names were given to specific interviewers and contact was attempted.<sup>10</sup> Successfully completed interviews were achieved for 194 people. Alternatively, interviews were not compiled for 300 members of the potential sample. A number of reasons existed for failure to complete an interview:

1. Direct refusal of respondent	123
2. Non-response to mail contact <sup>11</sup>	96
3. Respondent had moved	16
4. Respondent unable to speak sufficient English	15
5. Non contact via telephone	31
6. Non contact; personal visit	19
TOTAL	300

Thus, the response rate for the study was 194 of a possible 494 (39 percent); however, the refusal rate was only 25 percent. Analysis of the non-response data collected for telephone contact reveals, on average, no difference between the distribution of respondent demographics and the distribution of demographics for those choosing not to participate in the study.<sup>12</sup>

#### *Demographics*

The demographics of the final sample are important in determining to what extent the sample is representative of the population. For the present study, information regarding age, sex, marital status, education, occupation, and income seem most relevant.

*Age:* A reasonably wide diversity of ages was present in the sample. Average respondent age was 33.4 years. However, the mode or most frequent age was 25 years. Sample median age was 30.8 years; 8.2 percent of the respondents indicated ages greater than 50 years.

*Sex:* The sample included 125 men and 69 women respondents.

*Marital Status:* About 75 percent of the participants were married. Of the remaining 46 individuals, 22.2 percent of the final sample were single or separated/divorced, and 1.6 percent were widowed.

<sup>10</sup>Geographical and time problems prohibited the distribution of all names.

<sup>11</sup>For those with unlisted phone numbers only. If no one was at home when door-to-door contact was attempted, a letter explaining the study and a postcard response form was left at the home.

<sup>12</sup>The bases for this conclusion are chi-square and t-tests for 57 non-respondents regarding: age, educational level, policy type, face amount, and income. Significance is tested at the .05 level.

*Educational Level:* The respondents' median indicated educational level was "some college". The breakdown between possible answers, however, yielded the following information:

1. Without high school diploma	7.3%
2. High school diploma	30.9%
3. Some college	27.2%
4. College degree	17.8%
5. Beyond Bachelor's degree	16.8%

This educational distribution is slightly skewed towards the college end of the scale. Since the study was conducted in an urban/suburban setting with wide vocational/technical school, community college, and general college opportunities, this result is neither surprising nor out of balance with population trends.

*Income:* The income distribution was consistent with the educational level. That is, there was a slight skewness in the distribution towards the upper incomes. The category breakdowns were as follows:

\$ 0 - \$10,000	9.4%	\$35,000 - \$50,000	9.4%
\$10,001 - \$15,000	13.5%	\$50,000 and more	3.6%
\$15,001 - \$25,000	38.5%	Refused	3.1%
\$25,001 - \$35,000	22.5%		

*Summary:* The final sample does not appear to suffer from any self-selection biases. Furthermore, the demographics indicate that there was diversity in the categories. Thus, it appears that no one demographic segment dominated the sample population. When the demographic characteristics of this sample are compared to the existing pool of life insurance owners<sup>13</sup> and the trend in life insurance purchases, the final sample's demographic characteristics appear to match the population's demographic composition favorably.<sup>14</sup>

### *Policy Characteristics of the Sample*

Another aspect of the sample that is relevant in determining the representativeness of the research results is insurance purchase characteristics. The sampled group of life insurance buyers reported the purchase of a variety of

<sup>13</sup> As presented in the *1980 Life Insurance Fact Book*.

<sup>14</sup> A slightly higher percentage of women is present in the sample than in the population of life insurance buyers (36 percent versus 29 percent).

There is more density in the sample distribution at the upper incomes resulting in a slight skewness to that side of the distribution. However, the *1980 Fact Book* shows a similar skewness.

Finally, with respect to ages, the sample represents very well the insurance buying ages. The most dense age group is 25-34 years, but ages from twenty to the mid-fifties are well represented.

insurance plans. In order to simplify the terminology involved, the respondents were asked to categorize the policy purchased as: whole life insurance, term life insurance, or a combination of whole life insurance and term life insurance.<sup>15</sup> Table 2 shows the distribution of responses, the distribution of policy types derived from the available Policy Summary Sheets, and the distribution of policy purchases as reported by the *1980 Life Insurance Fact Book*. The sample distribution of types of insurance indicates an over-representation of term insurance when compared to the distribution of policies purchased.

Table 2

Sample Reported and Derived Policy Types  
versus Nationwide Actual Policy Purchases

	<u>Respondent</u> <u>Reported</u> <u>Percentage</u>	<u>Policy Summary</u> <u>Sheet Derived</u> <u>Percentage*</u>	<u>1978</u> <u>Nationwide</u> <u>Percentage of</u> <u>Policies Purchased**</u>
Whole Life Insurance	40.6%	36.9%	57%
Term Life Insurance	29.7	48.9	18
Combination	18.2	14.2	21
Endowment	0.0	0.0	4
Don't Know	11.5	0.0	0
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

\* For only 141 respondents.

\*\* According to the 1980 Life Insurance Fact Book.

The final population characteristic that needs to be compared with the sample is policy size. The average size life insurance policy purchased in 1979 according to the *Fact Book* was \$22,970. The sample average policy size, as reported by the respondents, was \$31,111; however, a few large policies were included. The median policy size was \$24,679, which may be more representative in this case.

Whereas characteristics of the respondents and their policies were collected by this research, demographics and operational characteristics of the salesperson of record were not gathered and cannot be analyzed. It is possible that agent factors, such as age, income, sales volume, knowledge/education, experience, relationship with the buyer or the insurer, and others, could account for variance in buyer behavior, knowledge, awareness, and/or satisfaction. For example, Prudential agents are classed (by the insurer) as either

<sup>15</sup> Endowment insurance purchasers were not solicited by the author.



district agents (those who service a particular geographic area and may use debit marketing practices) or ordinary agents (those who sell only premium notice policies and can solicit business in any location). Buyers of ordinary premium notice life insurance solicited by district agents may uniformly respond differently to the questionnaire used in this research than those who purchased their Prudential policy from an ordinary agent. This question of agent influence is left for future research.

*Summary:* A variety of insurance policy types and amounts are represented in the sample. Thus, the data provides the capability to break down the entire set of observations by policy characteristics and further helps the research to be considered representative of the population of insurance purchasers.

### Impact Evaluation

The NAIC Model Regulation attempts to aid the life insurance consumer by (1) providing a Buyer's Guide and a Policy Summary Sheet and (2) prohibiting certain solicitation practices. The objectives of these disclosure/solicitation rules have been cited earlier in this report. However, at this point it is useful to outline the relationship between the Model's goals and the methods taken by this research to measure the impact of the Regulation upon consumers.

#### *Goal Achievement: Insurance Appropriateness*

The first goal of the legislation is to "improve the buyer's ability to select the most appropriate insurance plan." Presumably, this goal is most directly achieved by the Buyer's Guide distribution mandated by the bill. Therefore, monitoring the impact of the Regulation with respect to this objective should focus upon receipt, utilization, and comprehension of the Buyer's Guide.

Of course, the ultimate test of achievement with respect to this objective is the improved extent to which consumers are making good or bad purchase decisions. It would be very difficult for any research effort to evaluate individual purchases. This task is made even more difficult when, as was true for this study, incomplete environmental information is gathered and individual tastes and preferences are not scrutinized. Consequently this report makes no such judgments.

*Results:* The disclosure section of the interview began with unaided and aided recall questions regarding receipt of the NAIC Buyer's Guide. When asked whether they had received such a pamphlet, 32.0 percent of the respondents recalled the Guide. Those respondents not recalling the Guide were shown a copy of the pamphlet similar to that distributed by the insurer. Of those individuals, 13.6 percent recalled having received the Guide. Thus, 114 individuals, or 58.5 percent of those asked, did not remember receiving a copy of the Buyer's Guide, even after having seen a copy of it.<sup>16</sup>

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<sup>16</sup>The interviewing process could not determine whether the agent *actually* delivered the Buyer's Guide except via the self-report of the buyer. The possibility exists, of course, that some consumers did not receive the booklet.

Table 3

**Buyer's Guide Receipt: Timing and Usage  
by the Salesperson**

<u>Timing of Buyer's Guide Receipt</u>		<u>Presentation of Buyer's Guide By the Salesperson</u>	
With Policy	28.2%	Encouraged to Read	30.0%
During Sales Presentation	39.7%	Used by Salesperson as Selling Tool	8.7%
After Sales Presentation, Before Sales Receipt	9.0%	Ignored	5.0%
Other	11.5%	Other	26.2%
Don't Know	11.5%	"Bad-Mouthed" by Salesperson	1.2%
		Not Sure/Don't Know	28.8%

Table 4

**Consumer Recall/Reading of NAIC Buyer's Guide**

	<u>Frequency</u>	<u>Percentage</u>
Read all of the booklet carefully	16	8.2
Read parts of the booklet carefully	13	6.7
Skimmed the booklet	29	14.9
<u>Didn't really look at the booklet</u>	22	11.3
No recall of receipt	114	58.8
Total	<u>194</u>	<u>100.0%</u>

Table 3 shows when the respondents recalling receipt of the Buyer's Guide said they received it and how the agent used the Guide in the sales presentation. With a substantial percentage of buyers report that the Buyer's Guide was received during the sales presentation, a large percentage of buyers report that the Guide was not presented until the policy had been processed.<sup>17</sup> Only a few consumers reported salesperson derision of the booklet; many recalled salesperson encouragement to read the Guide.

Unfortunately, the Buyer's Guide was not read, and therefore, was not utilized with any great frequency. Table 4 indicates the degree to which these respondents had looked at the Buyer's Guide.

Only 29.8 percent of the insurance buyers interviewed by this study looked at the Buyer's Guide at all. Further, only 14.9 percent of the respondents recalled reading either the booklet or some portions of it carefully. In other words, 70.1 percent of the insurance buyers sampled here never looked at the

<sup>17</sup>The NAIC Model provides for a "ten-day free look" under these circumstances. An examination into consumer awareness of this feature is included later in the paper.

Buyer's guide.<sup>18</sup> That a large proportion of life insurance consumers do not receive and/or read the Buyer's Guide is evidence that the Model Solicitation Bill will have difficulty in achieving its first goal of aiding consumers in their purchase of the appropriate life insurance policy for their needs.

#### *Goal Achievement: Policy Understanding*

The NAIC Regulation includes as the second objective, to "improve the buyer's ability to understand the features of the policy chosen." Again, the principal aspect of the legislation utilized to implement this result is the Buyer's Guide. Additionally, however, the buyer is provided with the Policy Summary Sheet, which summarizes the costs and benefits of the policy purchased.

The research design included a number of alternative ways to measure the impact of the NAIC system with respect to consumer policy understanding. Most directly, the consumers were given a quiz about some basic life insurance principles.

Furthermore, each respondent was asked in a step-by-step multiple choice fashion, to describe the life insurance policy that he or she had purchased. The extent to which policyholders could accurately describe the features of their own policy is a secondary measure of policy attribute understanding.

Finally, with respect to policy understanding the study monitored the extent to which respondents could recall the Policy Summary Sheet.

*Results:* Respondent recall of the Policy Summary Sheet was considerably better than recall of the Buyer's Guide. When asked if they remembered the Policy Summary Sheet by name only, 43.8 percent indicated that it had been received. Furthermore, when a copy of a "John Doe" Policy Summary Sheet was presented, an additional 29.0 percent recalled the information. Thus, 32.5 percent of the sample population did not recall the Policy Summary Sheet at all. This figure compares with 58.8 percent of the sample population who did not recall the Buyer's Guide.

Assuming the Buyer's Guide was actually received, this result can be interpreted as indicating that the buyers perceived the Policy Summary Sheet as more important or noteworthy than the Buyer's Guide. A possible explanation for this result may be that the Buyer's Guide is general, while the Policy Summary Sheet deals specifically with the buyer's policy. Further evidence of this observation is contained in the responses to questions regarding the current location of the Buyer's Guide and Policy Summary Sheet. Nearly 25 percent of the respondents recalling the Buyer's Guide reported that they did not know (20.5 percent) the current location of the Guide or had thrown it out (4.1 percent). The comparable figure for those recalling the Policy Summary Sheet was only about six percent. Furthermore, 87.5 percent of the respondents who recalled the Policy Summary Sheet reported that the item was filed

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<sup>18</sup> When asked, earlier in the interview, whether they had read *anything* to help with their life insurance purchase decision, 68.3 percent responded "No." Of those who said "Yes", 71.6 percent read essentially only life insurance industry (company) publications and less than three percent cited reading any insurance commissioner or other government publications.

with the policy, while this figure was 68.5 percent for those recalling the Buyer's Guide.

Of course, the timing of information delivery may be a significant factor. While thirty percent claimed receipt of the Buyer's Guide before the policy, only sixteen percent claimed pre-policy delivery for the Policy Summary Sheet.<sup>19</sup>

For a secondary measure of policy understanding the questionnaire included seven questions which, taken together, would describe the policy the respondents had purchased. The questions focused upon the following policy attributes: policy type (whole life, term, combination), length of premium payment duration, premium amount fluctuation (increase, level, decrease), face amount, face amount fluctuation, cash value, and dividends. In each case, an "I don't know" category was also provided.

The policy self-description data was checked by comparing the consumer's perceptions of the policy purchased with the actual policy data. Each interviewee was asked to authorize the author of this report to examine a copy of the policy summary sheet. The author then solicited policy summaries from the insurer involved. Of the 194 completed interviews, a total of 148 authorizations were analyzed.<sup>20</sup> Table 5 compares the consumer's perceptions with the facts.

Two striking observations emerge from these data. First, the percentages of consumers who did not know or recall their policy terms vary from item to item. The average difference is about ten percent of the sample population. Second, both insurers, Prudential and Metropolitan, pay dividends on all policies purchased.<sup>21</sup> Nevertheless, 21.6 percent stated explicitly that their insurer did not pay dividends; another 9.5 percent did not know whether their insurer paid dividends. This result may indicate a lack of understanding among policyholders about the difference between participating and non-participating policies.

Two further issues are involved in comparing consumer perception with actual data; (1) the extent of information and misinformation in the subsample population, and (2) whether those who received and read the Buyer's Guide understood their policies any better than those who did not remember or read the Buyer's Guide. With respect to the type of policy purchased, for example, 52 people actually bought whole life insurance policies.<sup>22</sup> In the interviewing process, 62 respondents from the group of persons for whom policy summaries were available, reported that they had purchased whole life insurance policies. However, case-by-case comparing reveals that only 25 of the 52 actual whole life buyers, or 48.1 percent, correctly reported this type of

<sup>19</sup>The administrative difficulty reported by the life insurance industry in providing Policy Summary Sheets prior to policy delivery may indicate that respondents are recalling the typical sales presentation ledger sheet as the NAIC Policy Summary.

<sup>20</sup>The difference is accounted for by (1) rejection by the respondent (26) and (2) difficulty on the part of the insurer in reproducing the sheet (20).

<sup>21</sup>At least for all of the policies included in this sample.

<sup>22</sup>From the policy summary sheets.

Table 5

Comparison of Policy Descriptions:  
Actual Versus Respondent Reported

	Actual		Reported	
	Number	Percent	Number	Percent
<b>1. Policy Type</b>				
a. Whole life	52	36.9	62	44.0
b. Term	69	48.9	40	28.4
c. Combination	20	14.2	24	17.0
d. Don't know			15	10.6
<b>2. Premium Fluctuations</b>				
a. Increase	18	12.4	23	15.9
b. Decrease	26	17.9	30	20.7
c. Level	101	69.7	84	57.9
d. Don't know			8	5.5
<b>3. Face Amount</b>				
a. Mean		\$28,642		\$35,973
b. Mode		20,000		10,000
<b>4. Face Amount Fluctuations</b>				
a. Increase	8	5.5	37	25.5
b. Decrease	65	44.8	30	20.7
c. Level	72	49.7	65	44.8
d. Don't know			13	9.0
<b>5. Cash Values</b>				
a. Yes	81	54.7	112	75.7
b. No	67	45.3	19	12.8
c. Don't know			17	11.5
<b>6. Dividends</b>				
a. Yes	148	100.0	102	68.9
b. No			32	21.6
c. Don't know			14	9.5

insurance purchase. Similarly, the percentage of term insurance buyers who identified their purchase correctly was only 42 percent and of combination policies only nine percent. In total then, of the 148 interviews for which case comparisons were possible, only 56 respondents, or 37.8 percent, correctly identified the type of policy purchased.

A similar type of analysis dealt with the accumulation of cash values. Although 112 respondents reported cash values in their policies, in fact only 81 had cash value policies. Of the 81 having contracts with non-forfeiture values, 67, or 82.7 percent correctly reported this feature. Among the 67 whose policies did not contain cash values, only 13, or 19.4 percent, realized that this was the case. Thus, those policyholders having cash value policies

generally were aware of their existence; but many policyholders apparently presumed the inclusion of cash values, even when they did not exist.

With respect to other policy features, the results are less definite because only aggregate data were examined. Some noticeable differences between actual and reported descriptions are:

1. Respondents perceived (or remembered) more variability in premium amounts than actually existed. Contracts with level premiums were observed 101 times, but only 84 respondents reported having level premiums.
2. Respondents slightly inflated the amount of insurance protection purchased.
3. Thirty-seven interviewees thought that the amount of insurance protection purchased would increase with time. In fact, only eight policies with that characteristic were present in this group of ninety policies. Similarly, 65 policies had decreasing insurance protection (in the face amount), but only 30 respondents reported decreasing death benefits over time.<sup>23</sup>

The picture is not improved when the sample is broken down between those having read the Buyer's Guide and those respondents who did not read or receive the Guide. For example, there were 30 respondents indicating that they had read all or part of the Buyer's Guide carefully. Of those 30 people, only 12, or 40 percent, correctly reported the type of policy chosen.

These findings indicate widespread misunderstanding or lack of knowledge concerning policy attributes and insurance policy operation over time. The life insurance buyers sampled were generally misinformed about their own policy and were unable to report accurately policy features. In order to measure fundamental knowledge and understanding of life insurance, each subject was also administered a quiz.

The quiz contained six questions reproduced below which were specifically geared to life insurance knowledge and understanding. The correct responses are underlined.

1. For a 35-year-old man, which policy will have a lower premium *at first*?
 

a. <u>\$25,00 renewable term policy</u>	39.4%
b. \$25,000 whole life policy	17.6%
c. don't know	43.0%
  
2. Which kind of policy pays your survivors a death benefit if you die with the policy in force?
 

a. Term	3.1%
b. Whole life	17.5%
c. <u>Both</u>	64.9%
d. Neither	0.0%
e. Don't Know	14.4%

<sup>23</sup>Of course, in each of these three results individual error has *not* been captured. For example, there actually were 72 policies with level amounts of insurance. Sixty-eight respondents reported a level amount of insurance. There may be a sizeable individual error in this comparison. For instance, those having increasing or decreasing amounts of insurance may have mistakenly reported a level amount.

3. John Jones bought a \$25,000 whole life insurance policy 10 years ago. He notices that the cash value now amounts to \$5,000. If John dies tomorrow, how much will his survivors receive?
- |                    |       |
|--------------------|-------|
| a. <u>\$25,000</u> | 63.0% |
| b. \$30,000        | 12.5% |
| c. \$20,000        | 5.2%  |
| d. Don't Know      | 19.3% |
4. Bob Smith bought a \$10,000 whole life policy 30 years ago. A month ago, when the policy's cash value amounted to \$5,000, Bob decided to take out a \$3,000 policy loan. If Bob dies tomorrow, how much will his survivors receive?
- |                  |       |
|------------------|-------|
| a. \$10,000      | 7.3%  |
| b. <u>17,000</u> | 52.6% |
| c. \$12,000      | 9.9%  |
| d. \$15,000      | 2.1%  |
| e. Don't Know    | 28.1% |
5. True or False: The dividends of a participating policy are usually guaranteed.
- |                 |       |
|-----------------|-------|
| a. True         | 46.1% |
| b. <u>False</u> | 22.3% |
| c. Don't Know   | 31.6% |
6. True or False: Life insurance is a good savings method to beat inflation.
- |                 |       |
|-----------------|-------|
| a. True         | 24.9% |
| b. <u>False</u> | 55.4% |
| c. Don't Know   | 19.7% |

At best these results indicate that the sampled insurance buying public had a rather poor working knowledge of life insurance contracts. This characterization is based upon the highest percentage correct score of 64.9 percent (question two). The percentage of correct responses to question one, dealing with relative premiums, and question five, on participating dividends, however, suggest an even poorer working knowledge.

Only 39.4 percent of these life insurance buyers knew of the lower term life insurance premium during the early years of the contract. Because only a small percentage of the sample claimed to have received and read the Buyer's Guide, this result is understandable. However, it highlights the need for the effective distribution and promotion of the consumer education material.

Only 22.3 percent of the sample population knew that dividends are not guaranteed even though (1) the NAIC Model Regulation specifically requires the non-guarantee caveat be posted wherever dividends are cited, and (2) all of these sample individuals purchased participating policies.

#### *Goal Achievement: Cost Comparison*

The third and final objective of the NAIC Model Solicitation Regulation is to improve the life insurance consumers' ability to evaluate the relative costs of similar plans of insurance. In order to accomplish this goal, the NAIC system mandates the disclosure of three cost indices, each for two points in the policy lifespan. The indices are the Surrender Cost Index, the Net Payment Cost Index, and the Equivalent Level Annual Dividend. Each cost index is

computed and disclosed in the Policy Summary Sheet for the tenth and twentieth policy years.

In a fashion similar to that used to evaluate the NAIC Model's impact for the first two objectives, success for the cost comparison objective is to be measured via consumer awareness, knowledge, understanding, and, to some extent, behavior. First, the respondents' perceptions of life insurance costs were measured. Second, each respondent was asked to indicate the amount of attention paid to each of sixteen aspects of the life insurance product/purchase environment, including a cost characteristic. Third, respondents were asked to judge the relative cost of their own policy and indicate their own level of inter and intra-insurer cost comparing. Finally, the quiz included a number of questions dealing with the cost disclosure aspects of the NAIC Model Regulation.

*Results:* In order to measure consumer perceptions of the dispersion of costs for the life insurance product, each respondent was asked to agree or disagree with two items presented below at the inception of the interview:

1. There is a good chance of being "ripped off" or "taken" when you purchase a life insurance policy.
2. There is a wide range of costs that one might pay for different life insurance policies that have essentially the same features and same reliability.

The first item is a measure of perceived *risk* in the purchase and the second item measures perceived *cost dispersion*. The same questions were asked relative to an automobile purchase and a dental check-up.

Table 6

Mean Responses of Consumer Perceptions of Relative Risk  
and Cost Dispersion

	<u>Risk*</u>	<u>Cost Dispersion**</u>
Car	5.686	5.722
Dental Check-up	4.474	5.541
Life Insurance	5.057	4.959

Table 6 presents the mean responses to these two Likert items. The scale used was a seven point scale of "strongly disagree" (1) to "strongly agree" (7). The mid-point (4) was labelled "neither agree nor disagree." Table 6 indicates that buyers generally perceived less risk of being "ripped off or taken" in life insurance than in an auto purchase, but more risk than in purchasing a dental check-up. However, answers to the second item indicate consumers were less aware of cost variation in life insurance markets than in either auto or dental purchases.<sup>24</sup>

<sup>24</sup>This result is consistent with other studies in which consumers were found to be unaware of cost variation in life insurance markets. See Footnote 3. The absolute and relative levels of these responses may be influenced by the fact that the respondents were aware that the focus of the interview was their life insurance purchase.



When asked to respond to the following true-false question,

Similar life insurance policies cost just about the same because each state's insurance commissioner sets the rates for all policies sold in his state.

22.7 percent of the sample answered "true." An additional 43.3 percent admitted they did not know the correct answer. Therefore, only 34.0 percent knew that either (1) similar life insurance policies do not cost just about the same, or (2) insurance commissioners do not set life insurance rates, or both. Given this widespread misconception or lack of knowledge concerning life insurance costs, it is not surprising that these consumers perceived less cost dispersion in life insurance than in automobiles or dental check-ups.

Having observed that the sampled consumers were relatively unaware of cost dispersion in life insurance products, the implication for behavior is straightforward. One would expect, given the above result, that these consumers would be only mildly interested in the relative costs of similar life insurance products. Each respondent was asked to indicate the amount of attention<sup>25</sup> paid to each of a list of product/purchase attributes in buying the life insurance policy being discussed.

Table 7

Mean Response and Rank of Amount of Attention  
Paid by Respondents to Each of Sixteen Product/  
Environment Attributes

<u>Life Insurance Attribute</u>	<u>Mean Response</u>	<u>Rank</u>
Amount of death benefit	3.71	1
Amount of annual premium	3.53	2
Reputation of insurer	3.44	3
Competence of salesperson	3.37	4
Personality of the salesperson	3.15	5
Availability of convenient payment plans	3.10	6
Ability to obtain more coverage at some future point	3.02	7
Whether insurer paid dividends to policyholders	2.91	8
Size of Insurer	2.90	9
Interest rate earned on savings portion of policy	2.82	10
Cash and loan values	2.80	11
Ability to convert the policy to a different type of policy	2.75	12
Readability of the policy	2.74	13
Variety of settlement options	2.69	14
Requirements of a medical exam	2.38	15
Total cost of policy compared with similar policies from other insurers	2.36	16

According to Table 7, consumers in the sample population, on average, devoted the least amount of attention to cost comparison issues when com-

<sup>25</sup> A four point scale of (1) no attention at all, (2) very little attention, (3) some attention, and (4) very much attention, was used.

pared with the other items on the list. Although consistent with the finding dealing with perceived cost dispersions, the degree of indifference to cost-based shopping is startling. For example, 36.6 percent of the sample indicated they paid "no attention" to cost comparison; while only 27.8 percent claimed "very much attention" was allotted to total cost issues. Further, consumers generally paid more attention to the total annual premium amount and the convenience of payment plans than to shopping for total cost among companies.

Similar questions were asked later in the interview, but focused upon the distinction between inter-insurer comparisons and intra-insurer cost examinations. Table 8 reveals that significantly more attention was devoted to comparing the cost of policies sold by one insurer than to comparing the cost of policies of different insurers, which is the objective of the NAIC Model. Even though the life insurance consumers sampled were confronted with the NAIC Solicitation Rule, they (1) were generally not aware of the cost differences that exist between insurers, (2) could not judge the benefits to be derived from cost shopping, and, therefore, (3) did not devote much attention to total cost comparisons between the life insurance policies of different insurers.

Table 8

Percentage Frequency of Consumer Behavior: Inter and Intra-Insurer Cost Comparing

	Cost Comparisons	
	<u>Inter-Insurer</u>	<u>Intra-Insurer</u>
No attention	38.7	22.7
Little attention	17.5	12.9
Some attention	22.2	30.9
Very much attention	21.6	33.5
	100.0%	100.0%

A number of questions included in the quiz section of the interview were intended to probe the respondent's basis for comparing cost. One important objective was to determine whether or to what extent life insurance consumers use premiums as the sole measure of cost. Two true-false questions were posed:

1. Policies with identical premiums usually provide identical amounts of benefits.  

<i>True</i>	9.3%	<i>False</i>	77.3%	<i>Don't Know</i>	13.4%
-------------	------	--------------	-------	-------------------	-------
2. The best way to judge the relative cost of two policies is to compare their premiums.  

<i>True</i>	21.6%	<i>False</i>	64.9%	<i>Don't Know</i>	13.4%
-------------	-------	--------------	-------	-------------------	-------

The response frequencies to the first question are encouraging. Consumers generally recognized that there is no necessary relationship between premiums and benefits across policies. However, in the second question the

percentage of knowledgeable consumers was smaller. Better than one-in-five of the respondents (21.6 percent) were satisfied that premium information was sufficient to judge the costs of different life insurance policies.

Since the NAIC disclosure system had been presented to these purchasers, three questions were asked to determine whether the respondents knew how to use this system.

1. True or false: The lower a policy's cost index, the better a buy it is.  
*True* 7.2%    *False* 39.7%    *Don't Know* 53.1%
2. The Net Payment Cost Index helps you compare the cost of similar policies if at some future point in time you were to surrender each policy and take its case value.  
*True* 31.1%    *False* 4.7%    *Don't Know* 64.2%
3. The best way to choose between a term policy and a whole life policy is to compare each policy's Surrender Cost Index and Net Payment Cost Index.  
*True* 27.8%    *False* 11.3%    *Don't Know* 60.8%

These results indicate that the cost index disclosure was not-at-all currently understood or usable by this sample of life insurance buyers.

*Goal Implementation: The Free Look*

The NAIC Model operates on a post-purchase basis. If for any reason a buyer believes, subsequent to the distribution of the Buyer's Guide and Policy Summary, that the (1) purchase was inappropriate, (2) the features of the policy were misunderstood, or (3) the policy was relatively too expensive, the consumer has ten days after delivery of the disclosure information to return the policy without charge. This ten-day free look aspect of the disclosure system is the vehicle that permits the post-purchase operation of the Regulation.

The interview included the following quiz question to determine whether the purchasers were aware of the ten-day free look:

Today Janet Small bought a life insurance policy in New Jersey. If Janet decided she made a mistake and wanted to cancel the policy, how long does Janet have to notify the company so that she could get *all* of her money back?

The responses are as follows:

- |               |       |
|---------------|-------|
| a. 5 days     | 10.3% |
| b. 10 days    | 9.8%  |
| c. 30 days    | 22.2% |
| d. 60 days    | 4.1%  |
| e. Don't know | 53.6% |

A majority of the respondents did not know the length of the free-look period. Even more discouraging, however, is that 26.3 percent of the consumers believed that the free-look period was significantly longer than the actual ten-day term.

*Buyer's Guide Effectiveness*

To analyze the effectiveness of the Buyer's Guide, the knowledge scores of those respondents who reported reading the Buyer's Guide entirely or in part were compared to the scores of those respondents not recalling receipt of the Buyer's Guide. One would expect that utilization of the Buyer's Guide by life insurance purchasers would lead to better scores on the fifteen elements quiz, especially since many quiz items come directly from the Buyer's Guide material. In fact, the mean quiz score for those reading the pamphlet was 6.38 ( $n = 29$ ) and for those not recalling receipt of the Guide 6.10 ( $n = 114$ ). However, a t-test of the means found no significant difference between two values ( $p = .4$ ).<sup>26</sup> Furthermore, the average number of incorrect, as opposed to "I don't know," responses was 4.31 for those reading the Guide and 3.47 for the 'control group' ( $p = .10$ ). In either case, the level of life insurance knowledge was rather low.<sup>27</sup>

**Summary and Conclusions**

This research has attempted to evaluate the impact of the NAIC Model Life Insurance Solicitation Regulation in New Jersey. The effort has been directed at ordinary life insurance purchasers who had bought a life insurance policy subject to the provisions of that legislation. The research plan utilized was to evaluate the disclosure and education system relative to the prescribed objectives of the Regulation.

The first observation is that the typical buyer of the sampled 194 consumers was uninformed concerning the nature of life insurance, the operation of life insurance policies, and the cost of different life insurance policies. The NAIC Buyer's Guide as a vehicle to combat this misinformation and ignorance is not making a strong impression on consumers. Nearly sixty percent of the buyers interviewed did not recall the Buyer's Guide, even when presented with a copy. Furthermore, 63.7 percent of those recalling that they had received the Guide, only gave the pamphlet a cursory investigation. These consumers were apparently not aware of the importance and benefits to be derived from being informed buyers. If the intent of the NAIC Regulation is to pique consumer interest in learning about life insurance and its uses, the distribution system and the material must do a better job of getting the buyer's attention.

Even for those respondents who had read parts of or the entire booklet carefully, little, if any, improvement in life insurance knowledge was found. In fact, the overall difference between groups having read the booklet and those who had not was a decrease in the percentage of "don't know" responses, with no corresponding increase in correct response.

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<sup>26</sup> The p-value indicates the smallest significance level for which the hypothesis would be rejected.

<sup>27</sup> These quiz findings could be a result of educational differences of the groups, however, a check of the educational level of the two groups reveals no difference ( $p = .3$ ) in the average educational attainment.

The research found widespread misreporting of policy information. Only 38 percent of the respondents could correctly report their policy type. Many had misperceptions regarding their cash values and dividends.

With respect to cost disclosure, respondents in the sample devoted the least amount of attention to inter-insurer cost comparisons, when compared to fifteen other life insurance attributes. As a result, very little cost based shopping behavior was observed. Generally, the subjects of this study were not able to use, or did not know about, the cost disclosure information generated by the NAIC Regulation.

Finally, a substantial percentage (53.6 percent) of the respondents were not aware of the "ten-day free look." An additional significant proportion of the buyers (36.6 percent) did not know the proper length of the free look period. It is the "free look" nature of the disclosure system that permits the Regulation to operate on a post-purchase basis. In order to have an opportunity to work effectively, a higher percentage of consumers than one found in this survey (9.8 percent) should be cognizant and knowledgeable concerning the "ten-day free look."

In sum, this research indicates that generally life insurance consumers are unaware of elements relevant to the purchase of life insurance, a condition that the Model Regulation attempted to correct. Even with the NAIC Model Regulation, buyers are unaware of the Buyer's Guide, cost differences both between policy types and companies, the "free look," and the substantial benefits accruing to the informed consumer. This condition prohibits disclosure information from being truly effective unless the potential user can be convinced that the benefits of the program are more valuable than the costs of investing the time and effort required in its use.

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