Nebraska Law Review

Volume 48 | Issue 4 Article 4

1969

Abuses in the Replacement of Life Insurance

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ABUSES IN THE REPLACEMENT OF LIFE INSURANCE

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I. INTRODUCTION

With the trend in American merchandising toward "trade in the old when you buy the new" and "if it's newer it must be better, so scrap the old," the question might be asked as to why a policyowner should not surrender his old insurance when he buys new.

Some individuals have reacted indignantly to full disclosure regulations adopted by life insurance regulatory authorities for the protection of the public. "Don't try to tell me I can't cash in my policy," they have said, "If I want to surrender my old insurance, no one can stop me."

It is often difficult to prevent people who are determined to take foolish actions from doing so, but the answer to "Why not trade in the old?" is quite simple. With life insurance we are not dealing with an automobile or a TV set or a washing machine. We are dealing with a contract for the future delivery of dollars, and once having such a contract and having paid the bulk of its acquisition costs, it is usually *not* to the advantage of the owner to "scrap it and start over." If more dollars are needed for future delivery, by all means contract for them on the most favorable basis possible, but beware of any salesman who urges a "scuttling action," especially one who would seek to cut you off from receiving "the other side of the story" from the agent or company with which you already own life insurance.

The abuses in this area are so prevalent that the insurance departments of a number of states, Nebraska among them,[1] have recently instituted new regulations designed to furnish greater protection for the public by assuring adequate disclosure of material facts in any replacement recommendation or suggestion.

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1 Nebraska Department of Insurance, Department Rule No. 32, effective March 1, 1969.

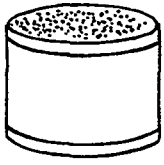
If replacement is effected by means of incomplete or inaccurate or misleading information, the act is termed "twisting," and is illegal. Although victims of "twisting" are entitled to recovery, most people are reluctant to admit that they have been duped. So caution, in advance, is better than trying to "unwind a twist" after it has occurred.

Abuses in inducing the unwarranted and unwise replacement of life insurance are not new. They have been going on in the United States for about a hundred years. During all this time the techniques of the replacers have followed much the same pattern, namely, to infer that the owner of life insurance is being overcharged, and to offer a cheap substitute, usually some form of term insurance.

In the 1870's the controversy was between agents of the legal reserve life insurance companies, which offered guaranteed whole life coverage at a level premium, and the assessment societies or "cooperatives" as they were then called, who sold term insurance on the "buy now, pay later" plan—with the "later" costs rising to prohibitive heights at the time in life when people were least able to afford them.

This is the way one newspaper in 1874 exposed the fallacy:

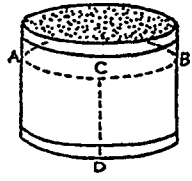
If a farmer sells one bushel of wheat for one dollar, he is expected to give full measure, and the purchaser receives the worth of his money. This truism applies to genuine life insurance.



Genuine Life Insurance

But suppose people didn't know how much wheat it took to make a bushel, and that some fellow was scamp enough to advertise that he could sell one bushel of wheat for, say fifty cents, and that he should prepare a measure with a false bottom, like that shown below; the analogy between that fellow and the cooperatives (assessment insurance organizations) would be complete.

Cooperative (Assessment) Life Insurance
A—B False Bottom C—D Extent of Fraud



The cooperative companies pretend to give the same protection as the genuine life insurance companies for one-half the price, when in fact the real protection furnished by them is not one-fourth of that furnished by any of the regular life companies.

> Whenever any standard article is offered to the public at remarkably cheap rates, it is a good idea to stop and inquire if it is not 'too cheap to be good' and probably examination will reveal that there is a false bottom somewhere.[2]

It is a bit ironic that some 95 years later, in spite of readily acquired knowledge of atomic energy and transplants of human organs, many educated and otherwise intelligent people have not learned to detect the "false bottom" in the sales pitches of destroyers of sound estate plans.

There are two types of salesmen—creative and destructive. In the financial field, the creative salesman, whether in life insurance, banking, securities, real estate, or any other, assists the client in building an estate through some form of saving or investing. This requires that the individual refrain from spending all that he earns, so that an estate will be created for the future.

The destructive salesman, unable to perform this constructive function, attempts to destroy what has been created through the efforts of others, so that he may feed, via commissions on his sales, on the transfer of funds from some other form of property which actually may better serve the individual's needs than that which he is selling.

In order for a salesman to receive a commission he must receive money for whatever he is selling. Salesmen of real estate, automobiles, television sets, and other tangibles or consumer goods frequently rely on credit, so that the salesman receives his commission immediately, whereas the buyer pledges a portion of his future income.

Salesmen of thrift plans, investments, or speculations have a somewhat different problem. To invest there must be cash to invest, and there are currently rules against speculation on credit, based on the valuable lessons of past experience.

The principal "replacers" today are some mutual funds salesmen, frequently posing as "financial planners," "financial advisors," or "financial analysts." To find the money on which to receive commissions for what they are selling they seek: (a) bank accounts, (b) real estate, or (c) life insurance.

Inasmuch as bank accounts are generally guaranteed, and as mutual funds contain no guarantees as to either principal or interest, the contrast here is too great and few people are inclined to sacrifice their savings. Therefore bank accounts are a relatively unproductive source of funds.

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[2] Milwaukee Sentinel, April 26, 1874.

Similarly, although many people own real estate, usually their homes, few indeed are inclined to mortgage or sell such property to provide funds for securities over which they have little or no control.

And so the attack of some mutual funds salesmen is directed against life insurance, and for several reasons. First, many people are not as well informed as they should be about their life insurance. They do not know how a "life" policy differs from a "term" policy, and how the reserves in their policies are necessary to maintain lifetime protection at a premium guaranteed not to increase.

Second, the mutual funds salesmen have dusted off the threadbare "buy term and invest the difference" argument, referred to earlier in the "false bottom" analogy. With seemingly low rate (but in the long run high cost) policies, often issued by "captive" companies unable to compete effectively in underwriting insurance providing coverage for the whole of life, they proceed on a campaign of destruction.

They are frequently aided and abetted in this by propaganda books or articles written by other mutual funds salesmen, posing as "financial planners," or even presuming to advise on how to avoid the legal procedures of probate by adopting boilerplate trust instruments which divert estate monies into mutual funds.

The purpose of the balance of this article is to analyze and expose the errors, misrepresentations, and derogations employed by salesmen who use these destructive tactics. In the process, if the fundamentals of legal reserve life insurance are not already fully understood—and we cannot assume that they are, or many of the tragic errors we have seen would not have been committed—then it will be necessary to learn them.

II. REPLACEMENT

Is Term Insurance Cheaper?

The first step in the replacement process is the contention that the owner of whole life insurance is being overcharged. Usually this is combined with an attempt to derogate the life underwriter, so that he will be shunned as a source of information.[3] The contention is made that term insurance is cheaper.

[3] Examples of Current Attacks on the Life Insurance Agent—And the Fallacies inherent in them: *Consumers Reports*, January 1967: "[M]ost families are under insured. They need not be.... They are talked into buying a combination of life insurance plus savings account.

As with many falsehoods, there is an element of truth in this one. It can scarcely be called a "half-truth," for the possibility of its being truthful is considerably less than 50 percent, but it must be conceded that for the person who dies in the very early years term insurance is, or in these instances has been, cheaper.

The most widely sold policy, ordinary or straight life, is just such a combination. In one well-known company's rate list, a $10,000 ordinary life policy calls for $135 a year in premiums for a man who takes it out at age 25. For the same price and from the same company he could buy as much as $36,000 of pure insurance on a five-year renewable term policy."

Then, in the February issue, *Consumers Reports* published their proposed solutions, "lower-premium 5-year renewable term insurance and a separate savings or investment program" involving the identical outlay as the whole life policy.

Apparently, when in their January issue *Consumers Reports* blamed the agent for talking the customer into whole life insurance, instead of the $36,000 of term insurance, they did not know they were going to contradict themselves in their February issue! For if the customer uses all of the $135.00 for term insurance, where is he going to get "the difference" to invest, per their February recommendation? And if he does follow their February recommendation, then he does not have any more insurance than he had under the recommendation of the agent, whom they criticized! They obviously feel that their readers have short memories.

A recent book THE MORTALITY MERCHANTS, by a mutual funds salesman, has in the introduction the sad story—real or hypothetical—of two young men, each age 25 when he had bought insurance. The first young man paid $363.80 a year and had $20,000 of insurance; the second paid $362.44 and had reducing term insurance. Both young men, by coincidence, had the misfortune to die at age 27, the second "the victim of a highway crash" according to the author. The agent of the first man was severely criticized for having sold "the policy that was best for the agent and the insurance company." The second man had, according to the author, the "rare good fortune of finding the right agent, [and] had bought a contract that gave the agent and company a fair profit..." and yet resulted in a claim for $105,000. Just where the "profit" arose, in either of these transactions, for total premiums of some $725.00, is a bit obscure. As any thinking person knows, *no* insurance transaction can be judged by the extremely long shot possibilities outlined here. The first man had *life* insurance which would provide long range coverage; the second had decreasing term which would be guaranteed to expire completely, and without value, long before his normal expectancy. However, if we are to judge results by hindsight, the second agent was not the "hero" pictured by the author. In the light of what happened, he should not have sold term insurance; he really should have sold only accidental death insurance, the cost of which should be no more than $1.00 per thousand at age 25. On the author's basis of hindsight, widow No. 2 could have had approximately $362,000 of death benefits instead of the $105,000 of term insurance, so by the author's logic this agent deprived the widow of over $250,000!

If our foresight could only equal our hindsight, particularly in hypothetical illustrations!

So, as far as practical advice is concerned, if the buyer is "certain"—or even has a "strong premonition"—that his death is imminent, then it would be logical to urge his purchase of term insurance, and at as low a rate as possible.

As a matter of actual fact, there is a strong element of what is called "adverse selection" employed by the purchasers of insurance and annuities. Those who think they are going to die soon try to buy the cheap term plans. Thus all companies experience less favorable mortality under term insurance than under permanent insurance plans. Therefore, they must charge more.

Even with paying the higher mortality costs necessarily built into term insurance plans, the buyer will be better off with them *if he can be certain* that he will be among those fortunate enough to die, and thus have his claim paid, within the limited period for which term insurance is effective.

For those tempted to rely on term insurance—but not being among those certain of early death—it might be of interest to have at least a basic acquaintance with the probabilities of death within a specified period.

The mortality table,[4] on which the "non-forfeiture values" of most modern life insurance is based, indicates the following as the percent of those living at any age that die within a given period:

Age	*5 Years*	*10 Years*	*20 Years*	*30 Years*	*40 Years*
25	1.00%	2.11%	5.50%	12.99%	28.98%
35	1.41%	3.47%	11.12%	27.45%	
45	3.17%	7.93%	24.85%		
55	7.59%	18.37%			
60	11.67%				

Most term insurance expires at or before age 65. If it is decreasing term insurance there is little if any protection left at age 65. Even if the actual deaths among insureds in a given company followed the mortality table, it will be seen that the chance of death before age 65 is only about one in four. Stated differently, the probability of survival beyond age 65—or beyond the time when term insurance is likely to furnish any appreciable measure of protection—is thus about three out of four.

It is important to note again that the mortality table used by any company for computations of policy non-forfeiture values does not necessarily bear any close relationship to the *actual* incidence of deaths within that company. A company which is "selective" in

[4] 1958 C.S.O. (Commissioners Standard Ordinary) Mortality Table (National Assoc. of Insurance Commissioners 1958).

its acceptance of risks can usually achieve an actual mortality experience much more favorable than indicated by the table. In a mutual company these "mortality savings" are returned to policyowners in the form of dividends which thus reduce their insurance costs. In the company with which I am associated, to be specific, mortality savings represent $68 million, or 40 percent of the $169 million in dividends to be returned in 1969.[5] Thus an insured individual, who has been accepted by a selective company, although not able to predict his own individual date of death, at least has the satisfaction of knowing that he is a member of a group which has considerably less chance of dying within the periods indicated above than is shown by the mortality table figures.

Consequently, we shall consider primarily the interests of those who are not certain that they will die within the early years, but who are interested in life insurance which will provide: (1) adequate protection if they should be among those who die prematurely, and (2) reasonable cost if they should survive to "normal" expectancy.

What are the specific devices used by the replacers, and which constitute misrepresentations? At least four are combined in one proposal currently being used in a number of states by mutual funds salesmen who are also licensed by one or more companies which specialize in the sale of decreasing term insurance in conjunction with mutual funds. These, which we will discuss separately, are:

1. The "Three Mortality Tables"
2. The failure to take dividends into consideration
3. The failure to take cash value increases into consideration
4. The use of a fallacious and misleading "cost" formula

Specific Devices used in replacement[6]

The Three Mortality Tables

The first page of one of these proposals consists of three mortality tables.[7] Although a mortality table is a record of the number

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[5] The Northwestern Mutual Life Insurance Company, *Annual Report*, 1968.

[6] In the accompanying exhibits the author is interested in providing the authenticity of actual documents, submitted in specific replacement proposals, but not necessarily identifying the individual agents or distributors who are merely symptomatic of a current trend. For this reason, Exhibits A through D are reproductions of actual documents. Only the individual identification of agents and companies using this material has been deleted. The additional markings and writing on the documents are those of the agent using the material.

[7] *See* Exhibit A *infra* at 937.

of deaths, per thousand of insured individuals, which may be anticipated at the various ages, one of these tables is headed by a dollar sign, with the figures at age 35 marked: $8.95 under the first table (American Experience Table), $4.59 under the second (1941 Commissioners Standard Ordinary Table) and $2.51 under the third (1958 Commissioners Standard Ordinary Table).

There is no printed comment explaining the significance of the three tables or the reason for including them in the proposal.

Now, there is not anything necessarily illegal or unethical about publishing mortality tables; they are in the public domain. If, however, they are accompanied by any verbal sales talk to the effect that the owner of insurance, especially in a mutual life insurance company, is being overcharged by reason of the mortality table indicated in the reserve basis section of his existing insurance, then this *is* a misrepresentation.

Each company, stock or mutual, uses its *own* mortality assumptions for the computation of its premium rates. The *sole* purpose of the standard mortality tables of which those in Exhibit A are examples, specified from time to time by the state insurance regulatory authorities, is for the calculation of non-forfeiture values. These are the guaranteed cash, extended insurance, and paid-up insurance values that are available to every owner of whole life or endowment insurance (as distinguished from term insurance), in event it should be either necessary or desirable to discontinue premiums.

In a mutual life insurance company, its actual mortality experience is compared annually with the assumptions applying to each group of policies at each age at issue. To the extent that its actual mortality is more favorable—as is almost always the case in a well managed company employing sound underwriting practices—the mortality gains become an important source of dividends to policyowners.

Thus the assumed mortality is immaterial. If a mutual company experienced an actual mortality charge of $2.00 per thousand, at age 35, for example, and if it had assumed the figures indicated in the tables printed, its mortality gains for that year available for dividends to policyowners age 35 would thus be $6.95, $2.59 and $.51, respectively, depending on the table in their respective policies.

The use of these three tables in a proposal raises a strong inference that they are intended to disparage policies which have been in force for a number of years, when the more conservative mortality tables were in use. As we have seen, in a mutual life insurance company the owner's actual mortality costs are adjusted, through

dividends, to the actual experience of the company, so the specific mortality table used for computation of the non-forfeiture values is *immaterial.* Consequently, the use of the three mortality tables in a replacement sales talk in an attempt to disparage a policy in a mutual company would constitute a misrepresentation.

Failure to Take Dividends into Consideration

There are two general types of life insurance companies operating side by side in the United States and Canada: stock and mutual. Both deal in long range contracts, which may provide benefits for well *over* a hundred years. For example, an individual might purchase insurance in his youth, die in old age, and have benefits paid in the form of a life income to grandchildren. Both types of companies thus provide *unconditional guarantees* which are not available from any other type of financial institution. Specifically, although it may be possible elsewhere to get guarantees (not, however, involving life contingencies) based on money invested currently, a life insurance company provides guarantees both as to principal and interest based on money to be paid to it many years into the future, and income payments beyond.

Certainly no living individual, including life insurance company top management, is able to forecast precisely the conditions of mortality, interest, and expense which will apply many years into the future. Best judgment by actuaries is used, and a safety margin is included for the protection of the company, which is highly desirable for both the insureds and the owners. This leads us to the essential difference between stock and mutual companies.

In the former, which are corporations organized for the profit of their owners, the insureds and the stockholders are separate individuals. To the extent that a company is able to furnish the benefits stipulated in its policies at less cost than provided by the premiums, the profits belong, and quite properly so, to the stockholders who have supplied the venture capital.

In the latter, there are no stockholders, and each policyowner owning participating insurance is a part owner of the company, in the relationship which his insurance bears to the whole. Because of the annual adjustment of costs, by way of dividends, the initial premiums charged by mutual companies are of relatively little significance. They tend to be a bit higher than those for non-participating policies (policies which by definition do not participate in the divisible surplus of the company) issued by the stock companies, and which cannot be raised or lowered. This slightly higher premium provides the margin for safety in the mutual companies which the stockholders' capital investment provides in the stock companies.

Although the dividends of mutual companies obviously cannot be guaranteed, for by definition they adjust actual costs to future conditions, they can be illustrated quite accurately based on assumptions of a continuation of interest, mortality, and expense factors existing as of the date of purchase. Furthermore, the records of actual dividend performance are readily available in several standard reference manuals,[8] so that the prospective buyer is able to appraise the relative performance of the various companies.

For all of these reasons, the insurance laws or regulations of many states[9] require that in any comparison involving participating life insurance, dividends *must* be taken into consideration.

The so-called analysis form used by agents of some companies that specialize in decreasing term insurance used with mutual funds originally had no space even to record dividends (Exhibit B).[10] A later version has the space but, as will be noted (Exhibit C),[11] the agent usually fills in the space with the word "unavailable." As a matter of fact, dividend information *is* available, either from the policyowner as to the current dividend, or from the issuing company as to the current scale of dividends. The misleading effect of the failure to take dividends into consideration will be shown later, as applied to specific cases.[12]

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8 FLITCRAFT COMPEND. (A.M. Best Co.); LITTLE GEM MANUAL (The National Underwriter Co.); UNIQUE MANUAL DIGEST (The National Underwriter Co.).

9 Representative of these laws or regulation: N.Y. INS. LAW § 127(2) (McKinney 1966); Nebraska Department of Insurance, Department Rule No. 32, effective March 1, 1969.

In California under a pronouncement issued in 1961 in a monthly report to the Governor, the Insurance Commissioner stated: "[A] member of the public is entitled to a fair, complete and impartial comparison of all factors that would be pertinent to his decision. When participating insurance is to be compared, a full presentation of the anticipated dividends on both the new insurance and the existing insurance is essential to a fair comparison. The failure, or lack of ability, by the agent to furnish figures essential to a fair comparison may not be excused by an oral disclaimer to the prospect that pertinent facts or figures are not provided.... If the agent is unable to make a full disclosure and a fair comparison of all pertinent facts and figures he should refrain from soliciting the prospect to change insurance." This position was reconfirmed by the California Insurance Department in a letter to the author on June 28, 1968.

10 *See* Exhibit B *infra* at 938.

11 *See* Exhibit C *infra* at 939.

12 The magnitude of the misrepresentations in ignoring dividends can be quickly appreciated—if the reader will pardon a personal reference—by reference to just a few of the author's own policies: Premium $200.20; Dividend $110.81. Premium $418.50; Dividend $203.20. Premium $510.30; Dividend $203.30, etc. Incidentally, the increase in

The Failure to Take Cash Value Increases Into Consideration

The company issuing term insurance is concerned only with early deaths. If the insured survives the term period, as most do, the company's only outgo is for its expenses. In contrast, the company issuing whole life insurance, which is a unilateral contract cancellable by the insured but *not* by the company, knows that if the insured elects to continue the contract the company must pay the claim eventually. The only question is when. The company creates an increasing reserve against this day of ultimate payment. What is important to understand, however, is that this reserve is the property of the company and that the insurance is the full face amount of the policy and *not* the face amount minus the reserve as is sometimes erroneously contended.

In the early days of life insurance, both in England and the United States, there were no cash values even in whole life policies. The companies had to create the reserves against the day of ultimate payment of the claim, but in event of termination of premiums prior to death the result was the complete forfeiture by the insured of any internal values created.

This led to some unfortunate situations. As individuals became old or disabled, many were unable to continue paying premiums, with the result that they risked losing their insurance when they needed it most. In England, auction sales took place where the life insurance policies of unfortunate individuals, possibly near death, were sold to the highest bidder. Thus the person, possibly desperately ill, could at least recover something even though the professional speculator reaped the gain at the insured's death.

As a result of this rather gruesome situation Elizur Wright, who was to become the first Insurance Commissioner of the Commonwealth of Massachusetts, pioneered in requiring that all life (as distinguished from term) insurance policies contain a table of guaranteed non-forfeiture values.[13] Thus the insured would not be deprived of insurance protection in time of emergency, or if he wished to terminate the insurance he would be able to recover a reasonable portion of the insurance company's reserve, no longer needed because of the termination.

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cash value of this latter policy was $650.40 this past year—so the omission of either the dividend or the cash value increase would quite obviously constitute "a material misrepresentation."

[13] For an excellent treatment of Elizur Wright's *Studies & Reports* see THE BIBLE OF LIFE INSURANCE (The American Conservation Company, Chicago, Ill. 1932).

This was the origin of cash and loan values in whole life policies. Such values were an outgrowth and by-product of the legal reserve required to maintain the integrity of the contract, and they do not in any way add to the cost of the life insurance coverage. However, inasmuch as they represent property values, available to the insured either as collateral, or as cash in event of termination, they *must* be taken into consideration in any objective analysis, for determining insurance costs.

Specific Misrepresentations as to Cost of Insurance

Two samples illustrate the type of misrepresentations currently extant. The first (Exhibit B)[14] purports to be an analysis of a retirement income policy issued by the Provident Mutual Life Insurance Company. The second (Exhibit C)[15] purports to be a policy analysis of a graduated premium life policy issued by the Northwestern Mutual Life Insurance Company.

Observe that there is nó space to record the essential dividend or cash value information on the Provident Mutual policy. Note the technique used and the ridiculous costs developed. At age 57, for example, the premium is shown as $2,381.76. Interest at 5% on the then cash value, amounts to $1,366.20. "Total Cost" is thus $3,747.96. *No* deduction is made for the dividend, which would be substantial. Nor is any deduction made for the increase in cash value for that policy year, which almost undoubtedly exceeds the amount of the premium paid. As a result the ridiculous figure of $3,747.96 is produced as a "Total Cost."

Then the distortion is compounded. Although $33,260 is stated as the face amount and would be paid at death, the exaggerated cost is divided by the face amount minus the reserve on the fallacious assumption that the "insurance" is only this amount. The result is the completely ridiculous and distorted figure of $631.40 per thousand!

The cash value at age 65 is shown as $53,482.08. No mention is made of the fact that since this is a retirement income policy this would also be the death benefit at age 65. Had the "protection" been $1,000.00 at age 65, instead of zero, it would have been of interest to see the salesman attempt to convince the client that he was really paying $5,055.86 *per thousand* for his insurance protection!

This is an extreme but actual example of the heights of incredulity to which this fallacious formula can lead the ignorant or unscrupulous salesman.

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[14] *See* Exhibit B infra at 938.
[15] *See* Exhibit C *infra* at 939.

In Exhibit C, accurate dividend and cash value information will be supplied which will considerably change the eight year "Cost per Thousand."

The analysis states that the eight year cost is $27.50 per thousand. This is developed by taking the "basic premium" of $513.00, ignoring the dividend as "Unavailable," adding a so-called "interest factor" of 5% on the April 6, 1968, cash value, this being $112.61 bringing the total cost (not shown as such in the illustration) to $625.61. Dividing $625.61 by the "protection" of $22,747.75, produces the figure of $27.50 "per thousand" as the eighth year cost.

Now to correct the errors and misrepresentations. First, the dividend of $141.00 is available, and was in fact used to reduce the 1968 premium. Therefore, the net outlay for the life insurance for the current policy year was $372.00 (not $513.00).

The cash value as of April 6, 1968, was $2,252.25. The guaranteed cash value as shown in the policy will be $2,701.75 on April 6, 1969. Thus the guaranteed increase in cash value, for the year, is $449.50 ($2,701.75—$2,252.25).

If the insured had the cash value of $2,701.75 invested at 5% net after taxes, the hypothetical "interest factor" would be $135.09.

The net premium payment of $372.00 plus the interest factor of $135.09 totals $507.09. The guaranteed cash value increase of $449.50 must be subtracted, leaving the total eighth year cost as $57.59. Dividing $57.59 by $25,000, the face value of the insurance, gives a cost per thousand of $2.30, *not* $27.50.

The distortion and misrepresentation is obvious.

The Fallacies in the State of Washington Replacement Formula.

In 1968 the State of Washington adopted a replacement regulation[16] requiring the completion of a comparison of costs for the first, fifth and tenth years. The comparison must follow the format stated in the regulation, and *does* take dividends and cash value increases into consideration. As a tool to prevent misrepresentations of the type discussed earlier, it has merit. However, the formula as adopted contains certain inconsistencies and does not accomplish one of its stated objectives of providing a more meaningful basis for comparison of relative company costs.

[16] Washington State Administrative Regulation, WAC 284-30-010 (Insurance Commissioner's Administrative Order R-68-1).

Possibly the best way to illustrate this is by an actual example, using three stock companies which issued $10,000 non-participating Ordinary Life policies in 1949.[17] Data is from the *1949 Flitcraft Compend*,[18] a recognized industry compendium.

	Company A	*Company B*	*Company C*
Annual Premium	$222.40	$220.50	$223.00

Assuming the insured were interested only in *death* benefits, which company is providing the "lowest cost" insurance? Obviously, Company B is.

But suppose the insured were also interested in cash values in the event of surrender, and a retrospective look at comparative life insurance costs. Viewed in 1968, comparative costs would be:

	Company A	*Company B*	*Company C*
Premiums Paid, 1949–1968	$4448	$4410	$4460
Cash Value, 1968	3460	3320	3410
Net cost (without allowance for interest)	$ 988	$1090	$1050

In retrospect, the coverage in Company A shows the lowest "surrender cost."

However, what conclusions would be reached under the Washington formula? The following shows the steps set forth in the "Program Analysis Method" of that State:[19]

	Company A	Company B	Company C
1. Face Amount	$10,000.00	$10,000.00	$10,000.00
2. Cash Value, end of policy year	3,460.00	3,320.00	3,410.00
3. Amount at risk	6,540.00	6,680.00	6,590.00
4. Annual Premium	222.40	220.50	223.00
5. Annual Dividend	none	none	none
6. Increase in Cash Value for Pol. Yr.	194.00	194.00	198.00
7. Interest on Cash Value—Percent (in policy)	2½%	2¾%	2½%
Amount (of interest)	86.50	91.30	85.25
8. Annual Cost of Risk (4)-(5)-(6) + (7)	114.90	117.80	110.25
9. Cost per $1,000 of Risk (8) ÷ (3)	17.57	17.64	16.73

Thus we see that, in this instance, Company C, which has the *highest* premium, is portrayed by the Washington formula as fur-

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[17] The identities of these companies are not important, but are available on request from the author.

[18] FLITCRAFT COMPEND. (Flitcraft, Inc. 1949).

[19] Program Analysis Method, Attachment A-2, Washington State Administrative Regulation, WAC 284-30-010 (Insurance Commissioner's Administrative Order R-68-1).

nishing the *lowest* cost life insurance! Moreover, Company B which has the *lowest* premium of the three is pictured as furnishing the highest cost life insurance!

As will be noted by comparing the interest charged against Companies A and C above (which have the identical 2½% rate of interest assumed in their reserve basis), the Company (C) with the lower cash value receives the benefit of the lower interest charge. Even though its premium may be higher, as it is in this instance, it may be portrayed as furnishing lower cost insurance.

Under this approach, if the management of a company holds back more of the reserve, rather than paying it in surrender values to the policyholders who terminate, the cost of the insurance to the policyowner is portrayed as being reduced. In a world "where ignorance is bliss, 'tis folly to be wise!' " Similarly when providing low nonforfeiture values in a policy is pictured as a virtue, by reason of a discriminatory formula, it is indeed folly to offer to the buyer a policy contract with high cash values!

It will be seen, however, that even more important than the cash values as an influence on "annual cost," under the Washington formula, is the rate of interest applied against the cash value. The rules say that, for non-participating policies, the rate in the reserve basis section of the policy will be used. In the Company A-B-C comparison above, it will be seen that Company B assumes a 2¾ percent rate. Although it has a lower cash value, the application of the higher interest rate boosts its interest charge to $91.30 and results in its being shown as the "highest cost" of these three companies, when actually it has the lowest premium!

The discrimination is even more apparent when a participating policy is involved because the Washington regulation requires that for all participating insurance—unlike non-par, where the policy rate applies—a 4% rate will be used. Generally a participating policy will have much lower net premiums after a period of years, and will show up well under the Washington formula in spite of the higher charges arbitrarily assessed. However, to illustrate the discriminatory effect of the different rate of interest applying to "nonparticipating" vs. "participating" assume that the policy in Company C, above (portrayed under the formula as the lowest cost company of the three) was a participating policy and that all other factors were the same, except that 4% interest applied, as it must for *all* participating policies under the Washington regulation.

	Col. 1 Company C As it is, 2½% Non-Par	Col. 2 Company C If it Assumed 4% Non-Par	Col. 3 Company C If it Were Participating
1. Face Amount	$10,000.00	$10,000.00	$10,000.00
2. Cash Value, end of Pol. Yr.	3,400.00	3,410.00	3,410.00
3. Amount at Risk	6,590.00	6,590.00	6,590.00
4. Annual Premium	223.00	223.00	223.00
5. Annual Dividend	none	none	51.15
6. Increase in Cash Val. for Pol. Yr.	198.00	198.00	198.00
7. Interest on Cash Value—Percent	2½%	4%	4%
—Amount	85.25	136.40	136.40
8. Annual Cost of Risk (4)-(5)-(6) + (7)	110.25	161.40	110.25
9. Cost per $1,000 of Risk (8) ÷ (3)	16.73	24.49	16.73

By comparing Column 2 with Column 1, above, it will be seen how it may be made to appear that the cost per thousand of insurance varies from $16.73 to $24.49—a difference of $7.76 per thousand, or almost 50%—depending merely on whether the company receives the favorable "policy guarantee" rate on most older stock company policies, or whether it is charged with the 4% rate required for *all* participating policies, regardless of the rate assumed in their reserve basis.

Column 3 illustrates how much the dividend would have to be under a participating policy (charged with the compulsory 4% rate) to have it show up with the same purported per thousand cost as applies to a non-par policy under the Washington formula. If the policy were participating, even with the same premium, it would have to return a dividend of $51.15, or 22.9% of its premium and show a net outlay of only $171.85, or 77% of the non-par premium, to have it appear under the Washington formula that its net per thousand cost was *equal* to that of the non-participating policy. How long can discrimination of this type, in a formula purporting to furnish the buyer with a more meaningful understanding of life insurance costs, go unchallenged?

No single, double, or triple year cross section of the type utilized in these formulas can provide *any* sound, realistic or fair pictures of either actual or relative company costs. They provide a figure, but the figure standing alone is meaningless.

If the purpose of the interest charge is to take into consideration the earnings which the policyowner could be receiving on outside investment, then obviously there is no reason whatever for a different rate, applying arbitrarily in favor of stock companies, or against mutuals, as is the effect of the Washington regulation.

Even if this were eliminated by requiring a uniform interest rate for all companies, the fallacy of favoring the policy with the

lower cash value would still remain. It is obvious that a great need exists for education and understanding.

THE INFLATION SALES PITCH.

The author does not contend that there has not been inflation in the past, nor indeed that there may not be inflation in the future. That is not the point of this article which deals with misrepresentations linked to the replacement of life insurance.

The most common device illustrated as a measurement of "inflation" is the Consumer Price Index (CPI), computed by the Bureau of Labor Statistics. This index, based on the "market basket" principle, contains an element of distortion which in reality reflects improved quality factors (higher medical costs for modern life saving hospital and surgical techniques, for one example), so that perhaps 40% of the increase in the CPI has been a reflection of the increased cost of a higher standard of U.S. living, rather than reflection of a constant living scale. However, with due recognition of its deficiencies, the CPI is a widely accepted device for emphasizing the need for higher compensation, and it has also been used by the detractors of life insurance with the inference that life insurance has not "kept pace."

To illustrate, a reproduction of printed sales material currently being used by a mutual fund sales organization is presented. (Exhibit D).[20] The essence of this material is the contention that a loss of 33.1% has occurred, due to the difference in purchasing power of the dollar in 1967 as compared with 1947, the date of purchase of the life insurance.

The statement is then made, in the footnote, that the results illustrated are based on Non-Participating Ordinary Life and that "Had a participating or mutual policy been shown in this illustration, the loss would have been magnified . . . ."

Experience with the printed materials employed by some mutual funds salesmen who suggest or advise the replacement of existing insurance has demonstrated the necessity of taking nothing for granted.

A check of the facts produced the following.

The policy described in Exhibit D is a $50,000 Ordinary Life policy issued in 1947 at an annual premium of $935 at age 35 and with a 20th Year Cash Value of $16,250.

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[20] *See* Exhibit D *infra* at 940.

Although it is possible to buy such a policy today at about these rates, a search of the 1947 standard industry reference manuals showed no company then offering such a policy at the rate printed in this sales material.

The prospectus states the name of the insurance company used in the hypothetical illustration.

The 1947 issue of the *Unique Manual Digest*,[21] a standard reference manual, shows the rates of this company in 1947, for Ordinary Life, age 35, as $22.24 per $1,000, or $1,112.00; *not* $935.00 as stated—for a $50,000 policy. The 20th year cash value is shown as $310 per thousand, or $15,500—*not* $16,250, as stated—for a $50,000 policy.

So the first point in documenting the misrepresentations in this material is that the premium charged by the affiliated company is understated by $177.00 a year, or $3,540 over the twenty years in question, and the cash value overstated by $750.00, for a total error of $4,290.00. This is quite apart from the inflation loss argument which will now be explored.

The point is made that, by reason of the change in the consumer price index, a 33.1% loss has occurred. However, if the purchasing power of the proceeds (had death occurred in 1967 instead of 1947) is 33.1% less than it would have been, it follows that the purchasing power of the premiums paid over the twenty years has also been less. Gain or loss must be related to the premiums.

To demonstrate the misrepresentation, two sets of calculations were made with respect to a $50,000 non-participating policy in the life insurance company with which this mutual fund organization is identified. (Exhibit E)[22]

The first set of calculations involved the hypothetical assumption that there had been no change whatever in the consumer price index over this 20-year period. In that event, $50,000 of 1967 proceeds would still represent $50,000 of 1947 buying power, and premium dollars paid would have been worth $1.00 throughout. This exhibit shows that had death occurred in 1947, the proceeds ($50,000) would have been 45.0 times the premium ($1,112) paid. In the event of death in 1967 the proceeds ($50,000) would have been 2.248 times the sum of 20 premiums ($22,240) paid.

The second set of calculations converts all dollars, premiums paid and hypothetical proceeds paid, into terms of buying power

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[21] UNIQUE MANUAL DIGEST (National Underwriter Co. 1947).
[22] *See* Exhibit E *infra* at 941.

units, based on the consumer price index. On this basis, the ratio of proceeds paid to premiums would be identical in 1947, but in 1967 would have been a multiple of 1.905 times premiums paid.

This is 84.7% of what would have been paid in terms of buying power, had the consumer price index remained constant. Hence, the loss, if by loss is meant a gain of less than was originally anticipated, is 15.3%, and not 33.1% as contended in the sales material (Exhibit D).

Moreover, there is another misrepresentation. Recall the sales material stated that under a participating or mutual policy "the loss would have been magnified."

The identical process outlined above was repeated. But based on an ordinary life policy issued by the mutual company with which the author is associated, and for which the *actual* record of dividend payments during these 20 years (Exhibit F)[23] is available.

One of the effects of inflation has been to increase interest rates. This has increased dividends to policyowners, thereby reducing insurance costs on the ordinary life policy illustrated in Exhibit F by $1,465.00.

The exhibit shows that the purchasing power of the premiums paid under the illustrated policy is $19,436 in terms of constant Consumer Price Index dollars, as compared with $23,203 for the non-participating policy. Adjusting the purchasing power of the proceeds to Consumer Price Index dollars, the multiple of death benefits to cumulative Consumer Price Index premiums is 2.275 times, based on the actual results under the participating policy.

The exhibit shows that even after adjusting for inflation, the illustrated participating policy produced a higher multiple (2.275) of death benefits to premiums paid than did the non-participating policy (2.248) without any adjustment for inflation. Therefore, the statement in the sales material that "the loss would have been magnified" under a participating policy—at least as actually issued by the Northwestern Mutual, and doubtless other leading mutuals as well—is erroneous and a further misrepresentation.

What is the Cost of Life Insurance?

Unfortunately there has been a lot of fuzzy thinking on this subject, even within the life insurance industry, and when coupled with some completely fallacious and distorted cost formulas it is no wonder that the public is confused.

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[23] *See* Exhibit F *infra* at 942.

It is relatively easy, as has been demonstrated, to point out the fallacies in cost formulas which would divide the life insurance contract into two parts, and then attribute the costs of the whole, including an interest factor, against one part of the contract, to arrive at a "one year cost." Obviously no one year cost analysis can properly portray the actual cost of life insurance, and formulas which attempt to do so merely compound confusion.

If these formulas are fallacious, then does the public not have a right to inquire as to what is a proper measurement of cost? Indeed it does. But the answer is not as simple as stating the cost of consumer goods. Part of the confusion results from calling a life insurance contract a "product," which it is not.

Rather, life insurance is a unique financial service, being an unconditional promise to pay a guaranteed amount at death, whenever that death shall occur. One of the reasons that cost is so hard to pin down is that even in the same company, and under the same policy contract, issued at the same age, the cost in relation to the benefits will vary as between individuals, depending on the very thing that is being insured, the length of that individual life.

Does this mean that it is impossible to arrive at a meaningful measurement of costs, which will demonstrate the very real difference in values furnished by different companies? No, it does not, but it does mean that a sound basis upon which to measure cost must be established. Is cost to be defined as the cost if you die (and if so at what date), or as the cost if you live (and if so for what period)? Part of the problem is semantics, but if the same rules of common sense are applied to life insurance as are applied to the ownership of other forms of property, there should be no difficulty.

A buys a house for $25,000 cash, lives in it for one year and dies. B buys a house for $25,000 cash, lives in it for 25 years and dies. C buys a house for $25,000 cash, lives in it for 20 years and sells it for $20,000. What have been the costs of the respective houses to A, B, and C? Disregarding for the moment the residual estate values, it will be apparent that, whatever may be your measurement of cost, each individual received different value depending on his relative length of life, the factor which could not be forecast. So cost confusion is not limited to life insurance.

A, age 20, buys a $100,000 non-participating life insurance policy for a single premium of $25,000 and dies one year later, $100,000 being paid his widow. B, age 20, buys the identical policy for the identical single premium, but dies at age 65, also with $100,000 payable to his widow. C, age 20, buys the identical policy at the iden-

tical premium, and at age 65, decides he no longer needs the insurance. Consequently he surrenders it for its then cash value of $68,000.

Despite identical policies in the same company taken out at the same age, the cost for each has obviously varied greatly, due principally to circumstances beyond anyone's control. Yet these are the simplest of situations, involving the most basic form of insurance, non-participating single premium life.

Consider D, who at age 20, purchases $100,000 of single premium insurance in a mutual life insurance company.[24] His premium would be higher, to be sure: $27,248.90 to be exact, but he receives annual cash dividends (current 1969 scale, not guaranteed) of $354.00 the first year and increasing to $570.00 the 20th year and to $1,122.00 at age 65. Assume that he dies at age 70, when $100,000 is paid to his widow, in cash or income as elected.

Assume the same facts as above except that E elects to leave all of his dividends with the company as fully paid-up additions to his policy. When he dies the death benefit is a total of $216,000 (the $100,000 basic policy, plus $116,000 of dividend additions).

Again assume the same facts as above, except that F elects to leave dividends with the company, but at age 65, he decides to surrender his insurance coverage and use the cash value of $140,600 for a guaranteed lifetime annuity.

Once again, under the simplest form of policy, single premium life (but, in these instances, on the participating plan) what is the "cost" of the insurance to these three individuals, each of whom purchased identical policies at the same age and at the same premium?

What do YOU Mean by Insurance Costs?

Whatever measurement of value is developed, it should be meaningful to you, as the reader. How do you compute your automobile insurance costs, for example? Do you consider just your annual outlay? Do you compound your outlay at interest, year by year, on the theory that if you did not carry the automobile insurance, those funds would be available for productive investment? If so, what rate of interest do you assume? Do you assume a claim? If so, how much?

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[24] The Northwestern Mutual Life Insurance Company.

All forms of insurance involve compensation to the insurance company for the taking of a risk. Life insurance, for the whole of life, involves both a risk and a certainty, the *risk* of death in the early years, the certainty of death in the later years and thus of eventual payment.

Whole life insurance provides for either: (1) payment of the face amount, upon death or maturity or (2) payment of the cash value upon surrender. The amount of the cash surrender value in relation to premiums paid will depend upon: (a) the type of policy contract, (b) the length of time the coverage has been in force, and (c) the differences in company performance.

It should be apparent why the answer to "actual costs" or "relative costs" is not a simple one.

Comparing Costs as Between Companies

The wide variations in "cost" or "value" applying to different individuals insured by the same company, depending upon their respective dates of death, have been shown. If the objective of our study is to determine differences in cost as between companies, ground rules must be established. Obviously the assumed time of death must be a constant factor in every comparison. A choice must be made between (a) identical amount of insurance, to determine differences in premiums, or cash values, or both, or (b) the identical annual premium, to determine differences in death benefits or cash values, or both.

It is essential also that comparable forms of policy contracts be compared, such as whole life vs. whole life, 20 payment life vs. 20 payment life, etc. In an intercompany relative cost study, any attempt to compare "term vs. whole life" or "whole life vs. endowment," is bound to be confusing, and probably misleading as well.

For many years life insurance statistical services have published net cost[25] comparisons. Such comparisons are usually of policies of the same type, having generally similar gross premiums, and involving contracts issued subject to the same policy minimum sizes. They are based on either "Actual History of Performance" over a comparable period of years or on "Current Scale of Dividend Distribution."

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[25] The conventional "net cost" formula is: Gross Premiums multiplied by "X" years, minus dividends over "X" year period = Net Payments. Net Payments minus Cash Value at end of "X" years = Net Cost. (PX — D — C = N).

The former is exactly what it says, an actual record of performance over an identical period of time. The latter is an illustration of results which may be anticipated in the future, based upon an assumed continuation of conditions of interest, mortality and expense at the time of publication of the dividend scale.

Possibly a comparison of Actual Histories of Performance will be helpful:[26]

$10,000—Age 35—Male
Issued 1958

	Company A		Company B		Company C	
Gross Annl. Prem.	$251.40		2 Years $211.12 Thereafter 263.90		$263.90	
	Dividend	*Net Payment*	*Dividend*	*Net Payment*	*Dividend*	*Net Payment*
1959	$30.60	$220.80	$25.00	$186.12	$47.20	$216.70
1960	34.40	217.00	29.30	181.82	51.70	212.20
1961	38.40	213.00	42.20	221.70	56.30	207.60
1962	42.30	209.10	47.80	216.10	62.70	201.20
1963	46.50	204.90	52.90	211.00	66.90	197.00
1964	50.60	200.80	65.60	198.30	75.40	188.50
1965	58.00	193.40	70.50	193.40	80.30	183.80
1966	62.60	188.80	77.70	186.20	90.40	173.50
1967	66.70	184.70	83.20	180.70	96.00	167.90
1968	71.50	179.90	88.80	175.10	111.30	152.60
Summary:						
Actual Net Payments		$2,012.40		$1,950.40		$1,900.80
Average Annl. Net Payt.		20.24		195.00		190.10
Cash Value		1,754.70		1,600.00		1,863.60
Net Cost		257.70		350.40		37.20
Avg. Net Cost Per Yr. Per Thousand		2.58		3.50		.37

The above study indicates that there has been a difference in performance of these companies over the ten-year period of 1958–1968.

Critics of the "net cost" comparison method state that it is unfair because it does not take interest into consideration. For this reason, they say, the net cost figure is not a true reflection of actual cost to the buyer, and they contend that any meaningful cost analysis should take interest into consideration, on the grounds that had the money not been put into life insurance it could have been invested elsewhere.

An answer to this criticism is that "net cost" was never intended to illustrate actual costs to the buyer, but only *relative* cost differ-

[26] Data obtained from FLITCRAFT COMPEND. (A.M. Best Co. 1968).

ences between companies, based on generally comparable contracts. The same criticism—that "cost" does not include "interest"—could be made about the cost of anything else that a person buys.

However, the life insurance company does earn interest on the policy reserves, and this interest, to the extent that it exceeds the assumed rate, is used to reduce the policyowner's insurance costs through dividends. The higher the rate of interest earned on the reserves (all else assumed equal), the lower the cost of participating insurance to the policyowner. If interest is to be considered in a cost comparison, what rate of interest should be used?

Many contend that the gross rate chargeable should not be higher than the guaranteed rate applicable to policy loans in the contract, usually 5%, because if higher interest is obtainable elsewhere the policyowner can borrow the cash value at 5% interest and obtain the excess interest through the outside investment. If interest is included as a cost factor, the income tax consequences cannot be ignored. If a 30% income tax bracket is assumed fair, this leaves a 3½% net after tax return to use in the hypothetical calculations. In any event, if the primary objective is to determine the relative differences in company performance, the interest rate is almost immaterial.

Referring to the same three actual histories shown on page 47, if net payments are compounded at 3½% for the ten-year period the results are:[27]

	Company A	Company B	Company C
1958	$ 354.62	$ 297.81	$ 372.26
1959	300.93	253.66	295.34
1960	285.75	239.42	279.42
1961	271.00	282.07	264.13
1962	257.05	265.65	247.34
1963	243.36	250.60	233.98
1964	230.42	227.55	216.30
1965	214.42	214.42	203.56
1966	202.24	199.46	185.85
1967	191.16	187.02	173.78
Total	$2,550.95	$2,417.66	$2,471.96
Less 1968 Dividend	71.50	88.80	111.30
Payments Accum. at Interest	$2,479.45	$2,328.86	$2,360.66
Cash Value	1,754.70	1,600.00	1,863.60
Net Cost	$ 724.75	$ 728.86	$ 497.06
Average Net Cost Per Yr. Per Thousand	7.25	7.29	4.97

[27] A "compound interest" net cost formula might be expressed as: "Annual Payments compounded at Interest for "X" years, minus cash value = net cost. In this formula, inasmuch as dividends are payable at the end of the policy year, the first year gross premium is compounded, and the dividend payable at the end of the period under consideration is subtracted, in arriving at the accumulated input.

This formula doubtless provides a more accurate measurement of total cost of the insurance than the net cost formula which does not take interest into consideration. Note, too, that it avoids the fallacies of the split contract approach criticized earlier because (1) it is based on the entire face amount of insurance, and (2) it is a cumulative figure, taking the full ten years performance into consideration. However, as a relative measurement, the companies still rank in the same order as under the simpler net cost approach.

Another relative ranking of company performance is one which does not attempt to measure the cost of the insurance, but measures the ratio of values within the policy in relation to actual premium payments. This is known as the "Investment Quotient" (I.Q.), and is arrived at by dividing the cash value by premiums paid, as follows:

Ten Year "IQ"	Company A	Company B	Company C
Cash Values	$1,754.70	$1,600.00	$1,863.60
Net Payments	2,012.40	1,950.40	1,900.80
Investment Quotient:	87.2%	82.0%	98.0%

This measurement device indicates that Company A after having provided $10,000 of life insurance protection for ten years makes cash values available to the policyowner equivalent to 87.2% of premiums paid. Here again the ranking of the companies is the same as under "net cost."

Probably the most informative measurement of *relative* values, as between specific companies is a graphic technique, based on an identical premium payment, constant over a reasonable period of years, with death benefits and cash values measured separately. This device is particularly appropriate for comparing non-par vs. non-par, or participating vs. participating. If used to compare a non-participating policy vs. a participating policy, it must be borne in mind that the former, for a constant unit of premium, will generally provide a larger death benefit in the early policy years, when term insurance is relatively inexpensive, whereas the latter will normally provide the higher death benefit in the later years, when term insurance is of course more expensive if, indeed, it is available at any price.

III. CONCLUSION

Most of the problems dealing with either incomplete comparisons or misrepresentations arise where *different types* of policies in different companies are "compared," with one being portrayed as the better value.

As has been shown, there are cost differences between companies under similar types of policies. Because the premium for one

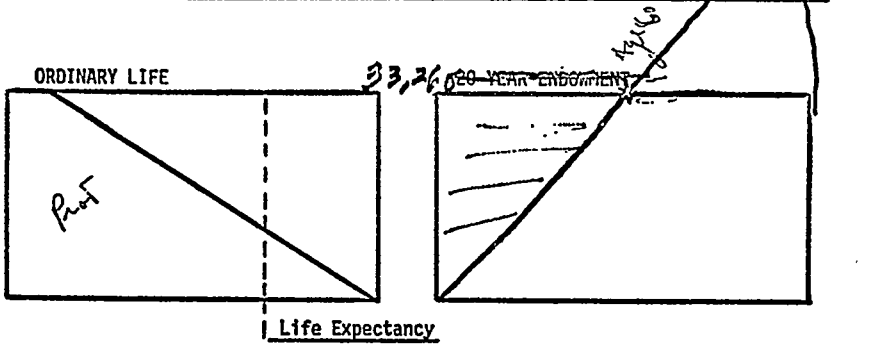
is lower does not necessarily mean that lower cost life insurance is being provided. It may mean that the low premium insurance will reduce in amount, or expire altogether without value, while the other insurance is still in effect. Consequently, any purported comparison of unlike contracts must be viewed critically to ascertain whether the basis is objective, or whether it is slanted to favor the point of view of the proponent. Extreme care must be taken when these comparisons involve replacement of existing insurance, because of the incentive of commissions which will be received by the replacer if he is successful.

Inasmuch as the owner of a participating policy in a mutual company receives his insurance at cost, any inferences that within a particular company one type of policy provides a "bargain" whereas another involves an "overcharge," simply compounds confusion. If responsible companies and responsible agents appear to favor whole life over term plans it is probably because they know the life insurance business well enough to know that the initially low premiums of temporary insurance are all too frequently a delusion. The vast majority of policyowners who carry term insurance are in the position of the house renter vs. the home owner. The former has a stack of rent receipts, but is at the mercy of the landlord as to future availability and costs. The latter has property values and a choice of attractive options for the future.

In the past ninety years our increased knowledge should have enabled us to detect "the false bottom" in the attempted comparison of unlikes. Nevertheless, the fact remains that otherwise well-informed people still fall victim to the siren song of the replacer. But when even some regulatory authorities adopt a system which produces contradictory results, under the label of "clarification," who can really blame Mr. Average Citizen, subjected to persuasive, but sometimes ill-informed or unprincipled salesmen, from failing to detect "the false bottom."

EXHIBIT A

Age	American Experience Table (1843-1858)	Age	Commissioners Standard Ordinary 41 (1931-1941)	Age	Commissioners Standard Ordinary 58 (1950-1954)
20	$ 7.81	20	$ 2.43	20	$ 1.79
25	8.07	25	2.88	25	1.93
30	8.43	30	3.56	30	2.13
35	8.95	35	4.59	35	2.51
40	9.79	40	6.18	40	3.53
45	11.16	45	8.61	45	5.35
50	13.78	50	12.32	50	8.32
55	18.57	55	17.98	55	13.00
60	26.69	60	26.59	60	20.34
65	40.13	65	39.64	65	31.75
70	61.99	70	59.30	70	49.79
75	94.37	75	88.64	75	73.37
80	144.47	80	131.85	80	109.98
85	235.55	85	194.13	85	161.14
90	454.55	90	280.99	90	228.14
95	1,000.00	95	396.21	95	351.24
		99	1,000.00	99	1,000.00



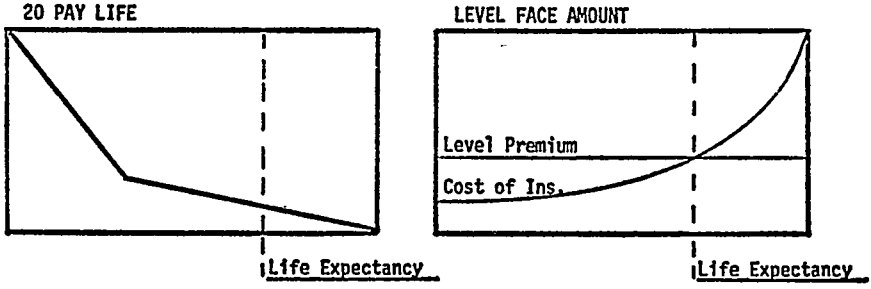


EXHIBIT B

3% 100% 50% 50% — POLICY ANALYSIS — As owner subject to Fed. Estate Tax

Insured / Company Provident Mutual Life

Owner Policy Number 2,015,827

Beneficiary - Mortality Table C.S.O. 1958 3%

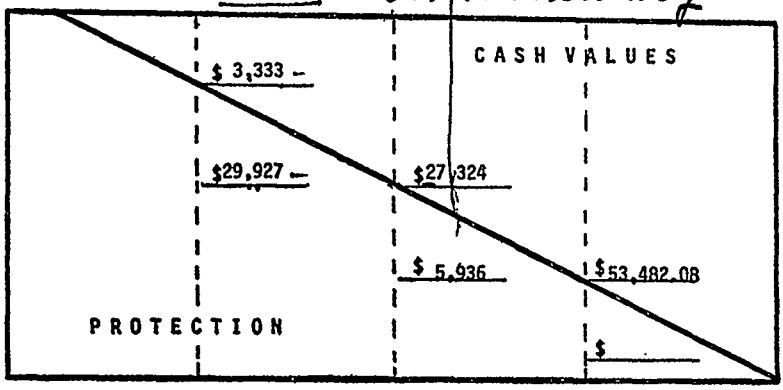
Analysis Date

NON-FORFEITURE OPTIONS

Total Premium	$2,474.22	Paid Up Ins.	$5,379
Acc. Death	$	Cash Value	$3,333
Waiver of Prem	$ 92.46	Protection	$2,046
	$		
Basic Premium	$2,381.76	Extended Term	$
		Period	Years Days

Consider a marital trust and residuary trust

FACE AMOUNT $ 33,260



	47	57	65
Basic Premium	$ 2,381.76	$2,381.76	$ 2,381.76
Interest Factor	$ 166.65	$1,366.20	$ 2,674.10
Total Cost	$ 2,548.41	$3,747.96	$ 5,055.86
Cost Per $1,000	$ 85.15	$ 631.40	$

Appendix "A" forms a part of this analysis

EXHIBIT C

POLICY ANALYSIS

INSURED_____

OWNER_____

ANALYSIS DATE April 6, 1968

Total Premium $ 521.00

Accidental Death $ 0

Waiver of Premium $ 8.00

* Current Dividend $ Unavailable

Basic Premium $ 513.00

Original Premium 161.50

$ 6.46 : Cost per Thousand at Inception

$ 27.50 : Cost per Thousand 8 Year

* Reducing Annual Cost

COMPANY Northwestern Mutual Life

POLICY NUMBER 5 211 574

MORTALITY TABLE CSO 1941 (2½)

NON-FORFEITURE OPTIONS

Paid Up Insurance $ 4,250.00

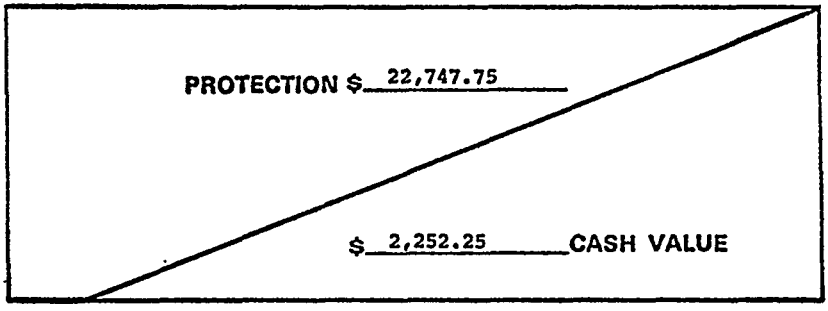
Cash Value $ 2,252.25

Protection $ 1,997.75

Extended Term $ 25,000.00

Period: 15 Years 75 Days

FACE AMOUNT $ 25,000.00



INTEREST FACTOR $ 112.61

Issue Date April 6, 1960 2033 Endowment Date

Issue Age 27 100 Endowment Age

Appendix "A" forms a part of this analysis

IMPORTANT: If this Policy is participating, dividends may be used to:

A. Reduce Annual Premium
B. Left on deposit to accumulate interest
C. Buy paid up additions

AO-77493-A(3)

EXHIBIT D

THE EFFECT OF *INFLATION* ON AN ORDINARY LIFE INSURANCE POLICY

The following chart illustrates the adverse effect of inflation on the most common life insurance policy issued in the United States — *Ordinary Life.*

Inflation is an economic condition that, in a general sense, cannot be seen or felt and most people are unaware of its devastating effect on their long range financial planning.

In evaluating which course your insurance programming should take in the future, ask yourself the question: "Will inflation continue to be a part of the economic future?" If, in your opinion, this will be the case, your most prudent course of action may well be to develop your insurance estate around the use of term insurance.

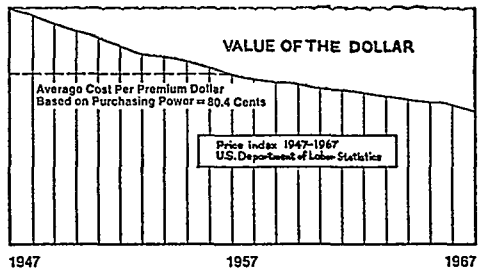
Term insurance provides *maximum protection with minimum outlay* and eliminates the use of the 2½ or 3% savings element built into an Ordinary Life policy.

The use of convertible term allows you to continue your insurance coverage by converting that policy to any number of available policies *without evidence of insurability.*

1947	$50,000 Ordinary Life*	1967
Guaranteed Values		Present Value in Terms of Purchasing Power†
DEATH BENEFIT.....$50,000		DEATH BENEFIT†.....$33,450
20th YEAR CASH VALUE.....$16,250		CASH VALUE†.....$10,871

33.1% LOSS†

Annual Premium $935 (age 35)



*NON-PARTICIPATING ORDINARY LIFE—Had a participating or modal policy been shown in the illustration the loss would have been magnified as a greater number of premium dollars would have been exposed to the eroding effect of inflation over the 20-year period.

EXHIBIT E

Adjustment of the purchasing power of Life Insurance (proceeds in event of death and Cash Values) to purchasing power of premiums period 1947-67. Consumers Price Index, complied by Bureau of Labor statistics, 1957-59 = 100 Source: Handbook of Basic Economic Statistics, 1968. $50,000 Ordinary Life, Age 35, (Non-Participating Basis) 1947- Source: Unique Manual Digest, 1947.

Year	Calendar Year	Annual Premium	Cumulative Premiums	Proceeds Payable at Death		Consumers Price Index (1957-59 = 100)	Adjusted Values Related to C.P.I. Buying Power			
				Face Amount	Multiple of Cum. Prems.		Annual Premium Payments	Cumulative Premiums	Proceeds at Death	Multiple of Premiums
1	1947	$1112	$1112	$50000	44.964	77.8	$1429	$ 1429	$64267	44.973
2	1948	1112	2224	50000	22.482	83.8	1327	2756	59666	21.649
3	1949	1112	3336	50000	14.988	83.0	1340	4096	60241	14.707
4	1950	1112	4448	50000	11.241	83.8	1327	5423	59666	11.002
5	1951	1112	5560	50000	8.993	90.5	1229	6652	55249	8.306
6	1952	1112	6672	50000	7.494	92.5	1202	7854	54054	6.882
7	1953	1112	7784	50000	6.423	93.2	1193	9047	53648	5.930
8	1954	1112	8896	50000	5.620	93.6	1188	10235	53419	5.219
9	1955	1112	10008	50000	4.996	93.3	1192	11427	53591	4.690
10	1956	1112	11120	50000	4.496	94.7	1174	12601	52798	4.190
11	1957	1112	12232	50000	4.088	98.0	1135	13736	51020	3.714
12	1958	1112	13344	50000	3.747	100.7	1104	14840	49652	3.346
13	1959	1112	14456	50000	3.459	101.5	1096	15936	49261	3.091
14	1960	1112	15568	50000	3.212	103.1	1079	17015	48497	2.850
15	1961	1112	16680	50000	2.998	104.2	1067	18082	47985	2.654
16	1962	1112	17792	50000	2.810	105.4	1055	19137	47438	2.479
17	1963	1112	18904	50000	2.645	106.7	1042	20179	46860	2.322
18	1964	1112	20016	50000	2.498	108.1	1029	21208	46253	2.181
19	1965	1112	21128	50000	2.367	109.9	1012	22220	45496	2.048
20	1966	1112	22240	50000	2.248	113.1	983	23203	44209	1.905

Values in Event of Survival

Twenty years Premiums	$22240
Dividends to Policyowners	None
Total Premiums 20 Years	$22240
Guaranteed Cash Value	15500
Difference	$ 6740

Adjusted $\frac{15.500}{113.1}$ =

	$23203
	None
	$23203
	13704
	$ 9499

EXHIBIT P

Adjustment of the Purchasing Power of Life Insurance (Proceeds in event of death and Cash Value) to Purchasing Power of Premiums Period 1947-67.
Consumers Price Index, compiled by Bureau of Labor Statistics 1957-59 = 100. Source: Handbook of Basic Economic Statistics, 1968.
$50,000 Ordinary Life, Age 35, issued by The Northwestern Mutual Life Insurance Co. (Participating basis) 1947. Source: Flitcraft Compend, 1947 & 1967.

Year	Illustration Based on 1947 Dividend Scale Proceeds Payable at Death					Actual Performance Dividends 1948 - 1967			Adjusted Values Related to C.P.I. Buying Power				
	Dividend	Net Payment	Cumulative Net Payments	Face Amount Plus Dividend	Multiple of Cum. Net Payments	Dividends Paid	Net Payments	Cumulative Net Payments	Consumer Price Index (1957-59=100)	Net Payments	Cumulative Net Payments	Proceeds at Death	Multiple of Cum. Net Payments
1	$	$1332.00	$1382.00	$50247.00	36.358	$	$1332.00	$1332.00	77.8	$1776.00	$1776.00	$64584.00	36.358
2	247.00	1135.00	2517.00	50264.00	19.970	247.00	1135.00	2517.00	83.8	1354.00	3130.00	59945.00	19.152
3	264.00	1115.00	3632.00	50281.00	13.844	233.50	1148.50	3665.50	83.0	1384.00	4514 00	60540.00	13.412
4	281.00	1101.00	4733.00	50298.50	10.627	248.00	1134.00	4799.50	83.8	1353.00	5867.00	59978.00	10.223
5	298.50	1083.50	5816.50	50316.50	8.651	263.00	1119.00	5918.50	90.5	1236.00	7103.00	55556.00	7.821
6	316.50	1065.50	6882.00	50335.00	7.314	278.50	1103.50	7022.00	92.5	1193.00	8296.00	54409.00	6.558
7	335.00	1047.00	7929.00	50351.00	6.350	328.50	1053.50	8075.50	93.2	1130.00	9426.00	54026.00	5.732
8	351.00	1031.00	8960.00	50367.50	5.621	352.00	1030.00	9105.50	93.6	1100.00	10526.00	53831.00	5.114
9	367.50	1014.50	9974.50	50383.50	5.051	385.50	996.50	10102.00	93.3	1068.00	11594.00	54028.00	4.660
10	383.50	998.50	10973.00	50400.50	4.593.	403.00	974.00	11076.00	94.7	1029.00	12623 00	53280.00	4.221
11	400.50	981.50	11954.50	50417.00	4.217	456.00	936.00	12012.00	98.0	955.00	13578.00	51519.00	3.794
12	417.00	965.00	12919.50	50433.50	3.904	488.50	893.50	12905.50	100.7	887.00	14565.00	50163.00	3.444
13	433.50	948.50	13868.00	50450.50	3.638	514.50	867.50	13773.00	101.5	855.00	15420.00	49801.00	3.230
14	450.50	931.50	14799.50	50467.50	3.410	548.50	833.50	14606.50	103.1	808.00	16228.00	49056.00	3.023
15	467.50	914.50	15714.00	50484.50	3.213	576.50	805.50	15412.00	104.2	773.00	17001.00	48567.00	2.857
16	484.50	897.50	16611.50	50501.50	3.040	606.50	775.50	16187.50	105.4	736.00	17737.00	48036.00	2.708
17	501.50	880.50	17492.00	50518.00	2.883	629.50	752.50	16940.00	106.7	705.00	18442.00	47521.00	2.577
18	518.00	864.00	18356.00	50535.00	2.753	704.50	677.50	17617.50	108.1	627.00	19069.00	46923.00	2.461
19	535.00	847.00	19203.00	50551.50	2.632	729.50	652.50	18270.00	109.9	594.00	19663 00	46229.00	2.351
20	551.50	830.50	20033.50	50568.00	2.524	606.00	576.00	18846.00	113.1	509.00	20172.00	44945.00	2.228
	568.00					832.50			832.50 / 113.1 =		736 / 19436.00	44209.00	2.275

Values in Event of Survival

Twenty Years Gross Premiums		$27640.00
Less: 20 Years Dividends (Illustrated, 1947)		8171.50
Net Payment Illustrated		$19468.50
Guaranteed Cash Value		19036 00
Difference (Net Gain + or Cost -)		$ - 432.50

		$27640.00	
Less Dividends Actually Paid		9636.50	
		$18003.50	
		19036 00	
		$+1032.50	Adjusted 19036 / 113.1 = $ 19436.00 / 16831 00 / $ 2605.00