The failure to impose these duties on law enforcement agencies may be but one example of how the Iowa bill fails to meet the standards set forth in pending federal funding legislation.[212] That bill, which is sponsored by House Judiciary Committee Chairman Peter Rodino, would impose a number of other requirements upon states seeking reimbursement from the federal government for payments made under their own crime victim compensation acts.[213] Although the federal bill may fail to become law and thus moot the issue of federal standards, these requirements highlight some of the questions which should be considered by Iowa legislators before adopting a crime victims compensation plan. Furthermore, the Iowa legislators would be wise to examine the wealth of data contained in the annual reports of program administrators in other states. This will enable Iowans to profit from the mistakes of others and to enjoy the benefits of a fair and efficient program.

Gerald Thomas Husch

LIFE INSURANCE AND THE CONSUMER: AT WHAT PRICE DISCLOSURE?

I. Introduction

In 1975, American consumers purchased 12,599,000[1] policies for ordinary life insurance,[2] and those policies represented a total "death benefit" value of $189,556,000,000.[3] For those death benefits, consumers paid $21,032,000,-000[4] in premiums. The 1975 purchases brought the total value of death benefits in existence under ordinary life insurance policies in the United States to $1,083,421,000,000.[5] To give perspective to the magnitude of the 1975 purchases, figures for the twelve months of 1965 indicate consumers purchased less than half the amount purchased in 1975, or the amount $83,485,000,000.[6] Thus, by the end of 1975, one hundred and forty-five million people were in-

(McKinney Supp. 1976), which generally requires law enforcement officials to supply victims of crimes with information and application forms.

212. H.R. 7010, 95th Cong., 1st Sess. (1977).

213. *See id.* at § 4.

1. American Council of Life Ins., Life Ins. Fact Book 13 (1976) [hereinafter cited as Fact Book]. The Life Ins. Fact Book for 1977, containing statistics for 1976, has not yet been published.

2. As used herein, ordinary life insurance is a policy based on a direct transaction between the consumer and the insurer on a direct selling basis. "Industrial" and "group" life insurance are not included.

3. Fact Book, *supra* note 1, at 7.

4. *Id.* at 55.

5. *Id.* at 7.

6. *Id.*

sured by policies issued by the legal reserve life insurance companies of America,[7] which between them[8] controlled assets of $289,304,000,000.[9]

At the end of 1975, a task force of the National Association of Insurance Commissioners (NAIC) reported a regulation out of committee[10] which was designed to provide ordinary life insurance purchasers with more information about the nature of those complex purchases. NAIC, a voluntary organization of insurance regulatory officials of the fifty states, wanted to provide a guide to the consumer whereby the policies of different companies, or the distinct policies of the same company, could be compared by some objective measurement—cost. The term "cost" (or cost index) is used to represent the amount the consumer ultimately pays for life insurance coverage. A determination of cost takes into consideration the amount the consumer expends for premium payments, as well as the amount the consumer receives in return, in the form of either cash value or dividends.[11] The NAIC regulation, by formulating a method of measuring cost,[12] partly accomplished the goal NAIC sought to achieve. NAIC also wanted consumers to utilize cost information for purposes of policy comparison. Thus, in furtherance of NAIC's intentions, the regulation additionally provides a means of disclosing to the consuming public the cost of different life insurance policies.[13] This Note will examine the background to the adoption of the regulation; the mechanics of determining cost, both under previously utilized methods and the method adopted by NAIC; and the unique duty of disclosure imposed upon the insurer by the NAIC regulation. It should initially be noted that the NAIC regulation has recently been

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7. *Id.* at 9.
8. At the end of 1975, there were 1790 life insurance companies in America. *Id.* at 86.
9. *Id.* at 64.
10. I NAIC PROCEEDINGS 523-29 (1976).
11. The regulation provides that the consumer be furnished with the following explanation of cost:

> "Cost" is the difference between what you pay and what you get back. If you pay a premium for life insurance and get nothing back, your cost for the death protection is the premium. If you pay a premium and get something back later on, such as a cash value, your cost is smaller than the premium.
>
> The cost of some policies can also be reduced by dividends; these are called "participating" policies. Companies may tell you what their current dividends are, but the size of future dividends is unknown today and cannot be guaranteed. Dividends actually paid are set each year by the company.
>
> Some policies do not pay dividends. These are called "guaranteed cost" or "non-participating" policies. Every feature of a guaranteed cost policy is fixed so that you know in advance what your future cost will be.
>
> The premiums and cash values of a participating policy are guaranteed, but the dividends are not. Premiums for participating policies are typically higher than for guaranteed cost policies, but the cost to you may be higher or lower, depending on the dividends actually paid.

510 IOWA AD. CODE § 15.73, Appendix (1977). The quoted material is contained in a document known as the Buyer's Guide, which the regulation requires be given to the consumer. *Id.* at § 15.69(1); *see* notes 64-68 *infra* and accompanying text.

12. 510 IOWA AD. CODE § 15.68(3)-(6) (1977); *see* notes 48-57 *infra* and accompanying text.
13. 510 IOWA AD. CODE § 15.69 (1977); *see* notes 61, 71-73 *infra* and accompanying text.

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adopted as a departmental rule by the Iowa Department of Insurance, with an effective date of January 1, 1978.[14]

Consumer advocates, legal writers, members of the insurance community, and even some elected officials have lobbied for enforcement of a uniform method of cost comparison of life insurance policies in order to provide the consumer with an objective criterion to evaluate insurance policies.[15] It requires no exhaustive argument to conclude that insurance policies are difficult, if not impossible, for the lay consumer to understand.[16] The regulation adopted by NAIC is designed to serve two functions: to inform the insured as to what he is purchasing, and to utilize that information to compare the benefits in relation to the cost of various policies, thereby ultimately instilling competition in an industry which shows signs of monopolization.[17]

II. The Traditional Method of Determining Life Insurance Cost

The method of determining cost utilized by the NAIC regulation is neither the first nor only method available. Leaders of the life insurance industry have been cognizant of the developing consumer trends. In 1970, a Joint Special Committee on life insurance costs, comprised of members of the life insurance industry, undertook a study of the industry, and in particular, examined the available methods of evaluating the cost of life insurance.[18] The Joint Special Committee, in its ensuing report, first detailed the use of the "traditional" method of determining life insurance costs, a method which had been widely used in representing the cost of death benefits to the consumer.

The method of calculation utilized in the traditional method was summarized by the Joint Special Committee as follows:

> [A]dd together the premiums for a period of years . . . [then] subtract the cash value at the end of the period and the sum of all policy dividends shown in the life insurance company's illustration for the period. The result of this arithmetic, which might be positive or negative, was frequently then divided by [the period of years], and [then divided] by the number of thousands of the amount insured, the result being described in such terms as "average Surrendered Net Cost per $1,000."[19]

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14. 510 Iowa Ad. Code § 15.72; the entire text of the regulation is found in *id.* at §§ 15.66-.73.

15. *See, e.g.*, Belth & Maxwell, *The State of Competition in the Life Insurance Industry*, 15 Anti-Trust Bull. 213, 230 (June 1970).

16. Gerhardt v. Continental Ins. Cos., 48 N.J. 291, 225 A.2d 328 (1966); *see* Gray v. Zurich Ins. Corp., 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); Bauman v. Royal Indem. Co., 36 N.J. 12, 174 A.2d 585 (1961); Gunther v. Metropolitan Cas. Ins. Co., 33 N.J. Super. 101, 109 A.2d 485 (Super. Ct. Law Div. 1954).

17. Cummins, Denenberg & Scheel, *Concentration in the U.S. Life Insurance Industry*, 39 J. Risk Ins. 177 (1972).

18. As mentioned previously, "cost" is what the consumer pays for the death benefits, with the company's retention for expenses and profit added in.

19. Joint Special Comm. on Life Ins. Costs, Report to American Life Ins. Convention 5 (1970) [hereinafter cited as Comm. Report].

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As an illustration of the formula, assume the following hypothetical situation for a whole life participating policy (one which pays annual dividends):

Amount of insurance	$10,000
Age at issuance	35 years
Annual premiums	$240.00
Annual dividends	$18.00 at the end of the first year, increasing by $6.00 each year to $132.00 at the end of the twentieth year of coverage.

To determine the "average Surrendered Net Cost per $1000 dollars (of death benefit)" on this life insurance policy under the "traditional approach," the formula would be utilized as follows:

FOR THE FIRST TEN YEARS:

Sum of the premiums	$2400
minus the sum of the dividends	- $450
	$1950
minus cash value	- $1710
	$240
divide by 10, the number of years of policy coverage	$24
divide by 10, the number of thousands of the amount of the insurance to arrive at the average Surrendered Net Cost per $1000	$2.40[20]

FOR THE FIRST TWENTY YEARS:

Sum of the premiums	$4800
minus sum of the dividends	- $1500
	$3300
minus cash value	- $3610
	- $310
divide by 20, the number of years of policy coverage	- $15.50
divide by 10, the number of thousands of the amount of insurance, to arrive at the average Surrendered Net Cost per $1000	- $1.55[21]

It must be pointed out that these computations under the traditional method do not allow any consideration for interest on premiums, the dividends, or the cash value. In other words, measurement of cost under the traditional

20. *Id.* at 10.
21. *Id.*

method ignores the earning power of money, and makes a life insurance policy appear to be an incontestable bargain. For example, if the hypothetical policy discussed above is retained for ten years and then surrendered, the cost of insurance would be only $2.40 per thousand dollars of death benefits; but if the policy is surrendered at the end of twenty years, the cost would be a *negative* $1.55. Thus, after twenty years of retention, the consumer has been insured at his own cost of minus $1.55 for $1000, or minus $15.50 for $10,000, of insurance coverage. At the same time, however, the insurer is earning interest through investment of the insured's premium payments. Thus, the traditional method fails to include, within the measurement of cost, an allowance for the interest the insured would have earned had he invested the amount expended for the premium payments elsewhere. The failure to include an allowance for interest in the computation of cost was a strong basis for criticism of the traditional method by the Joint Special Committee.[22]

The Joint Special Committee found other problems inherent in the traditional method of computing cost. The Committee concluded that the traditional method: 1) assumes that the stated dividend scale will continue unchanged, when in reality the dividend scale at the time the insurance is sold is only an estimate as to what dividends will be paid in the future, subject to fluctuations in the national economy; 2) assumes that fluctuations in the national economy will affect the dividend scale of each company in a similar fashion; 3) is based upon and only applicable to a fixed period of policy retention, such as ten years or twenty years, or however many years were used as the divisor in arriving at the computation; and 4) perpetuates the insurance industry's most effective sales techniques, that being the longer the consumer pays into the policy, the less the cost will be for the stated death benefit.[23] Because of the difficulties encountered, the Joint Special Committee rejected the traditional method of cost determination as a useful approach.

III. The Interest-Adjusted Method of Determining Life Insurance Costs

Rather than lending its approval to the traditional method, the Joint Special Committee, in its report, recommended adoption of the "interest-adjusted" method of determining the cost of death benefits in a life insurance policy.[24] Basically, this method calls for *accumulation* of the monthly premiums. In other words, both principal and interest on the principal are added together, and interest is compounded annually on that sum for a given period of years. The rate of interest used is that which the consumer could reasonably expect in a personal investment, such as a savings account. In the same fashion, dividends are accumulated at the rate of interest, not merely added to-

22. *Id.* at 16.
23. *Id.* These infirmities in the traditional method are inherent in any method of life insurance cost comparison. *See* notes 45-47 *infra* and accompanying text.
24. Comm. Report, *supra* note 19, at 21.

gether. The accumulated dividends are then subtracted from the accumulated premiums (as opposed to the sum of the premiums lessened by the sum of the dividends as computed under the traditional method). The resulting figure is lessened by the cash value, and the remainder is divided by an amount to which a dollar, paid at the beginning of each year in the period, would accumulate, using the same interest rate which was used to determine the accumulated dividends and the accumulated premiums.[25]

As an example of the interest-adjusted method, the same hypothetical will be used as was used in demonstrating the traditional method. The key distinction between the computations under the traditional method and the interest-adjusted method is that under the latter method, the policy holder will be credited with a five percent interest factor (rather than a zero interest factor as in the traditional method) for his premium and dividend dollars:

FOR THE FIRST TEN YEARS:	
Accumulated premiums	$3169.68[26]
minus accumulated dividends	- $534.00[27]
	$2635.68
minus cash value	- 1710.00
	$925.68
divide by an amount equal to the accumulation of one dollar per year at 5% interest, or 13.207, to arrive at the cost, or cost index per year[28]	$70.09
cost index per year per thousand	$7.01

In short, under the interest-adjusted method of cost computation, the same $10,000 policy (if retained for ten years) now has a cost for death benefits of $70.09 per year, as opposed to only $24 under the traditional method. Although the interest adjusted method involves no more than adding an interest factor (in this case five percent per annum) to the traditional method of measuring the cost of life insurance, the difference between the two methods is fundamental. The traditional method assumes that money is of no value until spent, whereas the interest adjusted method assumes that money has potential earning power.

The Joint Special Committee, recognizing that reform was not only necessary but also most likely imminent,[29] recommended voluntary adoption by the

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25. *Id.* at 11.

26. The amount is determined by multiplying $240 by 13.207, as instructed in FINANCIAL COMPOUND INTEREST AND ANNUITY TABLES 670 (4th ed. 1966). Although the Joint Special Committee recommended a four per cent interest rate, the NAIC regulation prescribes a rate of five per cent, which is closer to the current rate obtainable by consumers. *See* 510 IOWA AD. CODE § 15.68(6) (1977). Thus, to be consistent, the examples utilized throughout this Note will use a five per cent rate.

27. FINANCIAL COMPOUND INTEREST AND ANNUITY TABLES 670 (4th ed. 1966).

28. Since the 13.207 figure was used to determine the accumulated premiums, it is also used as the divisor in this step: $925.68 divided by 13.207.

29. For examples of concern within the industry over "reform movements," *see Image*

insurance industry of the interest-adjusted method because: 1) interest is credited to the consumer; and, 2) "[o]f all methods [taking interest] into account, this method is the easiest to understand."[30]

IV. History of the NAIC's Task Force Report

NAIC, also aware of the need for a uniform method of cost determination, became formally involved in the development of a method in 1971. A task force on cost comparisons and price illustrations was appointed, primarily to study the available methods and report to the NAIC subcommittee on life insurance.[31] In its first report, the task force agreed with the Joint Special Committee's conclusion that the traditional method of cost evaluation was faulty, due again to the lack of consideration for interest. However, the task force members believed that the interest-adjusted method of cost evaluation was only a starting point for reform, and that they should begin their search where the Joint Special Committee had ended.[32]

The task force received help from the late Senator Phillip Hart of Michigan, who for years had argued for enactment of a measure which would uniformly and consistently evaluate life insurance costs.[33] Senator Hart, in conjunction with his duties as chairman of the Senate Anti-Trust and Monopoly subcommittee, had previously ordered detailed questionnaires sent to the leading insurance companies (eventually 250 companies were reached) in an effort to receive answers to some critical questions.[34] Senator Hart wanted to know how many life insurance policies lapse,[35] what is the level of consumer understanding of the life insurance industry and of the policies the consumers have actually purchased, and what could be determined about the accuracy of dividend predictions on participating policies. After being computer-analyzed, the answers to the questionnaires were made available to the task force by Senator Hart.[36]

Realizing that the analysis and comparison of such a large amount of complicated data would be an ambitious project, the task force requested NAIC to approve twelve separate research projects, which would evaluate and coordinate the information provided by Senator Hart.[37] These research projects

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of Life Agents is Stung, Journal of Commerce, May 20, 1975; *see also*, White, *Another Perspective—Disclosure and Cost Comparison*, National Underwriters, May 10, 1975.

30. Comm. Report, *supra* note 19, at 21.

31. Iowa was well represented in the effort. Former Iowa Insurance Commissioner William Huff was a member of the NAIC Subcommittee on Life Insurance; his chief actuary, Dan Andersen, headed up the task force which studied the cost analysis methods.

32. II NAIC Proceedings 480 (1972).

33. 121 Cong. Rec. 21476 (1975).

34. *Id.*

35. Allowing a policy to lapse is to breach the contract, and usually occurs by nonpayment of premiums, prior to the point where "cash value" has been accrued. By the Life Insurance Industry's own admission, the lapse rate is almost 21% for policies in force for less than two years, which is quite high. Fact Book, *supra* note 1, at 53.

36. 121 Cong. Rec. 21476 (1975).

37. II NAIC Proceedings 536-38 (1973).

provided the basis for the regulation which was eventually drafted and approved.[38]

Senator Hart was not the only "outside sponsor" from whom the NAIC task force received assistance. Also contributing to the task force's work was the Ad Hoc committee of the Society of Actuaries, and the Joint Special Committee, which had reported to the life insurance industry on the traditional method and the interest-adjusted method of life insurance cost evaluation in 1971.[39] Thus, whatever would be forthcoming in the way of a cost analysis method would have input from several sources.

Perhaps realizing that some justification would be necessary to repel possible court challenges against the necessity of any regulation that would be approved, the task force devoted one of its research projects to an evaulation of consumer awareness of the life insurance industry.[40] If consumer awareness was low, there would seem to be more justification for a measure which would increase that awareness, especially as to the cost of life insurance. The resulting report, however, was perhaps more negative than the task force expected. The conclusion was that the consumer did not know all the differences between *term* and *whole life* insurance, and, when asked to give a rating of their own awareness, more than half of the consumers surveyed admitted they knew very little about life insurance in general.[41]

Not all the reports which were the result of the twelve research projects were as negative as the report on consumer awareness. For example, the effect of dividend payments is an important factor in any method of life insurance cost analysis because: 1) according to the life insurance industry, fifty-nine percent of all the policies in force at the end of 1975 were dividend paying;[42] and 2) since dividends are paid in the future, the amounts of the dividends are only estimates, and if dividends could not be relied upon as consistent measurements of repayment to the consumer, their use as cost analysis factors would frustrate any point of sale method of cost comparison. However, one of the research reports stated,

> our examination of company dividend histories during the last twenty years shows that there has been a reasonably similar set of changes in dividend scales made for the policies included in our study. While by no means perfect, illustrations furnished at the time of sale, based on the dividend scale then in effect, can provide the buyer with a useful method of comparing the relative net costs that may emerge for different policies.[43]

Thus, the report of the task force did provide support for the use of dividends as a factor in a cost evaulation method.

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38. Interview with Dan Andersen, chief actuary of the Iowa Department of Insurance, and chairman of the task force which studied cost analysis methods, in Des Moines, Iowa (May 9, 1977) [hereinafter cited as Andersen interview].
39. *Id. See* text accompanying notes 18-19, 24 *supra.*
40. II NAIC PROCEEDINGS 536 (1973).
41. LIFE INS. MARKETING AND RESEARCH ASS'N & INST. OF LIFE INS., *Life Insurance Consumers; A Review of the Literature* 14 (Dec. 1973).
42. FACT BOOK, *supra* note 1, at 20.
43. THE AMERICAN LIFE INS. ASS'N SUBCOMMITTEE ON COST COMPARISONS, *Reports to the Nat'l Assoc. of Ins. Comm'rs* 2 (Dec. 9, 1974).

V. The NAIC Task Force Report

Although the earlier discussion of the 1971 report from the Joint Special Commitee dealt with only two methods of cost evaluation (the traditional and the interest-adjusted methods), the NAIC task force evaluated thirteen major methods, and found that only two of them, the "linton-yield" and "company retention," could be used to compare one policy with another in terms of cost.[44] Moreover, because insurance cost is based on factors which are unknown at the time of issuance of the policy, namely, the amount of future dividends and whether the consumer will "cash in" the policy or use the cash value to purchase more insurance, the task force concluded that the *true* cost cannot be determined at the time of the issuance of the policy. Rather the true cost can accurately be determined only "after the fact"—after the death of the insured, maturity of the policy, or surrender of the policy, and after the dividends have been paid. And even then, true cost can be determined only to the extent that the individual policy holder appreciates the time value of money.[45] In short, the task force concluded that any method ultimately approved would be imperfect, given the speculative factors involved.[46] However, the task force also realized that a carefully developed method of cost comparison would be of more benefit to the consumer than the current "interest-adjusted" method and certainly more than the traditional method, especially if it is made clear to the consumer that the cash dividends are not guaranteed, but are only estimated.[47]

The task force also concluded that more than one cost index would be necessary to adequately inform the consumers exactly what they were purchasing.[48] Therefore, formulas for determining three major indexes were developed. One index is designed to measure the cost, at the tenth and twentieth year, to those consumers who plan to keep their policy in force until death; this index is labeled "net payment cost" index.[49] The other index, called the "surrender index," is designed to measure cost if the policy is surrendered at the end of the tenth or twentieth year. This latter index incorporates a method whereby the cost of surrender is determined in the same fashion as the cost of life insurance was determined under the interest-adjusted method.[50] This surrender index is to be relied upon by those consumers who consider it likely that

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44. The Society of Actuaries Comm. on Cost Comparison Methods and Related Issues (Special), *Analysis of Life Ins. Cost Comparison Index Methods* 43 (Sept. 1974).
45. *Id.* at 9.
46. *See* II NAIC Proceedings 480 (1972).
47. The Buyer's Guide, *see* notes 64-68 *infra*, makes this fact available to the consumer. 510 Iowa Ad. Code § 15.73, Appendix (1977).
48. Only one cost index was used under the interest-adjusted method. *See* part III *supra*.
49. 510 Iowa Ad. Code § 15.68(6)*b* (1977).
50. The regulation provides as follows:

a. Life insurance surrender cost index. The life insurance surrender cost index is calculated by applying the following steps:

(1) Determine the guaranteed cash surrender value, if any, available at the end of the tenth and twentieth policy years.

(2) For participating policies, add the terminal dividend payable upon surrender, if any, to the accumulation of the annual cash dividends at five percent interest compounded annually to the end of the period selected and add this sum

they will surrender their policy either ten or twenty years[51] after the policy is issued and take the cash value at that time.[52]

Since the surrender index is substantially similar to the index computed under the interest-adjusted method, the major innovation provided by the task force was the inclusion of the "net payment cost" index. This index is determined by using the same formula utilized in the determination of the surrender index, *except that the cash value of the policy is set at zero.*[53] This adjustment changes the result a great deal. For example, as computed previously using the interest-adjusted method, the surrender index is $7.01 for a ten thousand dollar participating policy retained for ten years; but under the method approved by the task force, the net payment cost index for the same policy is $19.96:

FOR THE FIRST TEN YEARS:

Accumulated premiums	$3169.69
minus accumulated dividends	- $534.00
	$2635.68
minus cash value	-0
	$2635.68
divide by the accumulation of one dollar per year at 5% interest, or 13.207	$199.56
divide by 10, the number of thousands of death protection, to arrive at the net payment cost index	$19.96

Finally, a third index was developed by the task force, the "equivalent

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to the amount determined in subparagraph (1).

(3) Divide the result of subparagraph (2) (subparagraph (1) for guaranteed-cost policies) by an interest factor that converts it into an equivalent level annual amount that, if paid at the beginning of each year, would accrue to the value in subparagraph (2) (subparagraph (1) for guaranteed-cost policies) over the respective periods stipulated in subparagraph (1). If the period is ten years, the factor is 13.207 and if the period is twenty years, the factor is 34.719.

(4) Determine the equivalent level premium by accumulating each annual premium payable for the basic policy or rider at five percent interest compounded annually to the end to the period stipulated in subparagraph (1) and dividing the result by the respective factors stated in subparagraph (3) (this amount is the annual premium payable for a level premium plan).

(5) Subtract the result of subparagraph (3) from subparagraph (4).

(6) Divide the result of subparagraph (5) by the number of thousands of the equivalent level death benefit to arrive at the life insurance surrender cost index.

Id. at § 15.68(6).

51. The ten and twenty year figures were selected only because it was considered representative of how long people may plan on keeping the policy prior to surrender. Andersen interview, *supra* note 38.

52. The Buyer's Guide, *see* notes 64-68 *infra* and accompanying text, describes the surrender index as follows:

> 1. LIFE INSURANCE SURRENDER COST INDEX—This index is useful if you consider the level of the cash values to be of primary importance to you. It helps you compare costs if at some future point in time, such as 10 or 20 years, you were to surrender the policy and take its cash value.

510 IOWA AD. CODE § 15.73, Appendix (1977).

53. The regulation states that "[t]he life insurance net payment cost index is calculated in the same manner as the comparable life insurance cost index except that the cash surrender value and any terminal dividend are set at zero." 510 IOWA AD. CODE § 15.68(6) *b* (1977).

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level annual dividend,"[54] which is intended to demonstrate to the consumer how much of the annual premium has been delegated to the illustrated dividend. This figure is determined by taking the accumulated dividends, or $534 according to the same hypothetical. That figure is divided by 13.207,[55] (one dollar accumulated for one year at five percent interest) the result of which is $40.43. Again, as with the other indexes, that figure is divided by ten, the number of thousands of death protection, and the equivalent annual dividend under the policy is determined to be $4.04.[56] The computation basically consists of an averaging of dividend payments over a ten year period. The resulting index represents what portion of the consumer's premium investment is refunded through an annual dividend payment. Furthermore, addition of the equivalent level annual dividend index to the cost index permits the consumer "to compare total costs of similar policies before deducting dividends."[57]

Having approved what it felt was a workable set of computations,[58] the question for the task force then became one of how the information could be presented to the consumer. Without an actuarial background, the consumer would most likely not be able to comprehend the computations.[59] Furthermore,

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54. 510 IOWA AD. CODE § 15.68(3) (1977).
55. *See* note 28 *supra* and accompanying text.
56. The regulation provides as follows:

"*Equivalent level annual dividend*" is calculated by applying the following steps:

a. Accumulate the annual cash dividends at five percent interest compounded annually to the end to the tenth and twentieth policy years.

b. Divide each accumulation of paragraph "a" by an interest factor that converts it into one equivalent level annual amount that, if paid at the beginning of each year, would accrue to the values in paragraph "a" over the respective periods stipulated in paragraph "a". If the period is ten years, the factor is 13.207 and if the period is twenty years, the factor is 34.719.

c. Divide the results of paragraph "b" by the number of thousands of the equivalent level death benefit to arrive at the equivalent level annual dividend.

510 IOWA AD. CODE § 15.68(3) (1977). The regulation further provides:

The "*equivalent level death benefit*" of a policy or term life insurance rider is an amount calculated as follows:

a. Accumulate the guaranteed amount payable upon death, regardless of the cause of death other than suicide, of other specifically enumerated exclusions, at the beginning of each policy year for ten and twenty years at five percent interest compounded annually to the end of the tenth and twentieth policy years respectively.

b. Divide each accumulation of paragraph "a" by an interest factor that converts it into one equivalent level annual amount that, if paid at the beginning of each year, would accrue to the value in paragraph "a" over the respective periods stipulated in paragraph "a". If the period is ten years, the factor is 13.207 and if the period is twenty years, the factor is 34.719.

Id. at § 15.68(4).

57. *Id.* at § 15.73, Appendix.
58. I NAIC PROCEEDINGS 523-25 (1976).
59. The formula for the interest-adjusted (surrender index) method is:

$$ {}_{n}IAC_{x} = \frac{\sum_{t=1}^{n} tPx(1+i)^{n-t+1} - \sum_{t=1}^{n} tDx(1+i)^{n-t} - {}_{n}CV_{x} - {}_{n}TD_{x}}{S_{\overline{n}|}i} $$

THE SOCIETY OF ACTUARIES COMM. ON COST COMPARISON METHODS AND RELATED ISSUES (SPECIAL), *Analysis of Life Ins. Cost Comparison Index Methods* 27 (Sept. 1974).

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there was no assurance that even a mathematically inclined consumer would take the time to apply the formulas. For those reasons, the regulation calls for the actuaries at the insurance companies to apply the formulas to the figures for each individual policy which has been presented to the consumer, then include the indexes in a "Policy Summary" which the life insurance agent would give to the consumer at point of sale.[60] The Policy Summary is a document which includes, in addition to the indexes, the name and address of both the insurance agent and the insurance company.[61] Additionally, since many insurance companies lend money to their policy holders, using the cash value of the policy as collateral, the NAIC regulation requires that the Policy Summary contain the interest rate which will be applied to such a loan.[62] Finally, because many life insurance policies have death benefits which vary from year to year, the NAIC regulation requires insurers to list the death benefits of a policy at

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60. The regulation provides that:

(1) The insurer shall provide, to all prospective purchasers, a buyer's guide and a policy summary prior to accepting the applicant's initial premium or premium deposit, unless the policy for which application is made contains an unconditional refund provision of at least ten days or unless the policy summary contains such an unconditional refund offer, in which event the buyer's guide and policy summary must be delivered with the policy or prior to delivery of the policy.

(2) The insurer shall provide a buyer's guide and a policy summary to any prospective purchaser upon request.

(3) In the case of policies whose equivalent level death benefits do not exceed five thousand dollars, the requirement for providing a policy summary will be satisfied by delivery of a written statement containing the information decribed in 15.68(7), paragraphs "*b*", "*c*", "*d*", "*e*(1)", "*e*(2)", "*e*(3)", "*f*", "*g*", "*j*", and "*k*".

510 Iowa Ad. Code §§ 15.69(1)-(3) (1977). The regulation further states:

"*Policy summary*", for the purposes of this regulation, means a written statement describing the elements of the policy including but not limited to:

* * *

g. Life insurance cost indexes for ten and twenty years but in no case beyond the premium paying period. Separate indexes are displayed for the basic policy and for each optional term life insurance rider. Such indexes need not be included for optional riders which are limited to benefits such as accidental death benefits, disability waiver of premium, preliminary term life insurance coverage of less than twelve months and guaranteed insurability benefits nor for basic policies or optional riders covering more than one life.

h. The equivalent level annual dividend, in the case of participating policies and participating optional term life insurance riders, under the same circumstances and for the same durations at which life insurance cost indexes are displayed.

i. A policy summary which includes dividends shall also include a statement that dividends are based on the company's current dividend scale and are not guaranteed in addition to a statement in close proximity to the equivalent level annual dividend as follows: An explanation of the intended use of the equivalent level annual dividend is included in the life insurance buyer's guide.

j. A statement in close proximity to the life insurance cost indexes as follows: An explanation of the intended use of these indexes is provided in the life insurance buyer's guide.

k. The date on which the policy summary is prepared. The policy summary must consist of a separate document. All information required to be disclosed must be set out in such a manner as to not minimize or render any portion thereof obscure. Any amounts which remain level for two or more years of the policy may be represented by a single number if it is clearly indicated what amounts are applicable for each policy year.

Id. at §§ 15.68(7)*g*-*k*.

61. *Id.* at §§ 15.68(7)*b*-*c*.

62. *Id.* at § 15.68(7)*f*.

the beginning of the tenth and twentieth year of the policy, and at least once for one policy year between the insured's age of sixty through sixty-five.[63]

The insurance agent is also required to provide the consumer with a "Buyer's Guide," a pamphlet which was written by the task force of the NAIC.[64] The guide briefly explains the type of policies available and informs the potential insurance customer how to use the Policy Summary.[65] The purpose of the Buyer's Guide is to dispel at least some of the consumer unawareness concerning life insurance.[66]

Thus, the measure as approved by the NAIC[67] after more than four years of consideration and evaluation calls for the establishment of formulas for three separate indexes to be provided to the consumer by the life insurance agent. The threshold intention of the measure is to allow the customer to evaluate the benefits of the policy in light of some reasonably objective measurement of a policy's value—a measurement of numbers, as they reflect cost.[68]

The Insurance Department of Iowa was one of the first in the nation to enact the NAIC measure as a regulation pursuant to rule making authority.[69] The Iowa regulation is virtually identical to the one developed by the NAIC, and covers only ordinary life insurance transactions, not group or credit life insurance. As could have been predicted, one life insurance company has filed suit, seeking to block the enforcement of the provision.[70]

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63. The regulation provides that the policy summary must include:

The following amounts, where applicable, for the first five policy years and representative policy years thereafter sufficient to clearly illustrate the premium and benefit patterns including, but not necessarily limited to, the years for which life insurance costs indexes are displayed and at least one age from sixty through sixty-five of maturity whichever is earlier:

(1) The annual premium for the basic policy.

(2) The annual premium for each optional rider.

(3) Guaranteed amount payable upon death, at the beginning of the policy year regardless of the cause of death other than suicide, of other specifically enumerated exclusions, which is provided by the basic policy and each optional rider, with benefits provided under the basic policy and each rider shown separately.

(4) Total guaranteed cash surrender values at the end of the year with values shown separately for the basic policy and each rider.

(5) Cash dividends payable at the end of the year with values shown separately for the basic policy and each rider. (Dividends need not be displayed beyond the twentieth policy year.)

(6) Guaranteed endowment amounts payable under the policy which are not included under guaranteed cash surrender values above.

Id. at § 15.68(7)*e*. The influence of Senator Hart in the NAIC regulation is evident in this last requirement of the Policy Summary. Referring to those policies which vary death benefits as "gimmicks," the Senator criticized NAIC for not addressing such policies. *See* 121 Cong. Rec. 21477 (1975). Shortly thereafter, the NAIC task force revised the regulation to include these policies.

64. 510 Iowa Ad. Code § 15.69(1) (1977). *See* note 56 *supra* for the text of this provision.

65. The prescribed text and format of the Buyer's Guide is set out in full in the appendix of the regulation as it is enacted in Iowa. 510 Iowa Ad. Code § 15.73, Appendix (1977).

66. *See* text accompanying notes 40-42 *supra.*

67. I NAIC Proceedings 523-29 (1976).

68. 510 Iowa Ad. Code § 15.66(1) (1977).

69. Iowa Code § 505.8 (1977).

70. American Republic Ins. Co. v. Anderson, No. 7-3522 (Polk Co. Dist. Ct., filed

VI. Conclusion

The disclosure requirements imposed by the NAIC regulation appear fairly simplistic. The pertinent provision states that:

> The insurer shall provide, to all prospective purchasers, a buyer's guide and a policy summary prior to accepting the applicant's initial premium or premium deposit, unless the policy for which application is made contains an unconditional refund offer, in which event the buyer's guide and policy summary must be delivered with the policy or prior to delivery of the policy.[71]

However, the real requirement is the *duty* imposed by the regulation to provide information relating to cost, so that the insurance client can compare policies with some degree of expertise. Such a duty is unprecedented in insurance law. Although case law has established that the insurer does have a definite and explicit set of duties to the insured, such as to use reasonable skill, care and diligence under the circumstances in dealing with the insured, these obligations have been imposed by the courts, rather than by an administrative body.[72] The

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Feb. 24, 1977). Essentially, the plaintiff insurer claims that the Commissioner of the Insurance Department has no authority to promulgate a regulation which places an *affirmative* duty on the insurance companies. The plaintiff points to Iowa Code § 507B.4(1), which prohibits certain conduct as unfair or deceptive acts in the insurance industry, but makes no mention of an affirmative duty on the insurer. Brief re Proposed Life Insurance Cost and Benefit Disclosure Regulation, Submitted to the Administrative Rules Review Committee. The Commissioner argues that one of the prohibitions of § 507B.4(1) is an *omission*, and characterizes the failure of an insurance company to follow the regulation and the type of *omission* which constitutes an unfair trade practice. Departmental Brief in Support of Proposed Life Insurance Cost and Benefit Disclosure Regulation, Submitted to Administrative Rules Review Committee.

71. 510 Iowa Ad. Code § 15.69(1) (1977); *see* note 57 *supra* for the remaining text of the disclosure requirement imposed by the regulation.

72. For example, in Karam v. St. Paul Fire & Marine Ins. Co., 281 So. 2d 728 (La. 1973), the insured requested as much liability coverage as the agent could procure, and although $100,000 in coverage was available, the agent wrote a policy covering the property for only $10,000. After the loss occurred, which exceeded $100,000, the Louisiana court found the agent and the insurance company liable for $200,000 of the loss, stating, "[a]n insurance agent who undertakes to procure insurance for another owes an obligation to his client to use reasonable diligence in attempting to place the insurance requested and to notify the client promptly if he had failed to obtain the requested insurance." *Id.* at 730. Although this language establishes the duty to inform, the statement must be read in its entirety. The duty to inform is imposed as an extension of the duty to use reasonable skill and diligence in dealing with a client's needs, and it is a duty which arises under a given fact situation.

Another example of where an affirmative duty to inform was imposed upon the insurer is found in Hardt v. Brink, 192 F. Supp. 879 (W.D. Wash. 1961). In *Hardt* the court held that while normally the insurer does not have an affirmative duty to advise the client, the fact the insurance agent in this case held himself out as an investment counselor resulted in the imposition of an affirmative duty upon the insurance agent. *Id.* at 880-82. The NAIC regulation attempts to prevent the problem encountered in *Hardt*. The regulation states that "[t]erms such as financial planner, investment advisor, financial consultant, or financial counseling shall not be used in such a way as to imply that the insurance agent is generally engaged in an advisory business in which compensation is unrelated to sales unless such is actually the case." 510 Iowa Ad. Code § 15.70(3) (1977). For an excellent discussion of the expanding concept of liability for negligence and misrepresentation by an insurance agent, *see* Redenbaugh, *Liability Considerations Concerning Insurance Agents and Brokers*, 22 Drake L. Rev. 738 (1973). During NAIC proceedings in 1973, it was proposed that any forthcoming regulation should be designed in part to prevent misleading sales practices. II NAIC Proceedings 534-35 (1973).

cost disclosure requirement of the NAIC regulation is unique[73] not only in its effect but also in its inception. The regulation was not conceived as a result of an increasing number of actions brought against insurers for misrepresentation of cost, but rather was the result of a national trend which carries the somewhat vague nomenclature of "consumerism."

Although the measure has received support from several quarters, it remains to be seen if it will actually benefit the consumer.[74] Several possible problems are evident. First, it is the consumer who must examine and compare the different indexes from different policies, as each Policy Summary contains indexes *only* for that policy.[75] The consumer will be required to compare several different indexes after listening to numerous sales presentations by various insurance agents. It is not known if consumers will be willing to endure the extra sales presentations to be provided with a policy summary. Second, there is no real assurance that the measure will make prices more competitive. As mentioned previously, the indexes provided in a single Policy Summary are of no value unless those indexes are compared with others. If it is true that consumers usually buy life insurance from the sales person with the most persistent, or persuasive sales presentation, it seems safe to assume that many consumers will not look at more than one policy when deciding to buy life insurance, and therefore the companies may find there is little need to become more competitive in price. Third, the formulas approved by NAIC measure the cost of surrender at ten and twenty year intervals. However, many consumers do not purchase life insurance specifically to surrender the policy for its cash value, but rather to adequately protect their family in the case of an untimely death. Therefore, many consumers may place more emphasis on the death benefit, and it is possible NAIC should have devoted more attention to development of a formula which would show the cost of a policy at a point in time as far in advance as forty years after issue.[76]

Finally, the penalty imposed against an insurer under Iowa law for failure to properly provide the consumer with a Buyer's Guide or Policy Summary is

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73. It is not difficult to understand why the "cost comparison" fervor has not and most likely will not sweep all fields of insurance. The "cost" of liability or casualty insurance is what the purchaser pays in minus what is returned in cash value or dividend payments, with adjustments for interest. It would seem that consumers fully understand that if a premium is paid for a casualty or liability policy and the loss does not occur, the premium will not be refunded. Thus, it is accepted that the cost of such a policy is the premium.

74. The regulation has also received some strong criticism. One recognized figure, Professor Joseph Belth of Indiana University, stated that the regulation is heavily weighted in favor of the insurance companies, and called the regulation one which demands "pseudo disclosure." Specifically, Belth said the NAIC regulation provides 1) for no *yearly* price information at the point of sale, 2) no price information beyond twenty policy years, 3) no breakdown between the savings elements and the protection aspect of the policy, and 4) no rate of return information, thus perpetuating consumer ignorance about the rate of return on the savings elements in cash value policies. Belth, *NAIC has already Fallen Into Life Insurance Trap*, NAT'L UNDERWRITER, June 25, 1977, at 21, 24.

75. 510 IOWA AD. CODE § 15.68(7) (1977).

76. However, it can be argued that a determination of cost 40 years in advance would involve a large amount of speculation.

a cease and desist order issued by the Commissioner of Insurance, and possibly a monetary penalty and/or revocation of the insurer's license to engage in the insurance business.[77] However, the regulation itself is silent as to any possible remedy for consumers who are subsequently injured because their insurer failed to provide them with the Buyer's Guide or Policy Summary. Therefore, a consumer who believes a cause of action exists against the insurer for failure to disclose cost information as required by the regulation must resort to case law for support. Even if successful, the consumer will probably be limited to the remedy of rescinding the contract and receiving a refund of all premiums paid, because in order for an equity court to order reformation of the contract, it must be established that there is a valid prior agreement between the parties by which the contract can be reformed.[78] Establishing that prior agreement is a difficult proof problem that most consumers may not be able to overcome. Furthermore, any argument for damages may also fail because ascertainable damages may be too speculative. It seems that NAIC should have given more thought to protection of the consumer in the event of non-compliance by insurance agents.

On the other hand, the measure should be considered, at the least, acceptable by the insurance industry. As mentioned, a Joint Special Committee of insurance executives had previously recommended adoption of the interest-adjusted method, a method which the Joint Special Committee[79] was successful in persuading the task force of NAIC to adopt in computing the surrender cost index. Furthermore, it seems the measure does not discriminate between large and small insurance companies, nor will it present an advantage for insurers in one state over those in another,[80] provided that all states eventually adopt the NAIC model.

Perhaps the best method of analyzing the NAIC model regulation is not from the standpoint of how much good it will do as a matter of certainty; rather, it might be best to ask how much harm the measure will do. It probably will not additionally confuse or misinform consumers, and, as mentioned, insurance companies should be able to function effectively under the NAIC measure's prescriptions. It seems the worst that might be said for the measure is that it may have little beneficial effect. However, the task force understood this when it admitted that the measure it would approve would contain less than perfect

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77. *See* 510 IOWA AD. CODE § 15.71 (1977); IOWA CODE §§ 507B.4, .7, .11 (1977).

78. *See* D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES § 4.3, at 256 (1973).

79. It must also be remembered that the Joint Special Committee worked closely with the task force.

80. To perhaps provide "incentive" for the insurance industry to cooperate with the NAIC and eventually accept the regulation, Senator Hart introduced bills which would be much more stringent with the insurance companies. *See* S. 2065, 94th Cong., 1st Sess., 121 CONG. REC. 11977-80 (1975). Although at first glance it may seem that the cost disclosure problem is one which involves interstate commerce and as such is in the particular domain of the Congress, it is widely accepted that states have the right to regulate insurance, including sales practices, occurring within their own borders. *See* 15 U.S.C. § 1012 (1970); S.E.C. v. National Securities Inc., 393 U.S. 453, 460 (1969).

formulas.[81] Nevertheless, the task force still felt the measure was worthwhile, and if it is apparent that the regulation will cause little harm, it is logical to conclude that any benefit it brings to the consumer will represent movement in the right direction.

John Newell

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81. *See* note 46 *supra* and accompanying text.

Case Notes

DISABILITY INSURANCE—A CHRONIC ALCOHOLIC'S SOCIAL SECURITY CLAIM CANNOT BE DENIED UPON THE BASIS OF EITHER A LACK OF SIGNIFICANT ORGAN DAMAGE THAT PRECLUDES WORKING OR CLAIMANT'S ABILITY TO REMEDY HIS AFFLICTION VOLUNTARILY.—*Adams v. Weinberger* (8th Cir. 1977).

Claimant Adams filed his application to establish social security disability on October 17, 1972. The application was considered,[1] and reconsidered by the Secretary of Health, Education and Welfare (Secretary) and denied. Adams requested a hearing, which was held September 16, 1974. At the hearing, Adams testified that he commenced having blackouts in 1971, and that he was having trouble with diarrhea and involuntary nodding and sleeping. Adams further testified that he had been a heavy drinker, but since then he had only drunk beer. Adams stated to the administrative law judge that he continued to drink because "I enjoy it, and I don't think the beer hurts me, particularly."[2]

Medical evaluations, based upon examinations given by physicians between 1971 and 1974, indicated that Adams was suffering from chronic alcoholism, cirrhosis of the liver and emphysema.[3] Most of the examining physicians were of the opinion that Adams was disabled. However, one thought that he was competent to manage his own affairs, but lacked the necessary motivation.[4]

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1. An individual who believes he is eligible for social security benefits because he is disabled initiates the procedure by filing a statement of his intention to claim benefits. The Social Security Administration or a state agency will determine the claim's validity. If an individual's claim is denied, he may request an opportunity for reconsideration. A claimant whose claim is denied upon reconsideration may request a hearing before an administrative law judge. If the administrative law judge denies the disability claim, the claimant may request a review by the Appeals Council. The decision of the Appeals Council becomes the final decision of the Secretary of HEW. Having exhausted his administrative remedies, the claimant then can file suit in the United States District Court pursuant to 42 U.S.C. § 405(g) (1970). *See* Champagne & Danube, *An Empirical Analysis of Decisions of Administrative Law Judges In The Social Security Disability Program*, 64 GEO. L.J. 43, 44 (1975).

2. Adams v. Weinberger, 548 F.2d 239, 245 (8th Cir. 1977).

3. Normally, the decision of the hearing examiner or administrative law judge will be based upon reports submitted by the examining physicians. It is not uncommon for the medical opinions of the examining physicians to differ greatly as to the extent of claimant's disability. *See* Richardson v. Perales, 402 U.S. 389 (1971).

4. Adams v. Weinberger, 548 F.2d 239, 242 (8th Cir. 1977). Perhaps the basis of this physician's opinion was Adams' vocational and educational background. Adams was born in 1924. Prior to February 1971, Adams had been employed as a schoolteacher, sales clerk, insurance salesman, area consultant for the Tuberculosis Association, welfare case worker and watchman. *Id.* at 240. With this type of background, it could be presumed