LIFE INSURANCE: INDUSTRY STRUCTURE, REGULATION AND THE CONSUMER INTEREST

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PREFACE

The study "Life Insurance: Industry Structure, Regulation and the Consumer Interest" was prepared for the Consumer Research and Evaluation Branch, Consumer and Corporate Affairs Canada, by Dr. Phelim P. Boyle of the University of British Columbia.

This report contains a detailed account of the complicated institutional relationships underlying the retail life insurance market in Canada. In addition, the various products and product trends are examined and analyzed in detail. The nature of the regulatory system is probed and an attempt is made to isolate issues affecting the consumer interest. The concluding chapter identifies consumer needs and problems in life insurance markets.

Although this study was prepared in 1977, its publication was delayed to permit publication with complementary empirical research. Accordingly, the references to the existing literature and the empirical data cited reflect the date of its writing. This situation does not impinge upon the worth of this report as a comprehensive introduction to the consumer issues.

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EXECUTIVE SUMMARY

The purpose of this study by Dr. Phelim A. Boyle is to point out problems facing the Canadian consumer in the life insurance market. Basically, those problems are defined by Boyle to be anything which might impede the informed choice by consumers in that market. The author first considers United States Senate hearings into the nature of the life insurance industry as well as a report done for the Ontario Government regarding certain public aspects of the relationship between insurers and insured. A detailed examination of life insurance products and trends follows. Next is an examination of the regulatory system and the various inter-relationships between levels of government (as regulators) and the life insurance industry. Finally, the author attempts to identify areas where consumers encounter particularly serious problems.

Chapter 1

The first Chapter of this study is a background statement and review of the literature as well as a summary of the U.S. Senate Sub-Committee (Hart) Hearings of 1973 and 1974.

The Carruthers report, submitted to the Government of Ontario in 1973, contends that product proliferation and the complexity of products coupled with the lack of price disclosure at the retail level, do not afford consumers an opportunity to compare insurance contracts and their associated costs.

Carruthers' analysis of the problem relies heavily on complaints regarding the distribution system ranging from the actions and training of agents, structure of commissions, attitudes of companies in dealing with customers to lack of disclosure of sales costs.

Carruthers' proposals included price disclosure, policy standardization, permiting an agent to represent more than one company, a more sophisticated licencing system, more government involvement in the training process, disclosure of commissions, and recommendations regarding retention of information about agents as well as a suggestion to keep the acquisition costs separate from the premium payment.

Boyle's main criticism of Carruthers' report is that it does not display a deep technical understanding of the main life insurance products. However, he recognizes that Carruthers does

identify a number of aspects in the life insurance market which can lead to potential consumer problems.

Another criticism of the Carruthers report is that it does not make clear which solutions are related to which problems. Neither, according to Boyle, is it clear what the policy implications of the proposed solutions might be.

Perhaps the most comprehensive investigation of consumer life insurance problems came during 1973 and 1974, when Senator Philip A. Hart conducted an inquiry into life insurance problems for the U.S. Senate Anti-Trust Sub-Committee. Hart's report amounts to more than 3,000 pages of information, including submissions made by individuals, transcripts of testimony and cross-examination, and various research documents prepared for the sub-committee.

Among the Hart Sub-Committee witnesses was Ralph Nader, whose main arguments were that: a) life insurance fails to protect consumers from the financial risk of premature death. Nader cited evidence and statistics from the famous Widows' Study, which found that although 92% of widows received some form of life insurance from deceased spouses, 52% of a randomly drawn sample received less than $5,000 in benefits. b) life insurance salesmen generally dupe consumers into buying too much whole life insurance, that is, consumers are not aware of the split between savings and pure protection. c) Nader suggested that the lack of price competition in the distribution system for life insurance was a "national disgrace." Finally, Nader recommended the establishment of federal standards for life insurance and the expansion of social security death benefits.

Hart's next major witness was Professor Joseph M. Belth of Indiana University, who contended that the market for life insurance in the United States is ladened with deceptive trade practices. Belth advocated what he calls the Company Retention Method. This method analyzes the premium for whole life participating policies and for components corresponding to savings, protection, costs of illustrated dividends and amount retained by the company. In addition, Belth proposed an information disclosure system which would ensure policy holders of printed information giving future details of annual premiums, policy face amounts, cash surrender values, dividends, etc.

Other witnesses called to the Sub-Committee included Ernest J. Moorehead, President of the Society of Actuaries, who criticized the Interest-Adjusted Method which could be manipulated by unscrupulous insurance companies through increasing cash values at certain times. Mr. Moorehead also advocated more disclosure of information to the consumer.

Several other witnesses appeared and spoke in their capacity as regulators of the industry. Professor Spencer Kimball of the University of Chicago Law School discussed problems with "transparency of the market" and recommended solutions already implemented in Germany which essentially consisted of standardization of insurance contracts. He also commented on the publication of shoppers' guides, calling them somewhat premature, in that they tend to over-emphasize price in relation to other important considerations.

Dr. Mark Dorfman exhibited empirical evidence of the lack of consumer understanding in the life insurance market. He concurred with Kimball's suggestion that the information barrier would be lowered by adoption of standard policies which would allow consumers to make more informed choices and would stimulate price competition.

More detailed discussion of the testimony of these people as well as Professor Boyle's comments can be found in the text of this report.

This report then goes on to consider Canadian research on consumer problems in life insurance, pointing out that very little recent work has been done in the area. Among the works reviewed are studies by Claxton and Ritchie, in which life insurance was ranked as the third most difficult product from the viewpoint of consumer purchasing; work by Cameron on Rate of Return in Life Insurance which indicates that if a policy holder should surrender a policy in its early years, the return can likely be negative; work by Jacques Babin of the Economic Council of Canada dealing with rates of return from life insurance which corroborates Cameron's findings on negative returns in the early years due to front-end loading of these contracts; and finally a study by Geehan which investigated economies of scale in the life insurance industry and concluded that significant returns to scale do not exist in the Canadian industry, that taxation tends to shield smaller firms, and that consumer ignorance tends to permit wide variations in prices and unit costs to endure.

Chapter 2

The second chapter of this report analyzes the products available in the life insurance market. Term, whole life, and endowment contracts are considered and their merits and disadvantages are analyzed. Boyle also discusses the benefits of participating versus non-participating contracts.

There is also reference to contracts which permit the policy holder to bear all of the investment risk, based on experimental work done in the U.K. and Holland. These are known as "equity-based" contracts, and their main feature is that the premiums earned in respect of the policies are invested in a separate pool of assets, i.e., separate from the insurance company's main funds.

Next are adjustable whole-life contracts, a new type of insurance sold in Canada under which the insurance company retains the complete investment risk for the initial five-year period. Usually, with these contracts the assets backing them up are invested in bonds or mortgages which have a five-year maturity period. At the end of the five years the benefits under the insurance policy will increase if interest rates have risen or correspondingly will decrease if rates have dropped. In addition, those changes will be reflected by changes in the sum assured.

The discussion then turns to the evolution of the life insurance industry into three distinct classes of business: industrial, ordinary and group. In that context, the asset structure as well as insured amounts per capita are examined for the different classes of insurance and comparisons are drawn.

The relatively slow growth of life insurance industry assets in recent years is discussed and several explanations are advanced. For example, it is suggested that the swing toward pure protection insurance (i.e., term and group life) would be a reason for this slow exhibited growth of assets. The reason for this is that such contracts yield a lower premium volume than whole life contracts.

The chapter concludes with a short discussion of annuities and the growth in registered retirement savings plans as well as government and private pension plans.

Chapter 3

The third chapter deals with a review of insurance regulation in Canada at the federal and provincial levels.

The Canadian and British Insurance Companies Act, The Foreign Insurance Companies Act, and The Department of Insurance Act are the federal statutes governing the operation of the insurance industry in Canada. The basic intent of that legislation is to set up safeguards and controls to prevent insurance companies from becoming insolvent.

Basically, that is accomplished through statutory restrictions on the valuation basis which companies are permitted to use in the calculation of their liabilities and the imposition of restrictions on investments which insurance companies are permitted to hold in asset portfolios. The author points out that the use of low interest rates in calculating net premium valuations usually results in a reduction of the effective return to the consumer. After a fairly detailed discussion of the effects of low interest rates in the company calculations, Professor Boyle recommends further research on this topic.

Section 3.1.2 of this report contains a detailed discussion of the nature of restrictions on life insurance company portfolios. The author criticizes the 1977 federal legislation introduced in this regard as not being the most efficient way of preserving solvency. In particular, he makes suggestions concerning minimizing risk, which rely on portfolio theory, rather than the present system which permits only low individual risk instruments. He points out that while certain of these contracts appear riskless in long run nominal terms, in an age of inflation there is a great risk indeed in terms of preservation of value.

The method of licencing and testing prospective salesmen comes under sharp criticism in this report. In particular, it is pointed out that in its current form the examination generally requires a low level of product knowledge. It is suggested that recent changes to legislation in Canada tend to improve the situation.

The theory of legislation and the role of consumer groups in that process are also examined. It is suggested that the consumer has been looking in from the outside while insurance regulations have been justified by very broad appeals to the public interest. Boyle suggests that given the nature of the process the regulator and the regulated come to measure their effectiveness by their impact on each other and that, very often, the regulator tends to develop a cosier relationship with those he is regulating then with the public he is purported to be protecting. It is also pointed out that the insurance industry becomes a special case because the process of inter-action between public interest groups and the industry is further impeded by the fact that many of the technical experts in the field work for the industry.

The third chapter ends on a cautiously optimistic note, citing examples of improvements to the life insurance marketing situation, such as movements toward more disclosure and increased competition, but wondering aloud about how the consumer interest will be represented in the future.

Chapter 4

This chapter analyzes consumer needs in relation to the life insurance market. In particular three broad categories are treated: 1) information needs regarding the amount and type of life insurance required; 2) information needs with respect to the types of products available and their principal features; and 3) consumer needs in relation to the distribution system.

The main thesis of this chapter is that consumer needs relating to information, product knowledge, and the distribution system have certain inter-relationships. It is stressed that the consumer ought to consider his overall lifetime financial plan when deciding on the amount of insurance money required at death. The job of estate planning requires that one estimate the probable death and retirement benefits payable from different sources, such as private savings, life insurance policies, registered retirement savings plans, employee pension plans, Canadian Pension Plan, the Old-Age Security Program and the Guaranteed Income Supplement.

In addition, the consumer, even if he is successful in estimating his financial needs at death, must still deal with the problems of inflation and taxes. To do this, a proper discount rate must be used to assess the real return from future income streams. In this study a rate of 3% per annum is used. A fairly detailed discussion follows on the difference between nominal and real income protection streams along with an empirical example.

The ideal distribution system is depicted as one in which conflicts of interest are removed. Under the present system the same person who evaluates your insurance needs and recommends a particular contract receives compensation on the basis of what you buy. It is proposed that the model of physicians recommending certain medicines and pharmacists dispensing those medicines independent of the physician might be applied to the distribution of life insurance. The main point is that whatever system is in place, that system must enable consumers to access unbiased reliable information about life insurance at a reasonable cost.

Regarding the current situation in Canada, the present system of distribution provides little opportunity to shop around for life insurance products. The fact that significant price differentials persist is suggested by the author to be evidence that consumers do not engage in price search in the life insurance market. Evidence of price dispersion is provided in chapter 4.

Reference is made to a study by Rappaport on the problems in the U.S. market, which could apply to the Canadian situation: 1) it is very difficult for a new agent to get started. On average, fewer than 15% of newly hired agents become successful; 2) lapse rates are higher than desirable; 3) minimum deposit insurance is often sold when term should be sold instead; 4) the rewards to the agent for selling very large and very small policies are unrealistic relative to the effort required to make the sale; 5) vested commissions are paid to agents who no longer have any connection with the company and no longer provide any services to policy holders; and 6) policy holders do not receive services they are paying for when agents leave the business. An empirical investigation of Rappaport's contentions in the Canadian context is recommended.

Product comparison is difficult because much confusion exists. For example, given two seemingly similar whole life policies, it may be that the company with the higher annual premium has higher cash surrender values or larger anticipated dividends or both. Then to compare prices the consumer must evaluate two distinct payment streams each comprised of some components which are guaranteed and some which are not. Hence, the buyer must make assumptions concerning 1) the appropriate discount rate; 2) mortality assumptions; 3) surrender (lapse) assumption; 4) the individual's tax position; 5) utility preference; 6) size of anticipated dividends.

Introduction

The purpose of this study is to analyse the main problems facing the Canadian consumer in the life insurance market. A major aim of the study will be to identify and investigate factors which operate against informed choice by consumers. It is hoped that this study will be of assistance in the development of possible solutions to these problems and in the evaluation of the impact of these solutions. In addition, it is hoped the study will pinpoint areas where future research is required.

The layout of the study is as follows. The first part consists of four Chapters. Chapter I provides a review of some related research in this area. In Chapter II there is an analysis of the main life insurance products, and a discussion of current trends and practices. Chapter III looks at the current system of regulation and some of its consequences from the viewpoint of the consumer. Chapter IV contains an analysis of consumer needs and tries to identify the sources of consumer problems in this area.

1. Background and Literature Review

In the past decade, there has been an increasing awareness of some of the difficulties confronting the consumer in the area of life insurance. In the United States, a considerable volume of published material details some of these problems. In Canada, discussion has been somewhat less, although it appears there is increasing, concern on the part of consumer associations, Governments and the life insurance industry about the magnitude and extent of consumer problems in life insurance. The material published to date seems to indicate that many of the problems faced by the Canadian consumer are similar to those faced by his U.S. counterpart. In this part of the study there will be a review of some of the more important material which has appeared in recent years. The purpose of this review is to comment on the studies as well as to identify the main issues that have emerged.

1.1 The Carruthers Report

This report [1] was commissioned by the Ontario Government to analyse certain aspects of the relations between insurers and insureds with specific regard to the public interest. Report No. 1 (which dealt with life insurance) was submitted on December 12, 1973. On pages 18-22 the Report lists twenty specific characteristics of the life insurance market which cause problems for the consumer.

The report contends that because of product proliferation and complexity and the lack of price disclosure consumers cannot in general compare contracts or their associated costs.

Carruthers suggests that most of the problems facing the consumer arise from certain industry characteristics and practices, particularly those relating to the distribution system. They include:

- agents representing just one company.
- majority of sales force (agents) poorly trained and educated.
- recruitment and training geared to company interests not consumers.
- low level of product knowledge required to obtain a license.
- industry competition for salesmen.
- very high turnover of salesmen.
- existence of high lapse rates.
- industry reliance on field agency system rather than direct selling.
- commission structure tends to promote sale of higher cost products.
- lack of disclosure of sales costs.
- distribution system does not permit sale of other forms of investment.
- distribution system allows for very little if any post sales service.
- distribution system discourages existence of independent experts.
- contractual relationship with company seeks to encapture the agent.
- the attitude towards policy switching not in consumer's interest.
- words like premium, agent, dividend, etc. do not have usual meaning.
- sales force can hold itself out as independent when they are not.
- a distribution system which pays commission whether it is desired or not.

While Carruthers does not present detailed statistical evidence to support these points it seems clear to this writer that they are valid observations. Since the report was written some changes have occurred. For example, some provinces now permit multi-company representation by agents. The Canadian Life Insurance Association, which represents the insurance companies, has recommended certain changes to its membership with the object of helping consumers. Although the Carruthers report dealt specifically with Ontario, it is felt that most of the observations apply to the remainder of Canada.

Carruthers sets out twelve proposals which would help alleviate the consumer's problems. These include:

1. Price disclosure
2. Standardization of policies
3. Multi-company representation
4. Multi-product licencing
5. Step licencing
6. Licenses that restrict product that can be sold by holder
7. System of brokers and independent consultants
8. Creation of a sales force independent of the industry and paid for by the consumer
9. More government involvement in training
10. Upgrading industry information re lapse rates, agent retention, historical accuracy of projected dividends, disclosure of commission
11. Information concerning an agents' lapse rate (i.e., percentage of lost business) to be obtained for renewal of licence
12. Acquisition cost to be separate from premium and paid directly by purchaser

This report is useful in the sense that it represents an independent study of problems facing the Canadian consumer in the life insurance market. It pinpoints some of the major issues. However, the report is not comprehensive or particularly well structured. Not all the problems have been identified and those that are mentioned are not substantiated by statistics. At times the report does not portray a deep technical understanding of the nature of the main life insurance products. However, it is contended that, making allowance for certain changes which have taken place since 1973, this report does identify a number of aspects of the life insurance market which lead to consumer problems.

As Carruthers points out the proposed solutions have not been worked out in detail. It is not clear which particular problem or subset of problems each suggested solution is supposed to deal with. Neither is it clear what the policy implications of these solutions would be. For example what does "price

disclosure" mean? What precise form should it take and how exactly should it be implemented? In summary, Report No. 1 is successful in pinpointing some of the major problems but it fails to formulate the solutions in a satisfactory manner.

Carruthers prepared three additional reports [1]. Report No. 2 reviewed some practices of the Insurance Act and Regulations; Report No. 3 analysed problems in the other than life field. Report No. 4 proposed a new regulatory model for both life and non-life business. The basic objectives set out for the model were

> First, a buyer of insurance must have available a great deal more information before he buys than he now gets. This is a large and complex problem. Without a thorough and radical approach to the disclosure issue, the position of the consumer is unlikely to be much improved.
>
> Second, a body of advisors to consumers of insurance must be allowed to develop. Disclosure of adequate information to consumers is not enough. They must have access to unbiased and expert advisers who will act on their behalf to interpret the information.
>
> Finally, the system must allow the development of a wide variety of techniques for the marketing and distribution of insurance contracts and the delivery of services, a variety or mix that can be expected to change over time as conditions change.

To accomplish these objectives, Carruthers recommends a new system of regulation with greater emphasis on self-regulation and licensing of insurance intermediaries and new functions and roles for certain of these intermediaries. These can be summed up as follows:

- redefinition of roles, term "agent" to disappear.
- sales representative to work for insurer, brokers to serve insurance buyers and work on a fee basis.
- some simple summary disclosure.
- standard contracts for basic needs.
- non-standard contracts to disclose modifications from standard.
- detailed disclosure for expert analysis.
- a new regulatory system based on a combination of self regulation and licensing.

Report No. 4 also makes a large number of other suggestions and recommendations. In particular, it makes certain recommendations concerning disclosure. The Appendix to the report elaborates these disclosure requirements. It would appear

that a number of these requirements are more appropriate and more easily applicable to other than life contracts. In connection with life insurance contracts the Report does not come to grips with the practical and technical problems involved in coming up with disclosure regulations. For example, the discussion on how the expected monetary value of the benefits is to be computed ends with a series of issues that are really unresolved questions. The question of the savings/protection features of whole life does not appear to have been satisfactorily addressed. Very often a particular recommendation is followed by a host of issue questions which means that the recommendation is seldom pinned down.

In connection with the disclosure of information on past performance, Carruthers suggests that the dividends paid out on participating contracts be compared with those that were illustrated at the actual time of sale. It is true that the accuracy of dividend illustrations is important in the context of life insurance disclosure and cost comparison methods. However, it is not clear to what extent an ex post analysis is a valid indicator of future performance. The extent to which increased emphasis on cost disclosure might induce a company to pay dividends to new policyholders rather than existing policyholders is not discussed. This particular aspect of equity does not seem to be taken into consideration in most of the literature in life insurance disclosure methods. It has to be remembered that existing policholders are consumers too.

1.2 The Hart Sub Committee Hearings

During 1973 and 1974, the U.S. Senate Antitrust Subcommittee under the chairmanship of Senator Philip A. Hart conducted a comprehensive inquiry into consumer problems in the United States life insurance market. The completed report consists of four volumes amounting in total to 3011 pages. These volumes include copies of the submissions made by individuals and interested parties, records of the oral testimonies and cross examinations, various exhibits and research papers. They also give details of a comprehensive life insurance industry pricing study that was carried out by the Subcommittee. Because of the sheer volume of material involved, it is not possible to present a detailed summary of the report. Instead, there will be an analysis of the more important parts of this report.

Although there are some important differences between the United States and the Canadian life insurance markets, both markets have a great number of common features. For example, a number of Canadian companies write business in both countries and in 1975 there were 69 United States companies writing life

business in Canada. (These 69 companies accounted for 15.5% of total premium income in the Canadian market [3]). Consequently, the findings of the Hart Sub Committee will also have considerable relevance for the Canadian consumer.

Part 1 of the report of the Hart Sub Committee Hearings contains statements of Senator Philip A. Hart, Senator Roman L. Hruska, Ralph Nader, Joseph M. Belth and E.J. Moorhead.

Nader's main points were

1. Life insurance fails to sufficiently protect its ultimate consumers from the financial risk of premature death. As evidence he cited statistics from "The Widows Study" conducted by the Life Underwriter Training Council and the Life Insurance Agency Management Association and published in 1970. This study revealed that fifty-two percent of a representative sample of all widows received less than $5000 in benefits even though 92% were covered by some form of life insurance.

2. Through deceptions and inadequate information the life insurance industry dupes consumers into buying too much whole life insurance. The average consumer doesn't know the split up as between savings and pure protection. He suggests that the plan which is best for the company and the agent is not necessarily best for the consumer.

3. Mr. Nader suggested that the cost of the distribution system for life insurance products, in the context of a market with virtually no price competition, was a national disgrace. He noted that the industry frequently made reference to the high costs of selling and the failure to find, keep and adequately compensate life agents.

To rectify these problems, Nader recommends the establishment of Federal standards, yardstick competition through State or Federal life insurance funds to promote quality competition. In addition, he recommended the expansion of social security death benefits.

It would appear that Mr. Nader's basic criticisms are in order. Although he tends to use flamboyant language and does not always buttress his claims with adequate empirical evidence, his basic analysis appears correct. This is borne out by an analysis of the cross-examination of Mr. Nader by members of the Sub Committee. It is of interest to draw attention to an amazing attempt by Mr. Chumbris, minority counsel to show that a person who lapses a whole life policy within the first two years may actually save money. This occurs on page 209 of Mr. Nader's testimony. In my opinion, Mr. Chumbris' arguments are incorrect.

The next witness was Joseph M. Belth, Professor of Insurance, Graduate School of Business, Indiana University. Dr. Belth contended that the market for individual life insurance in the United States is characterized by "ignorance, complexity and apathy". He illustrated a number of specific examples of deceptive sales practices. Some of these involved the comparison of amounts payable at different points in time without reference to compound interest, while other practices were patently false. In the main, these practices were to be found in articles in various trade and company magazines directed at life insurance agents. Normally, the effect of these illustrations was to show whole life-insurance in a very favourable light and thus make it somewhat easier to sell. Dr. Belth outlined some of the problems associated with price measurement and disclosure, and briefly described his own method which is called the Company Retention Method. Essentially, this method analyses the premium for a participating whole life policy into four components corresponding to the savings element, the protection element, the cost of illustrated dividends and the amount retained by the life insurance company. He also outlined a proposed information disclosure system. Each policyholder or potential policyholder would receive a two page form. The first page would give for each future year details of the Annual Premium, the Face Amount of the Policy, the Cash Surrender value, the Illustrated Dividend, the Amount of Protection (Face Amount minus Cash Value) and the Yearly Premium (per $1000) for protection. The second page gives details of the present value of the gross premiums using 5% p.a. interest, the 1957-60 Ultimate Basic Mortality table and certain lapse assumptions. It also analyses the premium into the four components of the Company Retention Method. The second page also gives details concerning the rates of interest used to convert yearly premiums to semi-annual premiums etc., and details of the rate of interest charged on policy loans. Dr. Belth also recommends that policyholders be shown not only the dividend payable in a given year but also the dividend that would have been payable under the illustration given to him at the time of sale.

It seems to this writer that the disclosure system advocated by Belth has certain drawbacks. For the average consumer it contains too many numbers and not enough descriptive material. However it should be possible to compress the numbers into standardized indices and use graphical representations.

The last portion of Part 1 deals with the testimony of Ernest J. Moorehead. Mr. Moorehead has been President of the Society of Actuaries and has extensive experience in the life insurance industry. Until 1972, he was Chairman of the Joint Special Committee on Life Insurance Costs formed by the three major life insurance company organizations. His testimony is

considerably more balanced than that of the two previous witnesses. For that very reason his criticisms are all the more telling.

Mr. Moorehead pointed out that it is usually impossible for a life insurance consumer to make valid comparisons with other policies. He outlined the so-called Interest-Adjusted Method which had been recommended by the Joint Special Committee. This method represented an improvement over the so-called traditional Net Cost Method which completely ignored compound interest. Mr. Moorehead drew attention to some of the drawbacks of the Interest Adjusted Method and observed that it could be manipulated by an unscrupulous company by increasing cash values at certain pivotal durations. In connection with the information to be disclosed to the consumer, Mr. Moorehead stated on page 705

> No, I am in favour of an index presentation. It is designed to go beyond that, that I am speaking. In addition to giving it to him (the consumer), we must help him understand that prices do differ, and we must give him access to some means of determining whether that particular figure that he is presented with is just about the prevailing rate, or whether it is high, or whether it is exceptionally low, that is whether it is a 'good buy' or not.

Concerning the question of whole life versus term insurance, Mr. Moorehead suggested that to the extent the life insurance industry had expressed itself in favour of whole life insurance rather than term, the motives were good ones. He stated that there was a conviction that if an individual bought term insurance he would not have resources for retirement. The industry also believed that the semi-compulsive nature of the savings element is desirable. Thirdly, the industry felt that term insurance was unlikely to be in force when death occurred. Mr. Moorehead was careful to point out that he did not necessarily support these views but that they appeared to be sincerely held.

The first section of Part 2 is devoted to the testimony of Mr. T. Fuller, President of the Savings Bank Life Insurance Fund, New York and statements on behalf of other Savings Bank Life Insurance Companies. These organizations sell low priced life insurance in certain U.S. states. The product is sold over the counter by regular salaried bank employees and by mail without the use of commissioned agents. This in essence accounts for its very low price. There are state limitations on the amount of Savings Bank Life Insurance that any one insured individual can carry. Purchase of insurance can be made only in the State in which an individual lives and works. Every time the

Savings Bank Life Insurance companies attempt to raise the individual limits, they are vigorously opposed by the life insurance companies and agents. The following newspaper extract, which was quoted in an article on savings bank life insurance on page 907 of Part 2, gives some idea of the type of opposition

> Insurance men Thursday gave the Capitol its biggest and noisiest hearing of this legislative session.
>
> About 500 of them showed up to a Banking Committee hearing to oppose a bill that would raise the ceiling on savings bank life insurance from the present $5000 to $15,000.
>
> They filled every seat in the Hall of the House and its gallery and stood as many as 10 deep in the aisles. And they cheered, applauded, booed, hissed and catcalled during testimony.

At the present time acorresponding product does not exist in Canada. It is safe to assume that any move to introduce such would be opposed by the life insurance industry. However, on the basis of all the evidence presented at the Hart Sub Committee hearings it seems that they provide very low cost life insurance protection. From a consumer's viewpoint, this would seem to be a valuable benefit.

Mr. Stanley Durose Jr., Insurance Commissioner for the State of Wisconsin, testified on behalf of the National Association of Insurance Commissioners. He discussed the current situation with regard to cost disclosure and mentioned some of the problems involved. These include not only the difficulty of finding an acceptable comparison basis but also the problems associated with collecting financing and disseminating inter-company competitive cost data for consumers. During the cross examination of Mr. Durose, it transpired that some of the comments on one of the exhibits relating to cost comparison difficulties had been supplied by an actuary from the Northwestern Mutual on what was termed "a pro bono publico basis".

Spencer L. Kimball, Professor of Law at the University of Chicago Law School and an expert on insurance law and regulation testified at the request of Senator Hart.

Professor Kimball drew attention to the concept of "Markttransparenz" or "transparency on the market" which had been developed by German insurance regulators. One German device for improving the transparency (or efficiency) of the market is the standardization of insurance contracts. Kimball stated that in the American market "Price competition is greatly muted; it can hardly be said to exist at all." However, in his view, it was

desirable to improve the situation by implementing an effective price disclosure method rather than by standardization of contracts. Kimball opposed limitations on the sale of group life insurance and suggested that mass marketed group life insurance can most effectively provide insurance protection for the majority of American citizens during the years that their family obligations are greatest.

Commenting on the publication of the Shoppers' Guide by the Pennsylvania Insurance Department, Mr. Kimball noted the widespread interest it aroused. However, he felt that its preparation and promulgation were premature, that it tended to overemphasize price in relation to other important considerations. He stressed that such guides should be scrupulously fair to the insurance companies.

In discussing the question of whether or not price disclosure might lead to self-service insurance buying Kimball observed

> It is undeniable that the potential exists for the obscuring of the value of good agents. But there is also room for skepticism on the question whether the present marketing structure of life insurance, with agents compensated by commission, provides disinterested advice for the buyer. Perhaps compensation by commission is inconsistent with real professionalism. On how many occasions does an agent now advise his client to buy his insurance elsewhere?

The next witness, Dr. Mark Dorfman, displayed empirical evidence on the lack of consumer understanding in this area. He suggested that the information barrier would be lowered by adoption of standard policies. This would help consumers to make an informed choice and would stimulate price competition. He also suggested that consumers should be supplied with more educational material at point of sale and commented favourably on the Canadian regulations in this respect concerning equity linked products. Dr. Dorfman suggested that these descriptive educational phamphlets should be simple, brief and clear and avoid technical jargon.

Mrs. Virginia H. Knauer, Special Assistant for Consumer Affairs to the President, also drew attention to the consumer's lack of knowledge of the product. In her opinion the pressure for change stemmed from the following sources:

1. Consumers are discovering that substantial price differences exist.
2. The principal source of information is the insurance agent who is often in a potential conflict of interest situation due to the commission structure.

3. Consumers are frustrated in trying to decipher the terms used by the industry.
4. The forced savings associated with whole life may be a mixed blessing if better savings opportunities are foregone.
5. In the face of growing doubts and the proliferation of complex policies, the industry has additionally been unwilling to even talk about cost comparisons.

Mrs. Knauer suggested ways in which the industry could help in improving the situation. These included collecting and publishing information concerning the consumer's understanding of life insurance and having consumers actively involved in reviewing company policies and practices.

Joe A. Mintz, Vice President, Texas Consumer Association, stated that the consumer rarely receives clear, objective information with respect to the prices and benefits of life insurance. He indicated that there was a wide dispersion in life insurance benefits for the same premium outlay. Regarding the difficulty of finding a suitable cost index he commented:

> ...Mr. Moorehead has outlined six years of work, consuming thousands of man hours and the brain power of a major industry, going into meeting after meeting.! Our country has sent rockets and men to the moon--but no one can tell you today the cost of a single $1000 policy and find agreement. Is this a low cost plan? What a disgrace for the life industry to require the United States Senate to find out.

The next witness was Mr. Edwin Matz, a Senior Executive Vice President of the John Hancock Mutual Life Insurance Co. of Boston. Mr. Matz spoke on behalf of the American Life Assurance Association. He outlined the defects of the various cost comparison methods. If it were mandatory to furnish accurate comparison figures, then in his opinion, buyers would be repelled by the resulting arrays of figures and it might discourage underinsured persons with family responsibilities from purchasing insurance. Mr. Matz contended that any disclosure methods would overemphasize price. Other important considerations such as choice of plan, choice between participating and non-participating, and service might be overlooked. Earlier in the Hearings Mr. Nader had stated that the life insurance industry committed very little resources to eliminate threats to health and safety, or to encourage risk reduction and research in this area. Mr. Matz supplied evidence showing that life insurance companies had provided money for medical research and had undertaken various health and safety programmes.

Part II of the Hearings concludes with the testimony of John A. Durkin, Insurance Commissioner of the State of New Hampshire. He stated that there was absolutely no evidence of price competition in the life insurance industry. He contended that to the average citizen life insurance was an inscrutable contract. In his experience, any proposals that would benefit consumers were described (by the industry) as ill conceived, hastily contrived or poorly drafted and needed further study. However, if the proposals appeared to benefit the industry, the industry response is "Enact it". Mr. Durkin noted that companies often advertised that if a consumer submitted details to them they could generate an insurance programme in seconds. He felt that the same computer could equally well generate adequate clear-cut cost disclosure.

Part III of the Hearings opens with the testimony of Herbert Denenberg, Pennsylvania Insurance Commissioner. Part III also contains various articles and exhibits submitted by Mr. Denenberg as part of his testimony. Mr. Denenberg described the "Shopper's Guides to Life Insurance" which had been published by his Department. He stated that these guides had been widely distributed and that they served to stimulate competition and lower prices. In his opinion, the public would be better served if there were only two standard policies, straight life (whole life) and a five year renewable and convertible term. He stated that "The tens of thousands of policies that clutter the market are designed to confuse the buyer--not to protect him." He mentioned that their Policyholders Service Division handled about 100,000 complaints a year.

In Denenberg's opinion the life insurance contract was unnecessarily complex:

> Life insurance and especially cash value life insurance lends itself to misunderstanding. The elusive and complex nature of cash values and all the various options in a life policy are confusing to the uninformed consumer. To make matters worse, companies gimmick up the policies with special options and with all sorts of built in benefits, not to provide superior protection, but usually designed to confuse and obscure price differences.

Denenberg found that the companies which had higher costs in his Guide responded by claiming that they offered better service. He claimed that the Pennsylvania Insurance Department had demonstrated that the low cost companies are just as financially sound and just as capable of providing good service. He suggested that the following reforms would greatly benefit consumers.

1. Standardization of policies
2. Written disclosure of essential information on policies being considered for purchase including the agents' commission
3. Elimination of many unnecessary policies
4. Education of consumers on insurance in general
5. Every buyer to be provided with a "Shopper's Guide" containing comparative cost information
6. All policies to meet minimum standards of readability

Following Mr. Denenberg, representatives of the mutual fund industry and the credit unions stressed the need for more disclosure in connection with life insurance.

Peter H. Shuck, Director of the Washington Office of the Consumers Union also referred to the lack of price competition in the life insurance market and the extent of consumer ignorance in this area. This leads to product proliferation and product differentiation. Some features of life insurance which make it difficult for consumers to compare prices were:

The fact that insurance is paid for in periodic payments;
The existence of cash values obscures the cost of protection;
The true price is obscured by the existence of dividends;
Whole life insurance provides protection and savings but is sold as a package.

Part 4 of the Hearings gives details of an investigation of 195 major life insurance companies regarding lapse ratios, agent turnover, sales practices and price levels. Mr. E. Moorehead acted as actuarial consultant in connection with the Sub-committee's life insurance study. Each company was asked to supply data relating to premiums, cash surrender values and dividends in connection with its three best selling policies. These data were used to examine the range of price differences and to compare the various cost comparison techniques that were available. Because of the tremendous volume of figures involved, only certain summary figures were presented in the final record. One summary table ranks the companies in the study by their appearances in various deciles. If a particular cell contained 80 plans, the company with the lowest cost as measured by a particular index would register a one in the first decile. The company with the highest cost would register a one in the last (tenth) decile. Decile rankings were presented for individual companies for each cost index and for all the indices taken together. Six of the largest Canadian companies were included in this study and it may be of interest to present the results in respect of these companies.

TABLE 1: HART SUB COMMITEE PRICING STUDY

Aggregate Data on U.S. Business of 6 Canadian Companies

COMPANY / DECILE	PERCENTAGES FALLING INTO VARIOUS DECILES									
	1	2	3	4	5	6	7	8	9	10
Confederation Life	12.9	18.8	21.6	15.9	13.4	9.1	5.1	1.0	1.7	0.4
Canada Life Insurance Co.	0.2	7.9	14.4	19.8	16.5	16.7	12.8	7.5	3.6	0.6
Crown Life Insurance Co.	8.4	15.3	19.8	15.7	12.2	14.2	10.8	3.5	0.2	0.0
Great West Life Insurance Co.	1.7	6.0	8.8	9.8	10.7	16.6	20.1	15.1	10.7	0.7
Manufacturers Life Insurance Co.	6.1	13.1	11.6	8.2	8.2	11.5	13.8	11.0	9.9	6.4
Sun Life Insurance Co. of Canada	7.1	7.6	20.0	23.6	14.2	13.2	9.1	3.8	1.1	0.4

It should be stressed that the above results relate to U.S. business of these Canadian companies for one particular year.

The results published by the Hart Sub Commitee do not permit one to assess the extent of variation in price. However an examination of the combined results (U.S. + Canadian companies) on pp. 2483-2486 indicates that certain companies are high-cost companies no matter what cost measuring device is used and that other companies show up as low cost companies no matter how cost is measured.

The Subcommittee also obtained information on agent turnover, agent commissions lapse rates and various sales practices. This provides valuable information but it is not easy to summarize. It is significant to note that the average 13 month lapse rate (by number of policies) in respect of cash value insurance was approximately 26.8%.

The data also show that the commission structure furnished a built-in incentive to sell whole life insurance rather than term insurance. The following table has been calculated from the figures on page 2858 and 2859 [2].

TABLE 2: ANALYSIS OF COMMISSIONS AS A PERCENTAGE OF PREMIUM

	WHOLE LIFE		TERM - 5 Year Renewable	
FIRST YEAR	59.54%	(7.08)*	38.22%	(8.73)
YEARS 2-10	5.29%	(3.40)	5.36%	(2.76)
(2-5 for Term)				
YEARS 11-20	1.76%	(1.43)	N.A	

* Figures in brackets denote standard deviations

Notice that the average first year commission is 59.5% of the premium for whole life and that the corresponding figure for five year renewable term is 38.2%.

The data in the above table are reproduced from the tables given in the Report of the Hart Sub Committee. If it is assumed that the term policy is renewed after five years, then a number of life insurance companies will pay the agent commission when the policy is renewed. This information is not available from the tables published in the Hart Report.

It is clear that many of the opinions presented earlier in the Hearings seem to be confirmed by the data gathered for these studies. However, it appears that the full potential of the data has not yet been realized since it would appear that further analyses could be carried out. For example, the extent to which high lapse rates were related to high agent turnover rates could be investigated. In addition, the extent to which the split of new business as between whole life and term was related to (1) competitive position, (ii) commission structure could be analysed.

During these Hearings brief details were given of twelve research projects that were to be carried out under the auspices of the Life Insurance Cost Comparisons Task Force of the National Association of Insurance Commissioners. These additional reports

are in the present author's opinion of very uneven quality. The reports prepared by the Society of Actuaries appear to be carefully researched documents. However, the majority of the reports deal in a very superficial manner with the issues they were supposedly directed toward. For example, one research report [8] claimed that there was no evidence of deception or inaccuracy with regard to cost information since it stated

> "There is no evidence of dissatisfaction with cost information from agents. No one reported deception, inaccuracy or attempts to hide cost information".

However, it is suggested that interviewing a sample of recent purchasers of life insurance is hardly the most effective method of discovering whether or not deception has been attempted. In fact the report itself provides evidence on this very point by confirming that the respondents were unable to spot a misleading cost presentation technique since item 11 of the summary states

> "Respondents preferred simple cost explanations. When both the traditional net cost and the interest adjusted methods were explained the traditional was preferred by a wide margin".

The traditional net cost index ignores the rule of compound interest and has now been discredited as a valid cost comparison method.

It is suggested that the main published reports of the Hart Sub Committee represent a significant contribution to the literature on consumer problems in life insurance. Since these Hearings took place there have been developments aimed at rectifying some of the problems identified. There have also been changes in Canada in response to what is called the consumer movement. The Canadian Life Insurance Association, the major trade association, has recommended to its members that agents supply interest-adjusted cost figures to consumers on request and that consumers be allowed a ten-day free look period within which they could return the contract and recover the premium paid. The Consumer's Association of Canada has recently published a Shoppers' Guide to life insurance.

1.3 Canadian Research on Consumer Problems in Life Insurance

There appears to be very little recent research on the problems facing Canadian consumers in the life insurance market. Claxton and Ritchie [7] found that in a set of 25 commonly purchased goods and services, life insurance was ranked as the

third most difficult from the viewpoint of consumer purchasing. In two recent studies [9], Poapst has discussed the role of life insurance within the context of consumer decision making and personal financial planning.

There have been a few technical studies concerning the rate of return available on the savings element on whole life contracts. Cameron [4] analyses life insurance in its role of intermediation and separates the savings and investment components of the life insurance policy. On the basis of 1972 data, he calculated the following rates of return for a sample of Canadian, British and foreign life companies over a 20 year holding period.

TABLE 3

Group	Average Rate of Return p.a. Participating Policies	Non-participating Policies
Canadian companies	4.35%	3.10%
British companies	3.74%	2.75%
Foreign companies	4.07%	2.86%

Cameron compares life insurance savings with other investment media from the viewpoint of tax status, liquidity, risk differences and other factors. He notes that the average rates of return can be negative if a policyholder surrenders during the early years of the contract. In this connection, he comments

> Since most life policies are terminated by surrender rather than death and since most of the surrenders take place in the first few years of the contract this "downside risk" puts life insurance at a considerable disadvantage relative to other assets in Table 2.

Cameron notes that industry spokesmen often refer to the financial counselling services provided by the life insurance agent. He finds this objectionable on two grounds

> First, most agents have a large personal conflict of interest in the matter of which type of savings program the potential client chooses. Second many agents have little, if any formal training in such basic matters as the role of compound interest and time in a savings program.

In a more recent publication Jacques Babin [5] of the Economic Council of Canada has analysed the rates of return on life insurance savings. Babin uses a different technique from Cameron to obtain the rate of return on life insurance savings. A summary of Babin's results for the case of a 35 year old male are presented below.

TABLE 4: YIELDS ON LIFE INSURANCE POLICIES

DURATION (until surrender)	YIELD* NON PAR	YIELD* PAR	DURATION	YIELD* NON PAR	YIELD* PAR
1	-100%	-100%	11	3.0%	3.0%
2	-100%	-87.3%	12	3.4%	3.6%
3	-68.2%	-41.7%	13	3.7%	4.0%
4	-49.0%	-20.5%	14	3.8%	4.3%
5	-10.5%	-11.1%	15	3.9%	4.5%
6	-4.2%	-5.2%	16	4.1%	4.8%
7	-1.1%	-1.9%	17	4.2%	5.0%
8	.6%	0.0%	18	4.2%	5.1%
9	1.6%	1.2%	19	4.2%	5.2%
10	2.1%	2.0%	20	4.1%	5.5%

* These figures represent the average yield of three major companies operating in Canada.

It is noteworthy that the returns are negative for durations up to seven years highlighting the fact that there is a substantial front end loading in these contracts which is reflected in the cash surrender value scale. The returns obtained by Babin are somewhat higher than those found by Cameron. It turns out that there is no unique way to calculate the rate of return on the savings component of a whole life contract. Part of the difference between the results is due to the fact that different methods were used in both studies. In addition Babin used 1973 data whereas Cameron used 1972 data.

In his calculations, Cameron assumed that over a 20 year horizon a programme of buying 5 year renewable term insurance and investing an amount equal to the difference between the whole life annual premium and the term premium was set up so as to produce the same result as purchasing a whole life policy and surrendering it after 20 years. The balance of the whole life premium was thus to be invested in a sinking fund which would

accumulate to the cash value at the end of the period. The amount of term insurance to be purchased at each renewal was set so as that the death benefit under the two procedures would be approximately the same. In other words, the amount of the sinking fund plus the face value of the renewable term policy corresponded to the face value of the whole life policy. When both methods produced the same result the underlying yield on sinking fund gave the rate of return on the savings element of the whole life contract. To implement this method certain assumptions must be made and various approximations are involved. These are well analysed by Cameron. For instance, different rates of return can be obtained by varying the renewable term insurance rates.

Babin suggests that Cameron's approach and others like it lead to a decreasing amount of effective protection under the term insurance programme. He suggests an alternative approach which involves calculating the yearly difference between the annual premiums for a whole life policy and a level renewable term policy. These differences are accumulated with interest over each duration so as to equate to the expected cash value at each duration. In other words, the whole life contract is being implicitly equated with a renewable term policy plus a cash surrender value which provides a survivorship benefit. It is not apparent to this observer that Babin's approach offers any clear advantages over that of Cameron. It is suggested that it represents a more artificial approach. In addition, no justification is given for the use of the 1958 CSO Mortality Table. A more recent mortality table that reflected Canadian experience would have been preferable. It would appear that Babin's approach tends to overestimate the rate of return available on life insurance savings.

More recently Geehan [6] analysed the results of 43 federally registered Canadian companies to see if there were economies of scale in the life insurance industry. This research was based on the author's Ph.D. dissertation at the Massachusetts Institute of Technology. It appears to be a careful study and while the author was unable to produce an unambiguous result, the paper sheds light on a number of issues. The last paragraph of the paper deserves to be quoted:

> In conclusion, while the evidence is mixed, economically significant returns to scale do not exist in the Canadian life insurance industry. Two policy implications remain. First, taxation tends to shield smaller firms. Second, consumer ignorance tends to permit wide variations in prices and unit costs to endure. Policy aimed at educating consumers would provide the long-run benefit of improved competition and increased production efficiency.

> Improved competition would also eliminate observable returns to scale--if such exist.

It is interesting to note that Geehan finds some evidence that price is negatively correlated with firm size:

> The product is definitely not sold at the same price by all firms even after correcting for differences in product mix between firms. Belth (1966, pp. 201-203) has shown this clearly and provided evidence that price is negatively correlated with firm size. Some preliminary calculations with Canadian data show similar correlations.

Unfortunately, these calculations are not presented in the paper and so the extent of this negative correlation cannot be gauged.

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2. Life Insurance Products and Trends

In order to describe accurately the problems faced by Canadian consumers in the life insurance market, it is necessary to discuss the main life insurance products currently available. Accordingly the aim of the present Chapter is to provide background information on this topic. In particular, there will be an examination of the dual function of many life insurance contracts in relation to the provision of pure protection and savings. There will be a discussion of certain trends which have taken place and are taking place within the industry. We will analyse the main types of product sold and compare the growth of life insurance companies with other financial intermediaries.

The basic underlying principle of insurance is the so-called law of large numbers. Loosely speaking, this law implies that it is possible to predict accurately the number of deaths within a given time when dealing with a large group of people. For a given individual, it is much more difficult to make an accurate prediction of the time of death. The consequence of this law is that certain economies are achieved when risks are pooled or aggregated.

The simplest life insurance contract is term insurance (or temporary insurance). This provides life insurance coverage for a fixed period or term such as one year. The life insured pays an amount, called the premium, at the start of the year. Should he die within the year the sum insured or death benefit is payable to his estate. The total premiums collected by the insurance company (from this and similar contracts) enable it to pay the death claims and pay administrative expenses. Such a contract provides pure protection and has no savings component. No benefit is payable if the life insured dies after the policy has expired. While the risk of death is related to a number of variables it depends in a critical way on the age of the life insured. The risk of death increases with age. Hence term insurance premiums are initially quite low but increase with advancing years. A common type of insurance is five-year renewable term. In this case the initial duration of the contract is five years. At the end of this period the life insured has the option of renewing the contract for an additional five years without the necessity of supplying evidence of insurability. Of course the premium rate for the second five years increases. Five year renewable term policies may be continued to an age such as 65 or 70. Each time the policy is renewed there is a corresponding increase in the premium. The advantage of the renewable feature is that the policyholder can continue to purchase term insurance at normal premium rates even

if he would no longer be insurable under a new policy at normal rates.

In contrast to term insurance, whole life insurance provides a death benefit throughout the entire duration of an individual's life provided the contract is maintained in force by the payment of the premiums due under the contract. Typically this contract is financed by the payment of level premiums during the policyholder's lifetime. At the inception of the contract, the annual premiums for a whole life contract are much higher than those for a corresponding term policy. However a stage is eventually reached when the term insurance premiums exceed the whole life premium. In the case of a whole life policy the excess of premiums not required to pay death claims and expenses is invested to provide funds for the later years. If an individual elects to stop paying premiums under a whole life policy a cash termination benefit known as a cash surrender value is payable. In Canada it has been customary to guarantee (at the inception of the contract) the amount of the future cash surrender values. The existence of these cash surrender values gives rise to the savings function of life insurance. The presence of both the protection component and the savings component in the one contract leads to a number of potential consumer problems. Some of these problems have been referred to in Chapter I. An individual who purchases a whole life contract obtains the composite package of death protection and savings. The price he pays is for the combination and the price is not split up to reflect the cost of the two components. Since there are alternative contracts which provide either pure death protection (such as term insurance) or pure savings such as Registered Retirement Savings Plans, bonds, common stocks and other securities, this makes the comparison of whole life contracts with other investment vehicles very difficult. For instance, it is possible to obtain a range of values for the rate of return earned on a whole life contract by using different assumptions for the cost of the pure protection element. Under the present system, it is difficult even for technical experts in the area to determine the price of the separate components.

The third basic type of life insurance is represented by the endowment contract. In this case the sum insured is payable on the death of the life insured within a given period. If the life insured survives to the end of the period then the sum assured becomes payable at that time. For a given age and sum insured, premiums for endowment insurances are higher than the corresponding premiums for whole life contracts. There are a great many other contracts which represent combinations or variants of these basic types. As indicated in Chapter I there are a great many riders, endorsements and options which can be added to the basic contract. However, rather than get into such

details at this stage it is perhaps more useful to analyse in more depth the investment element of life insurance contracts and the consequences of providing certain guarantees.

The contracts discussed up to this point in this Chapter were assumed to be non-participating contracts. Such contracts provide for fixed premiums, fixed sums assured and where appropriate, guaranteed cash surrender value schedules. In other words, the benefits and premiums are fixed at the inception of the contract. Since whole life contracts can have very long durations, insurance companies have found it prudent, and to a large extent necessary, to use low rates of interest in calculating the premiums for these policies. In addition as we shall see later, the regulations of the Federal Department of Insurance regarding solvency have tended also to encourage the use of low interest rates in these calculations. However, the main consequence from the viewpoint of the consumer is that these contracts give a relatively low and secure rate of return. These low returns would not be so serious from the policyholder's viewpoint were it not for the persistence of fairly high rates of inflation. If an investment yields 4% p.a. in nominal terms and the rate of inflation is 6% p.a., the real return on the investment is minus 2% p.a. In summary, the rate of return under a non-participating policy is guaranteed at the outset but such contracts afford no protection against purchasing power risk. The consequence of the long term nature of these guarantees and stringent solvency regulations, has been relatively low rates of return on the investment component of these contracts.

In contrast to non-participating contracts, the benefits under participating policies are not completely guaranteed. Participating (par) policies have a higher premium than their non-par counterparts. However, par policies usually cost less in the long run because each year the insurance company declares a dividend on each of its par policies. This dividend can take the form of a premium reduction or premium rebate. Dividends usually are quite low (relative to the premium) in the early years of the policy but increase in size with the duration of the policy. Dividends arise in part from the fact that the par premium is greater than the non-par premium. Their amount also depends on the insurance company's investment experience, mortality experience and experience with regard to lapses and administrative expenses. These elements cannot be predicted with complete accuracy in advance. It is usual for insurance companies to furnish new par policyholders with a table of dividends currently payable and in the absence of any other information, this scale is regarded by the policyholder as being indicative of the future dividends under the policy. Such dividend scales are not guaranteed and furthermore they can vary considerably from company to company. This feature of par

policies makes it very difficult for a consumer to make sensible price comparisons of these policies. It is customary in Canada for par policies to provide for guaranteed cash surrender values. These guaranteed cash value schedules vary from company to company again presenting barriers to meaningful price comparison. As indicated at the end of Chapter 1, par policies have yielded higher returns than non-par in recent years. However the returns on par policies have also been disappointing in comparison to the rates of inflation experienced during this period. Thus while par policies provide for some of the risk to be borne by the insured through the existence of dividends, the returns obtained have been disappointing.

Contracts which permit the policyholder to bear all of the investment risk have been developed using similar contracts in Holland and the U.K. as prototypes. Such contracts are known as equity-linked contracts or equity-based contracts. In this case, the premiums in respect of these policies are invested in a separate pool of assets which are segregated from the insurance company's main funds. When one of these insurance policies becomes a claim, the amount payable is equal to the accumulated value of the invested premiums and based on the market value of the segregated assets. In addition, these contracts normally provide for an associated term insurance benefit and often provide additional guaranteed benefits such as the return of a certain percentage of the premiums (75%) on the maturity of endowment contracts. The problems associated with the issuance of such guarantees have been discussed recently by Boyle and Schwartz [1]. Although they are commonly known as equity based contracts the segregated assets need not consist of common stock but may include bonds, mortgages and other investments. These contracts do not provide guaranteed cash surrender values. A terminating policyholder is given an amount which is based on the market value of his accumulated investments. Such contracts have been sold in Canada since 1966 but their growth has been relatively modest. They were introduced towards the end of a period of spectacular stock market performance. It may be surmised that one of the reasons for their slow growth rate has been the poor performance of equity markets over the last few years.

More recently, new types of life insurance contracts have been sold in Canada under which the insurance company retains the complete investment risk for a period of five years. These contracts are known as adjustable whole life contracts and are often single premium contracts. Beyond the initial five year period, the sum insured may be adjusted to reflect the investment experience of the life insurance company. Such contracts permit the insurance company to take advantage of current high interest rates in their premium calculations. The assets corresponding to

these contracts are invested in bonds or mortgages which mature in 5 years. At the end of this 5-year period, the benefits under the policy will increase if interest rates have risen or decrease if they have fallen. These changes will be reflected by changes in the sum assured at that time. If interest rates have fallen and the policyholder wishes to restore the sum assured to its initial level, he can pay an additional premium at that time. If interest rates have risen at the end of the five year period the sum assured will be increased. It is this feature of the contracts which gives rise to the name adjustable. The policyholder takes on part of the investment risk after the initial five year period. However, these policies also provide a guaranteed floor of cash surrender values irrespective of what the investment experience turns out to be. The unique feature of these contracts is that the design allows the policyholder to take advantage of the current high level of interest rates. Further, it appears that it might be to the advantage of the holder of one of the traditional life insurance contracts to surrender it and use the surrender value to purchase an adjustable life contract. By decreasing the emphasis on long term guarantees, adjustable life policies can give more weight to the current high level of interest rates. At present, only two of the smaller Canadian life insurance companies are actively promoting the sale of adjustable life policies. If the major companies were to enter this field it could lead to surrenders on a massive scale. In general, this would not be to the advantage of the companies whose products were surrendered. Presumably the larger companies would be faced with a huge increase in the rate of surrender of traditional contracts. They would be forced to sell investments to meet the cost of the guaranteed surrender values available under these contracts. A holder of one of the traditional products can only be given advantage of new money rates under his existing policy to a limited extent if the policy is participating and not at all if the policy is non-participating.

To proceed further, it is necessary to examine certain classifications within the life insurance business which have developed. The historical evolution of the life insurance industry has led to three different classes of business. These are known as industrial business, ordinary business and group business. Although industrial business is no longer of importance in Canada, it is instructive to describe this type of insurance as it sheds light on some modern marketing practices. Industrial business referred to small insurance policies written on the lives of the so-called industrial classes. Premiums were collected weekly at the homes of the insured. The insureds were in the main hourly paid and were deemed incapable of budgeting for the higher less frequent premium payments under ordinary

insurance. The weekly calls by the agent were used not only to collect premiums on the business but also to service the policies and procure new business. The insured was issued with a premium receipt book. The agent was "debited" each week for the premiums he was due to collect. The agent's collections were confined to a specific area which became known as the debit. As weekly calls became more expensive, they were replaced by monthly calls. The sums insured under these policies grew. The term industrial insurance is no longer used for government statement purposes. However, some companies still use what is called a monthly debit ordinary system. The business is classified as ordinary but the agent collects the premiums at the insured's home at regular intervals.

The majority of individual life insurance in force in Canada is ordinary business. In this case, premiums are paid yearly, semi-annually, quarterly or monthly and the sums insured are not restricted. Most of the analysis in this report concerns ordinary life insurance, which can be sold either on a participating or non-participating basis. The majority of consumer problems arise in this branch of insurance.

In contrast to ordinary life insurance which is issued on an individual basis, group life insurance is issued to a group of people through one master contract. Generally the group consists of an employee group or a professional group although other types of groups can be covered. Under group insurance, a class of lives is covered. In most cases this leads to lower premiums because the lives can be expected to have lower than average mortality. Further, the fact that the benefit schedule is not within the control of the individual insureds means that there is no adverse selection against the insurance company and this also leads to lower costs. In addition, the employer usually collects the premiums by payroll deductions giving rise to administrative savings. As we shall see later, the growth of group life business in Canada has been dramatic. Very often group life insurance contracts provide term insurance protection for the members of the group. For example, the benefit might consist of twice salary in respect of each member of the group. Group life plans can also provide survivors income benefits which are based on the deceased's salary at date of death. In addition, group insured plans can be set up to provide disability benefits and pension benefits. However for the purposes of the present study, we shall be mainly interested in group life plans.

Table 5 illustrates the growth in the importance of group insurance in Canada. In 1945, group premiums represented 9.6% of total premium income. By 1965, the share of group premiums had grown to 31.4% of the total. At the end of 1975, group premiums accounted for 39% of the total premium income. These figures

TABLE 5: HISTORICAL ANALYSIS OF ORDINARY INDUSTRIAL AND GROUP PREMIUM INCOME IN CANADA (Federally Registered Companies Only)

YEAR	ORDINARY AND INDUSTRIAL $'000,000	PERCENTAGE	GROUP $'000,000	PERCENTAGE
1900	15.0	100.0	0	0
1910	29.8	100.0	0	0
1920	89.8	99.2	.7	0.8
1930	217.0	97.4	5.7	2.6
1940	201.6	94.1	12.6	5.9
1945	261.5	90.4	27.8	9.6
1950	362.6	84.5	66.6	15.5
1955	493.0	78.8	133.0	21.2
1960	654.5	72.2	252.0	27.8
1965	851.2	68.6	390.2	31.4
1970	1158.7	65.6	606.3	34.4
1971	1269.4	63.1	743.6	36.9
1972	1382.5	61.3	871.4	38.7
1973	1601.8	61.7	992.3	38.3
1974	1795.8	61.9	1103.1	38.1
1975	2011.6	61.0	1287.4	39.0

include the Canadian business of British and Foreign Life Insurance companies but exclude the foreign business of Canadian Companies (Federal Report [2]). In terms of sums insured, the growth of group life insurance has been even more spectacular. Table 6 shows that the total sums insured under group life have exceeded those under ordinary life in the last few years. During

these years, group life premiums were significantly less than ordinary life premiums - a reflection of the fact that group insurance affords more life insurance coverage per premium dollar than ordinary life. However, the ordinary life figures over the period include an increasing proportion of term insurance as distinct from whole life insurance. Term insurance contracts are similar to group life contracts in terms of the relationship between premiums and sums insured.

It is also instructive to examine the composition of the ordinary life insurance business by type of plan. Table 7 illustrates the changes that have taken place over the last 15 years. The figures in Table 7 include the foreign and domestic business of Canadian life insurance companies but only the Canadian business of foreign and British life insurance companies. Table 7 indicates that the relative percentage of term insurance (measured by sums insured in force) has increased steadily over the period. The relative percentages of whole life insurance and endowment insurance have declined steadily over the fifteen year period. It would have been preferable to analyse the composition of ordinary business in terms of premium income, but these figures are not readily available from the Reports of the Federal Department of Insurance (the source of the figures contained in Table 7). The ordinary life insured purchased in 1975 reflects the trend towards term insurance; it was subdivided by sum insured as follows:

whole life	34.22%
endowment	9.23%
term	56.55%

These figures have been calculated using Table XIX of Volume I of the Report of the Superintendent of Insurance for Canada [2].

In recent years, the relative percentage of participating ordinary life policies has declined. Table 8 illustrates this decline. As in the case of Table 7, Table 8 includes the non-Canadian business of Canadian companies and the Canadian business of Canadian and foreign companies. Since this is so, the figures for total sums insured in Table 8 are greater than the corresponding figures in Table 6. For example, the total ordinary life sums insured in force in 1975 was $126,942 million. This figure includes $35,546 million representing the foreign business of Canadian companies. Hence the total sums insured for ordinary life insurance in force in Canada is $91,396 million as shown in Table 6.

From Table 8 the percentage of participating life insurance in force has declined from 76 per cent of the total in

TABLE 6: HISTORICAL ANALYSIS OF LIFE INSURANCE IN FORCE IN CANADA (Federally Registered Insurance Companies Only)

YEAR	ORDINARY AND INDUSTRIAL SUMS INSURED $'000,000	PERCENTAGE OF TOTAL	GROUP SUMS INSURED $'000,000	PERCENTAGE OF TOTAL
1925	4,017.9	96.61	141.1	3.39
1930	6,010.6	92.58	481.8	7.42
1935	5,750.1	91.86	509.4	8.14
1940	6,247.1	89.55	728.8	10.45
1945	8,688.5	89.09	1,063.8	10.91
1950	13,163.1	83.60	2,582.7	16.40
1955	19,328.1	75.94	6,123.5	24.06
1960	30,245.9	67.74	14,403.1	32.26
1965	42,013.4	60.32	27,642.6	39.68
1970	57,842.2	52.06	53,274.2	47.94
1971	61,445.1	50.41	60,445.6	49.59
1972	66,718.8	48.91	69,685.7	51.09
1973	72,623.4	47.28	80,986.9	52.72
1974	80,965.0	45.71	96,155.2	52.29
1975	91,395.8	43.92	116,683.6	56.08

TABLE 7: COMPOSITION OF ORDINARY LIFE INSURANCE BY PLAN - SUMS INSURED IN FORCE (Federally Registered Companies)

YEAR	PERCENTAGE OF TOTAL LIFE (whole life)	ENDOWMENT	TERM
1960	56.58	18.51	24.92
1965	54.85	15.37	29.78
1970	52.16	12.25	35.59
1975	46.96	11.59	41.45

TABLE 8: ANALYSIS OF ORDINARY LIFE INSURANCE AS BETWEEN PARTICIPATING AND NON-PARTICIPATING POLICIES - ANALYSIS BY SUMS INSURED IN FORCE (Federally Registered Companies Only)

YEAR	PARTICIPATING $'000,000	NON-PARTICIPATING $'000,000	TOTAL $'000,000
1960	30,642 (76.0)*	9,672 (24.0)	40,314
1965	42,160 (73.1)	15,533 (26.9)	57,693
1970	57,431 (70.6)	23,866 (29.4)	81,297
1975	84,173 (66.3)	42,769 (33.7)	126,942

*(Percentage of total)

1975 to 66% in 1960. It turns out that the main reason for this decline has been the relatively rapid growth of term insurance non-participating business. In fact, if we analyse the non-term

business there has been an increase in the relative percentage of participating business. However, this increase has been masked by the growth in non-participating term business. Table 9 analyses the composition of non-term business (whole life and endowment) as between participating and non-participating business over the period. Thus Table 9 demonstrates a gradual increase in the percentage of participating business as far as whole life and endowment policies are concerned. As mentioned earlier, participating contracts tend to give higher rates of return than non-participating contracts. The annual rates of inflation have risen considerably during the last half of this period and non- participating contracts have not represented good savings vehicles during this period.

TABLE 9: ANALYSIS OF NON-TERM ORDINARY LIFE POLICIES AS BETWEEN PARTICIPATING AND NON-PARTICIPATING POLICIES (Analysis Based on Sums Insured in Force: Federally Registered Companies Only)

YEAR	NON-TERM BUSINESS		
	PARTICIPATING $'000,000	NON-PARTICIPATING $'000,000	TOTAL $'000,000
1960	25,131 (83.7)	4,889 (16.3)	30,020
1965	34,242 (84.5)	6,268 (15.5)	40,510
1970	45,416 (86.7)	6,948 (13.3)	52,364
1975	65,335 (87.9)	8,992 (12.1)	74,327

As would be expected from the comments on Tables 8 and 9, there has been a marked increase in the relative percentage of non-participating term insurance business. This increase is illustrated in Table 10. It is this phenomenon which gives rise to the increase in non-participating business reflected in Table 8. The distinction between participating business and non-participating business is much more critical in the case of the non-term policies since they have substantial savings components. In this case, the trend is exactly opposite that revealed by the total ordinary business.

TABLE 10: ANALYSIS OF ORDINARY LIFE TERM INSURANCE BUSINESS BY PARTICIPATING AND NON-PARTICIPATING BUSINESS
(Analysis Based on Sums Insured in Force: Federally Registered Companies Only)

YEAR	TERM BUSINESS		
	PARTICIPATING $'000,000	NON-PARTICIPATING $'000,000	TOTAL $'000,000
1960	5,511 (53.5)	4,783 (46.5)	10,294
1965	7,918 (46.1)	9,264 (53.9)	17,182
1970	12,015 (41.5)	16,918 (58.5)	28,933
1975	18,839 (35.8)	33,777 (64.2)	52,616

The preceding analysis has examined the trends within the types of product sold (term, whole life), the nature of the contract (participating or non-participating) and the type of business (ordinary or group). Further analysis in this area is of course possible. However, the statutory returns, despite their volume, do not contain information on a number of the additional points one might like to investigate. For example, the returns do not permit any detailed investigation of the various equity-based contracts that are marketed. However, to place the growth of life insurance as a whole in perspective it may be instructive to proceed as follows. The absolute dollar figures do not give a comparative perspective since the total growth has occurred during a period which has experienced an increase in population and a prolonged bout of high inflation. Hence it may be instructive to analyse the figures in Table 6 on a per capita basis in both nominal terms and real terms. To this end, we have constructed Table 11. The per capita sum insured has been obtained by dividing the gross sums insured by the total Canadian population. To find the real per capita figures the gross national expenditure has been used to convert the figures to constant 1961 dollars. Table 11 shows that the per capita sums insured have grown dramatically over the period when they are measured in nominal dollars. There has been somewhat less growth when the sums insured are expressed in real dollars. Nevertheless, even in this case, there has been a five-fold

increase in the real per capita sum insured over the period. It should be pointed out that these figures do not include data for provincially registered insurance companies. In recent years the provincially registered companies have accounted for about 6% of the total sums insured in force. This proportion has remained fairly stable over the last fifteen years. The provincial companies have been excluded from the analysis because the appropriate data are not always readily available and because such companies account for a fairly small percentage of the total sums insured in force.

TABLE 11: ANALYSIS OF LIFE INSURANCE IN FORCE IN CANADA (Ordinary Plus Group) ON A PER CAPITA BASIS

YEAR	TOTAL LIFE INSURANCE IN FORCE $'000,000	SUM INSURED PER CAPITA (Nominal $'s)	SUM INSURED PER CAPITA 1961 dollars
1925	4,159.0	447	877
1930	6,492.4	636	1,303
1935	6,259.5	577	1,387
1940	6,975.8	613	1,341
1945	9,752.3	808	1,434
1950	15,745.8	1,148	1,519
1955	25,451.6	1,621	1,807
1960	44,649.0	2,499	2,511
1965	69,656.0	3,546	3,247
1970	111,116.4	5,217	3,905
1971	121,890.7	5,651	4,095
1972	136,404.5	6,251	4,317
1973	153,610.3	6,952	4,431
1974	177,120.2	7,891	4,418
1975	208,079.4	9,126	4,661

The growth in sum insured per capita illustrated in Table 11 is due in large measure to the rapid expansion in group life business. Further, we have already seen from Table 7 that the most significant growth in ordinary business has been in term insurance. It would be more meaningful for our purposes to split the contracts as follows: (i) term insurance plus group life, and (ii) other ordinary life contracts. The first division includes those life insurance contracts which provide pure death protection and do not have any savings element. The second division, comprising in the main whole life, endowment and variants of these basic contracts, consists of contracts which have a savings component as well as a pure protection component. The figures in Table 12 show the recent trends in the real per capita sums insured when the contracts are analysed in this manner.

TABLE 12: REAL PER CAPITA SUMS INSURED ANALYSED BY PURE PROTECTION AND PROTECTION PLUS SAVINGS CONTRACTS (Federally Registered Life Insurance Companies Only)

YEAR	PER CAPITA SUM INSURED 1961 DOLLARS (pure protection)	PER CAPITA SUM INSURED 1961 DOLLARS (protection+savings)	TOTAL PER CAPITAL SUM INSURED (1961 dollars)
	$	$	$
1960	1,234	1,277	2,511
1965	1,872	1,375	3,247
1970	2,596	1,309	3,905
1971	2,768	1,327	4,095
1972	2,987	1,330	4,317
1973	3,139	1,292	4,431
1974	3,199	1,219	4,418
1975	3,462	1,199	4,661

The figures in Table 12 do not include data in respect of provincially registered companies. However, inclusion of these additional data would not result in any significant departure from the trends illustrated in the table. The most interesting conclusion of this table is that there has been a decline in sum insured per capita for those contracts which include a savings

component. In contrast, there has been a dramatic increase in the term and term-like (group life insurance) per capita sums insured. These contracts provide pure death protection and the per capita sum insured has increased from $1,872 to $3,462 during the ten years from 1965 to 1975. This represents a real increase of 85% since these figures have already been deflated. During the same period, the per capita sum insured in respect of contracts which provided a savings element declined from $1,375 to $1,199--a decline of 12.8%. It is clear that the public has shown an increasing preference for the pure protection type of product during the period. There are a number of other savings vehicles available. An analysis of the growth of the assets of selected financial institutions confirms the impression that life insurance companies have fallen behind in terms of market share of the savings dollar.

This relative decline in assets of life insurance companies is portrayed in Table 13 which gives the growth in asset volume during recent years. There has been considerable growth in asset volume in the case of all the intermediaries. To gain a better perspective on the rate of growth, Table 14 has been prepared. The average annual compound rates of growth are given in this table. Thus the overall rate of growth during this period was 13.8% p.a. which means that the volume of assets would double every 5 1/3 years. However, this growth has not been distributed evenly over the various institutions. The highest rates of growth have been achieved by the credit unions, chartered banks and trust companies. Trusteed pension plans have grown at a rate close to the overall rate of growth. However the rate of growth in life insurance company assets is significantly less than the norm. This is highlighted in the second column of Table 14 where relative annual compound rates of growth have been calculated. In this case, the assets of each intermediary have been deflated by an index corresponding to the total assets of all the intermediaries combined for each year prior to computing growth rates. Thus the growth of asset volume of the chartered banks was 1.3% p.a. above that for the entire group. Credit unions (and caisses populaires) showed an even higher relative growth rate of 2.7% p.a. Trust companies also grew at a faster rate than the group as a whole. The assets of trusteed pension plans grew at about the same rate as the assets of the combined group. However, life insurance company assets declined (in relative terms) at the rate of 5.3% per annum.

It is possible to advance a number of reasons for the relatively slow growth of life insurance assets in recent years. As pointed out earlier, there has been a significant swing towards life insurance contracts which provide pure death protection (such as term insurance and group life). Such contracts do not give rise to the same premium volume as

TABLE 13: ASSETS OF SELECTED FINANCIAL INTERMEDIARIES

($BILLIONS)

YEAR	CHARTERED BANKS	TRUSTEED PENSION PLANS	LIFE INSURANCE COMPANIES	CREDIT UNIONS AND CAISSES POPULAIRES	TRUST COMPANIES AND MORTGAGE LOAN COMPANIES
1965	26	7	12	3	6
1970	47	11	16	5	10
1971	54	12	17	6	12
1972	63	14	18	7	13
1973	78	16	20	9	16
1974	97	18	22	10	19
1975	108	21	24	13	23
1976	126	25	27	16	28

TABLE 14: ANNUAL COMPOUND RATES OF GROWTH OF ASSETS OF SELECTED FINANCIAL INTERMEDIARIES DURING THE PERIOD 1965-1976

INSTITUTION	ABSOLUTE ANNUAL COMPOUND GROWTH RATE	RELATIVE ANNUAL COMPOUND GROWTH RATE
All intermediaries	13.8%	0%
Chartered banks	15.4%	1.3%
Life insurance companies	7.8%	-5.3%
Credit unions and caisses populaires	17.0%	2.7%
Trusteed pension plans	13.1%	-.1%
Trust companies and mortgage loan companies	15.0%	1.1%

whole life contracts. These lower premiums lead to slower asset growth. During this period the banks, trust companies and credit unions have expanded considerably their product range and entered new markets. While there have been a number of new life insurance products introduced during this period their success has not been anywhere near as spectacular. The one area where the life insurance industry did demonstrate significant growth was in the life annuity market. However, this was due in large measure to the monopoly which they exercised in connection with the treatment of the proceeds of a maturing Registered Retirement Savings Plan. The budget proposals of April 10, 1978 would no longer make it mandatory for these proceeds to be invested in a life annuity and so growth in this area will probably falter, now that these budget proposals have been enacted. Another reason for the modest growth stems from the increasing provision of retirement and survivor benefits through employer and government pension plans. In 1966, the Canada and Quebec Pension Plans were introduced and these plans were amended to provide indexed retirement pensions in 1973. During recent years benefits under the Old Age Security System have been improved. In 1966 the retirement age was reduced from age 70 to age 65 in a series of steps. The Guaranteed Income Supplement was introduced in the same year. In 1973 both the Guaranteed Income Supplement and the Old Age Security pension were linked to the Consumer Price Index. During this period there have been generous improvements in many of the government plans (federal and provincial) for civil servants. Life insurance contracts currently represent but one of a variety of methods that can be used to provide retirement savings and benefits for survivors. For a variety of reasons their relative share of the savings dollar has declined dramatically in recent years.

REFERENCES TO CHAPTER 2

[1] Boyle, Phelim P. and Schwartz, E.S., "Equilibrium Prices of Guarantees under Equity-Linked Contracts", The Journal of Risk and Insurance, Vol. XLIV, December 1977, 639-660.

[2] Reports of the Superintendent of Insurance for Canada, various years, Minister of Supply and Services Canada
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3. Insurance Regulation in Canada

This Chapter examines in broad terms the current system of insurance regulation in Canada and investigates some of the consequences of this regulation on consumers. Some of the recent work on theories of regulation will be used to provide background in the analysis of the current Canadian system. It should be stated at the outset that a well-developed theory of (insurance) regulation has not yet been published. However, some significant advances in the general theory of regulation have been made and these will prove useful in the analysis.

Insurance regulation in Canada takes place at two levels: the federal and the provincial. The principal objective of the federal legislation is to ensure that insurers remain solvent. The provincial legislation covers such matters as contract conditions and the licensing of agents. The provincial legislation includes rules similar to those characterized in a paper on insurance regulation by Borch [1]:

> "Rules designed to make certain that the insurance contracts offered to the public are 'fair'. The aim of such rules is usually to protect the little man who has difficulties with the 'fine print' in the policy"

As Borch [1] points out in his article these two major objectives of insurance company supervision may not always be in harmony. In fact Spencer L. Kimball has written [2]:

> "The objectives of insurance regulation are frequently in irreconcilable conflict, and they must be added up and weighed and a decision made how far to press this one and how far to relax that one".

In Canada, the fact that the legislation is divided between the federal and provincial authorities adds one more twist to this conflict of objectives. In addition to the federal and provincial insurance legislation, the provisions of the federal Income Tax Act can and do have important consequences for insurance companies and certain aspects of insurance contracts. Consequently, this Chapter will examine the federal and provincial insurance legislation as well as certain aspects of the Income Tax Act. Some of the consequences of this corpus of legislation will be explored. In addition, we will examine some aspects of the legislation using some general results from the theory of regulation and suggest areas requiring further research.

3.1 Federal Insurance Legislation

The detailed federal legislation governing the operations of insurance companies in Canada is contained in the Canadian and British Insurance Companies Act, the Foreign Insurance Companies Act and the Department of Insurance Act. The spirit of this legislation is captured in the following quotation from the preamble to Canadian and British Insurance Companies Act:

"Whereas it is contrary to the public interest that insurance companies that are unable to discharge their liabilities to policyholders in Canada as they become due, or are otherwise insolvent, should be permitted to carry on the business of insurance in Canada."

However, the scope of the legislation is such as to set up safeguards and controls which are specifically designed to prevent insurance companies from becoming insolvent. In fact, the preservation of solvency is the principal objective of the legislation.

This objective is accomplished in two main ways. First there are statutory restrictions on the valuation bases which companies are permitted to use in the calculation of their liabilities.[1] This aspect of the legislation will be examined in some detail because it has important consequences and because it is often not properly appreciated. Second, the legislation imposes restrictions on the investments which insurance companies are permitted to hold in their portfolios. Again we shall examine this aspect of the legislation.

As a prelude to discussing the restrictions on the valuation bases which insurance companies can use to compute their liabilities, it is helpful to introduce some additional terminology. For simplicity let us consider a single premium, whole life, non-participating policy which has just been purchased by a male aged 35. Assume that the face value of the policy is $10,000 and that the single premium is $2,700. Since this is a single premium the only premium payable is the first one which is equal to $2,700. Just after this premium has been paid the insurance company has received a cash amount of $2,700. For the purposes of this illustration, we ignore commission and expenses in order to simplify the analysis. This cash sum of $2,700 will be invested by the insurance company. When the premium has been invested, the assets corresponding to the liability arising from the sale of the policy will consist of these investments. However, if we were to make an evaluation of the liability arising

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[1] As we shall see later there are proposals to relax these regulations.

from the sale of this whole life contract on what basis should this be done and what figure should we use? The liability under the policy is represented by contingent claim to an amount of $10,000 payable on the death of the life insured who is currently aged 35. The value of this contingent claim is equal to the so-called policy reserve. To obtain this figure an actuarial calculation is performed which takes into account the probability of death at each subsequent age and makes allowance for compound interest. Details of this calculation are given in a number of books including that by Pedoe [3]. Until recently, the federal insurance legislation stipulated that only certain interest rates and mortality tables could be used by insurance companies in computing these reserves. (The new legislation concerning financial reporting of life insurance companies will be discussed). Under these proposals, a company can make application to the federal Superintendent of Insurance to use a reserve basis different from those specified in the Act. However, it is safe to claim that the effect of the legislation has been to produce conservative values for the policy reserves. In this sense, conservative means that the figures are relatively large. To demonstrate solvency, the assets of the insurance company must exceed its liabilities. The major component of the liabilities is the policy reserves and the higher the value placed on them the more difficult it is to demonstrate solvency. Conversely if an insurance company is solvent under this system then it would be even more solvent under a less rigorous basis of reserving. The imposition of these strict valuation bases for the calculation of reserves has had an impact not only on the reserves but also the premiums that an insurance company charges. This in turn influences the rate of return obtained by consumers.

To pursue this point and to gain some appreciation of the impact of statutory valuation bases, it may be helpful to examine some numerical illustrations. First we deal with whole life single premium non participating contracts. Table 15 gives the single premiums per $1000 sum insured for male lives. The underlying mortality basis is the so-called 1958 CSO table. (For a discussion of this table see McGill [4].) This mortality table is one of the allowable mortality tables for the valuation of life insurance business under the Act. The purpose of Table 15 is to show how the single premiums vary with different interest rate assumptions. For convenience, amounts have been rounded to the nearest dollar. Thus at age 30 the single premium for a policy of $1000 is $316 assuming a 3% p.a. interest rate. If the rate of interest is 6% p.a. instead of 3% p.a., then the single premium drops from $316 to $124, a reduction of 61%. At age 45 the corresponding premiums are $459 and $241. Moving from 3% p.a. to 6% p.a., in this case, produces a reduction of 47%. At age 60 the corresponding reduction is 32%. A major conclusion from Table 15 is that the use of higher interest rates in premium

TABLE 15: SINGLE PREMIUMS PER $1000 SUM INSURED
Mortality basis 1958 CSO

AGE OF LIFE INSURED	INTEREST RATE USED IN CALCULATIONS 3% p.a.	4% p.a.	5% p.a.	6% p.a.
30	316	226	165	124
35	359	265	201	155
40	407	312	244	194
45	459	365	295	241
50	515	423	352	297
55	573	486	416	360
60	632	551	485	429

(and reserve) calculations yields much smaller premiums (and reserves) for the same contract. The relative reduction is diminished as the age of the life insured increases because the expected duration of the contract is reduced and the impact of the choice of interest rate is less dramatic. To illustrate the consequences of statutory limitations on the reserving basis, recall the contract discussed earlier in this chapter. This was a $10,000 single premium, non-par, whole life contract in respect of a 35 year old male with a single premium of $2700. Let us consider a valuation of this contract just after it has been taken out. Assume that the value of the assets is $2700. If the liabilities are valued using 1958 CSO mortality and a 3% p.a. interest assumption the value of the policy reserve from Table 15 is 3590 (= 10 X 359). In this case, the company would be insolvent since the valuation balance sheet reads:

Value of Assets	Value of Liabilities
2700	3590

We have assumed, of course, that there are no other contracts. In practice there would be other policies but this is not of consequence in the context of the present discussion. The preceeding analysis has not explicitly taken into account the

role of taxes and expenses. Both of these items are particularly important in the context of premium calculations, from the viewpoint of the insurance company. An insurance company may well use a higher rate of interest than the valuation rate of interest to calculate premiums. However, it is the net effective return to the consumer that we are examining here. The effective return to the consumer is reduced by the inclusion of an allowance for these two items.

Notice, however, that if the insurance company were allowed to use a 4% p.a. interest rate assumption in calculating policy reserves the situation would be altered. The valuation balance sheet would now read

Value of Assets	Value of Liabilities
2700	2650

In this case, the assets exceeds the liabilities and the excess of $50 referred to as the surplus. If the liabilities were valued at 5% p.a., the surplus would be $690. Notice that these considerations must be taken into account when the insurance company determines its premium basis. If the company were required by law to value its liabilities at 3% p.a., it could not demonstrate solvency in the case of this particular contract if the premium were $2,700. To achieve this objective the premium charged would have to be raised to $3,590. This of course would represent a substantial increase in cost to the policyholder and adversely affect the rate of return earned on the investment component of the contract. For a long time the maximum interest rate permitted by the legislation was 3½% p.a. Insurance companies can, as pointed out earlier, apply to the Superintendent to use higher interest rates in policy reserve calculations. Most of the traditional business is still valued at interest rates of 3½% or less (from an inspection of the 1976 returns which are the latest available at time of writing).

A similar situation obtains in the case of annual premium contracts. Table 16 shows how the annual premiums in respect of non-par whole life policies vary with different interest rates for three different ages: 35, 45 and 55.

TABLE 16: ANNUAL PREMIUMS PER $1000 SUM INSURED NON-PAR, WHOLE LIFE, INSURANCE POLICY

AGE OF LIFE INSURED	INTEREST RATE USED IN CALCULATION 3% p.a.	4% p.a.	5% p.a.	6% p.a.
35	16.29	13.90	11.94	10.35
45	24.70	22.10	19.88	17.99
55	39.09	36.37	33.96	31.81

The reduction in the premium in moving from a 3% p.a. interest rate to a 6% p.a. rate are still substantial, although not as dramatic as in the case of single premium policies. It is of interest to compare representative non-par annual premiums currently quoted by life insurance companies in Canada with the figures in Table 16. The average annual premium rate per $1000 (in respect of $50,000 policies) given in the 1978 Edition of the Shoppers Guide to Canadian Life Insurance Prices [5] produced on behalf of the Consumers' Association of Canada are given below.

Male Age	Premium rate per $1000 Sum Insured (1978 figures). Non-par whole life annual premium contracts $
35	14.23
45	22.14
55	35.71

Comparing these premium rates with Table 16 we see that on the basis of 1958 CSO mortality the 1978 premium rates reflect an underlying rate of interest of approximately 4% p.a. It is not claimed that a life insurance company would consider this mortality table necessarily appropriate for premium rate calculations in 1978. It is suggested that 4% p.a. is indicative of the average yield obtainable on a representative non-par whole life contract. The yield is an average one in the sense that if a large number of individuals took out similar policies (and did not surrender them!) the average of the various yields obtained would be around 4% p.a. This figure of 4% is therefore on the

high side since lapses and surrenders are significant at the earlier durations. On the other hand, the yield for a participating whole life contract would probably be higher on the assumption that current dividend scales were maintained. This represents an area where additional empirical research would be useful.

The estimate of the yield obtainable on current whole life contracts highlights the point made earlier about the interest rate used in premium computations. From the viewpoint of the consumer, it is not the interest rate used by the insurance company in its premium calculations that is of primary concern. When allowance is made for commission, expenses, taxes and other items the yield is reduced. It is the net effective yield to the consumer that matters.

Thus far we have only discussed the annual premiums that arise from different interest rate assumptions in the case of non-par whole life contracts. We now investigate the impact of different interest rate assumptions on the reserves under annual premium non-par whole life contracts. For simplicity we restrict the discussion to the reserves at various durations per $1000 sum insured for a male aged 35 at entry. The reserve calculation in respect of an annual premium contract must take into account not only the value of the benefits payable under the policy but also the value of the outstanding premiums. For this reason, the calculation is more involved in the annual premium case than in the single premium case. Again we refer to Pedoe [3] for the technical details. Policy reserves at various durations for different interest rate assumptions are shown in Table 17. Notice from Table 17 that if the interest rate used to calculate the policy reserve is increased the value of the reserve is reduced. As in the single premium case, low interest rate assumptions lead to stringent reserve values. This in turn induces higher premium values and reduces the yield available to consumers. A price has to be paid for the stringent conditions on the valuation basis for reserves.

Before closing the discussion on the implications of using low interest rates for policy reserve calculations, a number of general observations are in order. The practice of granting guaranteed cash surrender values on many Canadian life insurance whole life contracts could provide justification for the stringent reserving requirements. The reserve on a given policy should be at least equal to the cash surrender value, since the policy owner has the option of surrendering the policy at any time and receiving in cash the amount of the cash surrender value. In the early years of a whole life contract,

TABLE 17: POLICY RESERVES AT VARIOUS DURATIONS PER $1000 SUM INSURED. ANNUAL PREMIUM NON-PAR WHOLE LIFE CONTRACT. MALE AGED 35 AT ENTRY

DURATION	INTEREST RATE USED IN COMPUTATION 3% p.a.	4% p.a.	5% p.a.	6% p.a.
5	75	64	54	46
10	156	135	118	102
15	243	215	190	168
20	334	300	270	243
25	426	389	356	325
30	516	479	444	412
Annual premium	16.29	13.90	11.94	10.35

the cash surrender values take into account the incidence of the substantial first year commission and expenses on the policy. At the later durations, it is common for the cash surrender values to approximate to the policy reserves calculated on a particular mortality and interest basis. For example, this basis might involve 1958 CSO mortality and 3½% interest. In order for the valuation basis used by the insurance company to produce policy reserves which are at least equal to the guaranteed cash surrender values it is necessary for the company to use a similarly conservative reserving basis. On the other hand, the fact that guaranteed cash surrender values are mandatory in the United States and the fact that the federal legislation in Canada has provided a framework within which it was possible for life insurance companies to provide similar guaranteed cash values on their Canadian policies, represent circumstances which help to explain the existence of guaranteed cash values in Canada. Following this line of reasoning, the guaranteed cash values may owe their existence in part to the stringent basis for policy reserves. Irrespective of what the rationale is for their existence, the presence of these guaranteed cash values tends to depress the returns on whole life contracts not only by their impact on the valuation of the liabilities but also in their impact on the types and nature of the investments that insurance companies hold. In the United Kingdom, it has not been customary

to provide guaranteed cash surrender values and this is one of the reasons why UK insurance contracts have tended to give higher yields than their North American counterparts.

In our discussion of the consequences of using low interest rates for policy reserve computations on the rates of return earned by consumers, the analysis was based on non-par whole life contracts. In the case of term insurance policies, these adverse repercussions do not exist to the same extent because term contracts are typically of short duration. Much lower reserves are required and the influence of the interest rate assumption is considerably reduced. In the case of participating contracts, the analysis is less straightforward but in general one can state that the requirement of using conservative assumptions for reserves and surrender values does tend to depress the yields available to consumers. However, the fact that the contract is participating means that the policy owner obtains dividends which are related in part to the experience of the insurance company. If we ignore deviations from the mortality assumptions and ignore premium loadings and expenses, in theory the yield obtained on the investments of the insurance company will give rise to surplus interest to the extent that this yield exceeds the interest rate assumed for policy reserve calculations. This excess interest should be reflected in the dividend payable. In practice, life is not so simple. In the first place there are substantial expenses associated with the contract in its early years; these may well be in excess of the first years' annual premium. In this case, the new contract at inception cannot show any surplus when valued in isolation. Corresponding to the liability represented by the policy reserve, there are no assets. In fact, there may well be a liability. For the insurance company to demonstrate solvency on its total portfolio, there has to be some cross-subsidy of these policies and this of course reduces the amount of divisible surplus which is available for dividends. The presence of guaranteed cash surrender values tends to produce the same results as were mentioned earlier. In addition, the dividends although not guaranteed can induce a conservative posture. Insurance companies do not like to reduce their dividend scales and so this leads to a cautious approach to the distribution of investment (and other) gains by this method. In fact, participating contracts raise a number of questions regarding equity that continue to be debated in the actuarial literature. The preceeding discussion has merely looked on a few of the issues in this area. It is suggested that additional research on this topic from a consumer perspective is required.

3.1.1 New Legislation Concerning Financial Reporting for Life Insurance Companies

In 1977, an Act to amend the Canadian and British Insurance Companies Act and the Foreign Insurance Companies Act was introduced with the objective of having the financial accounts of insurance companies conform more closely to generally accepted accounting principles. This new Act gives the actuary somewhat greater scope in the selection of valuation assumptions to calculate policy reserves. To date, no valuation reports on this new basis have been published, and it is thus not possible to state precisely what the effect of this new legislation will be.

Under the new provisions the actuary is free to choose valuation assumptions that are appropriate to the circumstances of the company and the policies in force. However, the valuation assumptions must also be acceptable to the Superintendent of Insurance. Thus to a large extent, the impact of these changes on the solvency requirements will hinge on what valuation bases are deemed to be acceptable to the Superintendent.

The new reserving basis will permit the actuary to defer acquisition expenses up to an amount equal to 150% of the first-year net valuation premium. To some extent, this eases the strain on the companies associated with the writing of new business. One of the major components of this high initial cost is of course the first year commission. Notice that the 1974 Report of the Superintendent of Insurance in discussing these proposals stated

> "It is considered that there are very few companies writing new business at a cost of less than 150% of one year's premium although there are companies that are spending more."

It would seem much more beneficial to consumers if the heavy initial costs had been reduced rather than set up a technical valuation method for deferring them. The absolute size of these costs does not seem to be an important issue as far as the legislation is concerned. These costs are paid for by consumers and their existence increases the size of the premiums that have to be paid. It is not suggested that the business can be conducted costlessly but 150% of the first year premium does seem rather excessive.

While the legislation could tend to reduce the size of the policy reserves there may be some forces which would limit the size of the reduction. First, the existence of cash surrender values and other options will tend to reduce the impact of the new regulations. Second, there will be a tendency to avoid an abrupt change. It would, however, be interesting to evaluate the impact of these new changes. It is possible that they could lead to a reduction in solvency standards and improve the rate of

return available to purchasers of whole life contracts. However, much depends on how the insurance companies react to their increased freedom in this domain.

3.1.2 Federal Legislation of Investments of Life Insurance Companies

We now turn to a discussion of the federal legislation regarding the investments of life insurance companies. Only certain types of investments are allowed and within this class there are sometimes restrictions with regard to quality and quantity. In general, the assets can be invested in Government bonds of Canada and certain other countries, provincial bonds, municipal bonds and public authority bonds. Subject to certain conditions the assets may be invested in corporate bonds, debentures, preferred shares, real estate mortgages and real estate for the production of income. In general, these investments are to be in Canada or else a country where the company is doing business. There are very specific requirements regarding investment in common shares. To rank as an eligible investment the shares must be fully paid common shares of a corporation that has paid a dividend or had earnings available for the payment of a dividend of at least 4 percent of its capital stock for at least four of the previous five years, including the last year in the five year period. Subject to various provisions a life insurance company is not permitted to

i) purchase more than 30% of the common shares of any corporation
ii) purchase its own shares
iii) purchase the shares of a corporation incorporated in Canada transacting the business of life insurance, and
iv) invest more than 25 percent of its total assets (book value) in common shares.

In addition, up to 7 percent of total assets may be invested in securities not otherwise permitted but not so as to exceed the limits placed on common shares.

The limitation on the amount of common shares does not apply to assets which are held in a segregated fund in respect of policies under which the benefits are determined with reference to the market value of these assets.

In addition, to the restrictions on the nature and type of investments, there are rules governing the method of valuation of the assets of the insurance company. The statutory returns

call for considerable detail regarding the investments held by insurance companies.

The rationale for the various investment rules seems to stem from the belief that solvency is the dominant consideration. In particular, common shares are regarded as being too risky to occupy a large share of an insurance company's asset portfolio. Pedoe [3] expresses the traditional viewpoint in the following quotation:

"Life insurance contracts in Canada (except under segregated funds) call for payment in fixed amounts of Canadian dollars, hence the securities they should hold should guarantee repayment in fixed amounts of dollars, which common stocks do not".

In practice, the percentage of common shares has been well below the statutory limit as Table 18 indicates.

Once again the existence of guaranteed cash surrender values serves to mitigate against large holdings of common shares in life insurance company portfolios. In the United Kingdom, there are no limitations on the percentage of the assets that can be invested in common stocks whereas in the United States the restrictions are even more severe than in Canada.

Even if one accepts the avowed aims of the legislation with regard to the preservation of solvency, it is not clear that the existing regulations - and in particular the present rules concerning investments - represent the only or indeed the most appropriate method of attaining this aim. The investment regulations appear to have been framed with the belief that the best way to minimize investment risk is to minimize the risk of each individual security. As a measure of risk one might use the standard deviation of the security's return. At least as far as common stocks are concerned, this line of reasoning is no longer in accord with modern thinking in the theory of finance and investments. Returns on securities are to some extent inter-related so that the risk of a security consists of an individual component and a component which is a measure of its relationship to returns on other securities (or the market). From this viewpoint, it is not simply appropriate to regard the return on each security as an individual entity standing by itself. In a number of respects, it is more as important to analyse its risk in relation to the portfolio as a whole.

TABLE 18: PERCENTAGE COMPOSITION OF ASSET PORTFOLIOS OF CANADIAN LIFE INSURANCE COMPANIES FOR SELECTED YEARS

	1955	1965	1975	1976
	%	%	%	%
Government bonds	19.0	13.4	8.1	9.4
Municipal etc. bonds	5.3	5.9	2.1	1.9
Other bonds and debentures	29.8	22.3	24.6	24.5
Preferred stocks	1.9	1.3	0.8	0.8
Common stocks	3.3	4.7	7.8	7.8
Mortgages	30.4	41.5	38.4	37.9
Agreements of sale	0.1	0.1	0.1	0.1
Real estate	2.5	3.1	6.1	6.0
Policy loans	4.8	4.6	7.6	7.3
Cash	1.0	0.9	1.1	1.1
Other assets	1.9	2.2	3.2	3.2

SOURCE: Report of the Superintendent for Canada, 1976, Volume 1

In summary, analysis of the federal legislation regarding investment returns us to a familiar theme. There is a relationship between risk and return. Attempts at reducing the riskiness of investments often are accompanied by a reduction in returns. As we have seen, the rules concerning the computation of policy reserves also tend to reduce the yields obtained by the consumer. Furthermore, the situation is exacerbated by the long-term contractual nature of the typical whole life contract and the provision of long term guarantees. Admittedly, the benefits under a number of these contracts (non-par ones in particular) are riskless. However, they are riskless only in nominal terms. In an inflationary era, it is real dollars which matter.

Although the federal legislation covers a number of other points that are of interest in the context of the present study,

space does not permit their examination. Instead, we will move on to a discussion of the provincial insurance legislation.

3.2 Provincial Insurance Legislation

In this section, we shall discuss a number of aspects of provincial insurance legislation. There is a high degree of uniformity among the various provinces with regard to provincial insurance legislation. This uniformity stems from the so called Uniform Life Insurance Act which serves as a basis for insurance legislation in the various provinces. One of the objectives of the Association of Superintendents of Insurance of the Provinces of Canada is to promote uniformity in the area of provincial insurance legislation.

As mentioned earlier, the provincial legislation deals with such matters as policy conditions and the licensing of agents. In addition, insurance companies which have a provincial charter must report to the provincial Superintendent of Insurance in much the same way as federally registered companies report to the federal Superintendent. Thus the solvency of provincially registered companies is a provincial responsibility. The solvency standards are similar to those imposed by the federal authorities.

The provincial insurance legislation contains general provisions regarding the licensing and regulation of insurers, special provisions concerning the various branches of insurance including life insurance and regulations concerning insurance agents. The provincial Superintendent of Insurance can prohibit policies which he deems to be unfair. For example Section 94 of the Insurance Act of B.C. reads

> "(1) The Superintendent may require an insurer to file with him a copy of any form of policy or the form of application for any policy issued or used by the insurer.
>
> (2) Where an insurer issues a policy or uses an application or advertisement relating to a policy that is, in the opinion of the Superintendent unfair, fraudulent, or not in the public interest, the Superintendent may, after hearing the insurer, prohibit the insurer from issuing further policies in the same or similar form and from using applications and advertisements in the same or similar form.

(3) Any insurer which, after being so prohibited, issues any such policy or uses any such application or advertisement is guilty of an offence against this Act."

There are some interesting aspects and possible consequences of this piece of legislation but to properly evaluate it we would need to analyse how it has been interpreted by the Superintendents. As it stands, it seems as if an insurer can get away at least once with issuing an application or advertisement that is "...unfair, fraudulent or not in the public interest" without necessarily being guilty of an offence against the Act.

The Insurance Acts contain fairly detailed provisions regarding the contract terms and conditions and certain administrative procedures. For example the policy has to contain particulars regarding

a) the insured - name
b) the benefits and conditions under which they are payable
c) the premium and period of grace
d) whether the policy is participating
e) the circumstances in which the policy lapses and how it can be reinstated
f) The options available regarding surrendering the policy for cash, obtaining a policy loan and of obtaining paid up or extended term insurance.

There are a great many other detailed provisions regarding further aspects of insurance policies but little would be gained by a mere recital of them. In general, their thrust seems to be to spell out in detail certain requirements and principles concerning insurance contracts. In the main these seem to be designed to ensure that the policy provisions are interpreted fairly and to cover certain eventualities.

The provincial legislation contains requirements regarding the licensing of agents and their actions. Again, the original intent of this legislation seems to spring from some conception of the public interest but certain aspects of the legislation have encouraged practices which cannot be said to be in the best interests of consumers. The reasons for the introduction of these provisions were no doubt good ones and it may be that arguments could be found for their maintenance. However all that is claimed here is that some of the regulations have had a negative impact on the interests of consumers.

Before a prospective agent can obtain a license from the provincial authorities to sell life insurance, he (or she) must pass an examination. In its current form, this examination calls for an extremely low level of product knowledge. This has been already commented on by Douglas Carruthers [6]. An applicant for a license must be sponsored by a life insurance company. Until recently, most provincial Insurance Acts prohibited the agent from placing insurance business with any insurer other than the one named in his license. Given the practical realities of how insurance is sold, it was hard to imagine a more effective mechanism for preventing competition. A typical consumer who wished to shop for life insurance would find it very difficult and time-consuming to obtain comparable quotations from a series of agents.

There has been some relaxation of this single company representation requirement in a number of provinces in the last few years. It is now possible under a number of provincial legislations for an agent to represent more than one company. However, not all insurance companies will allow their agents to place business with other companies. The legislation is generally silent on matters such as the level and amount of commissions payable on life insurance contracts, and on the differentials that exist on the commissions for whole life and term contracts. The amount of commission can (and no doubt does) represent a powerful incentive on the agents' actions and the biases induced in the agent's behaviour are not visible because the amount of commission is not revealed at the time of sale. Most provincial insurance legislation has been in the past very strongly biased against "twisting", that is, replacing one insurance policy with another. As Carruthers [6] has pointed out the legislation that has been in force in most provinces seems to be aimed more at protecting the insurance companies than the insureds. Currently, the Association of Superintendents of Insurance of the Provinces of Canada are considering changes that would make the twisting law somewhat less severe. Basically the traditional version of the anti-twisting legislation states that it is an offence for an agent to induce an insured to replace one insurance contract with another. For example, a typical statement reads

> "Any person licensed as an agent for life insurance under this Act who induces directly or indirectly
>
> a) an insured to lapse, forfeit or surrender for cash, or for paid up or extended insurance or for other valuable consideration, his contract of life insurance with one insurer in order to effect a contract of life insurance with another insurer;

b) a person to lapse, forfeit, cancel or surrender for cash or otherwise an investment contract within the meaning of the Investment Contracts Act in order to effect a contract of life insurance with an insurer;

c) makes any false or misleading statement or representation in the solicitation or negotiation of insurance;

is guilty of an offence against this Act."

One consequence of this type of legislation is to ensure that existing insurance policies are regarded as somehow sacrosanct. In cases where a consumer has purchased an excessively expensive or unsuitable policy, another agent is not allowed to advise the consumer to replace the policy with something more suitable. If one contemplates the outcry that similar legislation with regard to other items such as homes, securities or automobiles would raise it is amazing how this legislation has persisted for so long. Ultra protective measures such as this inhibit proper competition and give rise to inefficiencies. However, the winds of change are blowing.[2] The recently enacted Insurance Ordinance of the Yukon [7] includes the following

"227 (1) A person licensed as an agent for life insurance who,

a) makes a false and misleading statement or representation in the solicitation or registration of insurance; or

b) makes or delivers any incomplete comparison of any policy or contract of insurance with that of any other insurer in the solicitation or representation of insurance;

is guilty of an offence.

(2) The Commission may make regulations,

a) regulating the replacement of an existing life insurance contract by another contract of life insurance;
b) prescribing the duties of insurers and agents in connection with replacement of life insurance contracts."

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[2] See also the new Ontario proposals discussed in Chapter IV.

However, as mentioned previously, this is a developing area and one where the provincial superintendents of insurance have shown considerable interest.

3.3 Income Tax Legislation Regarding Life Insurance

In this section, we examine briefly how the income tax legislation impinges on life insurance. The taxation of life insurance companies is quite complicated and will not be examined. Instead, we shall deal with some aspects of the taxation of life insurance contracts from the viewpoint of the policyholder. We shall also cite instances of some rather effective lobbying by the insurance industry in this area.

Premiums for individual life insurance contracts are normally paid with after-tax dollars. The benefits payable on death are free of income tax and capital gains tax. If the policy is surrendered the difference between the cash surrender value and the premiums paid less dividends received is included as income for taxation purposes. Of course if the policy is terminated after a very short time, no income tax is payable on the surrender of a whole life contract because the amount of the cash surrender value is less than the total premiums paid (less dividends in the case of participating policies). In the 1977 budget proposals, provisions were made for the taxation of the investment component of whole life policies on death and for the taxation of policy loans in excess of premiums paid. Under these provisions, tax would be levied on insurance proceeds at death on the same basis as if the contract had been surrendered immediately before death. Policy loans would be regarded as advances and taxed on the same basis as cash surrenders. Various life insurance organizations mounted an effective campaign of protest against these proposals and the proposal to tax policy proceeds on death was subsequently withdrawn. The provisions regarding the taxation of policy loans have also been changed and at the time of writing it is not exactly clear what the current position is. The strength of the opposition marshalled by the life insurance industry prompted one observer to comment [8]:

> "If there was ever any doubt about the importance of the life insurance industry in Canada it was put to rest by what happened after Bill C-56 came before Parliament."

The following quotation, from the French version of the Life Underwriters Association of Canada's brief to the Minister of Finance, illustrates some of the arguments involved.

"Socialement répréhensible. Bien que les propositions budgétaires d'imposer les gains sur police au décès semblent logiques, en fait elles vont à l'encontre des besoins et des désirs de la société. Cet impôt frapperait indirectement les époux survivants, les enfants, et les autres bénéficiares, à une époque d'extrême tension et de difficile adaptation économique. Sans aucun doute, les règlements suivant la promulgation d'une telle loi imposeraient des restrictions au paiement des sommes dues au décès jusqu'à ce que l'impôt soit payé, ce qui causerait des difficultés supplémentaires. En termes humains, le principe de frapper d'un impôt les sommes dues d'assurance au décès est répréhensible. Il n'est de pire moment ou circonstance. Ce principe devrait être abandonné."

If enacted, these budget proposals would have made term insurance relatively more attractive to consumers since term insurance policies do not acquire surrender values and so the proceeds would be completely free of tax. This point was not lost on the drafters of the brief.

"Les mesures proposées sont un coup sérieux porté à l'assurance-vie permanente. Elles favorisent fortement l'assurance temporaire, alors que le système fiscal devrait rester "neutre" envers les différents genres de polices. A long terme, les propositions budgétaires entraîneront un déclin sérieux de l'assurance-vie en tout qu'instrument économique disponible à un grand nombre de Canadiens pour accumuler de petites épargnes. Les réserves mathématiques en souffriraient et les compagnies d'assurance-vie deviendraient une source de capital moins importante dans l'économie de notre pays."

We will make two observations on this paragraph. First, a more important method of making sure that there is no bias in the treatment of whole life and term would be to ensure that commission scales are neutral as between these two types of contract. Second, we have already seen that there has been a relative decline in the asset growth of life insurance companies. An increasing fraction of savings are already being channelled to other financial institutions.

More recently, the 1978 budget contained proposals which have extended the range of options available to holders of a Registered Retirement Savings Plan when the plan matures. In particular, the RRSP holder would have the option of buying a term certain annuity until age 90 or a new investment vehicle to be known as a Registered Retirement Income Fund. Previously it was mandatory to purchase a life annuity from an insurance company. In large part, these new measures were introduced because of pressure from the Consumers Association of Canada. By

the same token they were strongly resisted by the life insurance industry which saw its monopoly about to be broken.

3.4 Theories of Regulation and Role of Consumer Interest Groups

In the previous sections, we examined some of the detailed aspects of insurance regulation in Canada. This section summarizes some of the theories of regulation and comments on the insights they provide on the insurance situation. In particular, some features and practices prevalent in the current system of insurance legislation are shown to conform with findings in other areas. Below, we will examine the role of the consumer interest group and some of the reasons why it has traditionally been ineffectual in the formulation of legislation in this area.

First, we discuss some of the rationales for regulation. This discussion draws heavily on a recent paper on Government Regulation by Trebilcock, Waverman and Prichard [9]. One justification for government intervention in a regulatory capacity is where there exists a natural monopoly. Free competition would in these cases lead ultimately to a monopoly. Government action is necessary to prevent these monopolies from earning excessive rates of return. It seems difficult to invoke this argument as a justification for regulation of the insurance market. Another common argument for regulation is to avoid the potential for destructive competition especially in industries thought to be essential to the public interest. Versions of this argument can be used to justify the close attention paid to the solvency of life insurance companies by regulatory authorities. Sometimes there are informational limitations in the market place which provide the basis for regulation [9]:

> "For a number of goods and services, a competitive unregulated market will not provide the 'optimal' amount of information in order for consumers to make a correct, informed, choice among providers of goods and services."

This type of argument or something similar is frequently invoked as a justification for the regulation of life insurance. For example Pedoe [3] observes in his text book on life insurance

> "Policy contracts are technical documents and as the business of life insurance became an everyday concern of the average 'man in the street', it became necessary for the government to supervise the business."

Insurance regulation tends to be justified by broad appeals to the public interest. There seems to be little

published serious study of what the actual impact of the legislation has been on consumers as a group and what adverse side effects the existing system gives rise to. Often insurance regulation can lead to a cosy relationship between the regulators and the industry as the following quotation from an insurance regulator (!) shows [10]:

> "If institutions generally are not good at adapting to changes in their environment, government regulatory institutions may have special difficulty and be in special danger, for the regulatory process may bring out these traits that are most resistant to change.
>
> In most regulation, the public is only fitfully interested, and the regulator is insulated from public scrutiny by the complexity and obscurity of the regulatory process, just as the industry is isolated by the mere existence of the regulator.
>
> Left alone with each other, the regulator and his industry unconsciously find a mutual interest in ritualizing their relationship. The regulator must emphasize law and regularity against the day he is challenged in court or denounced in public. He thus must look to form and detail, and he may look away from the operating realities of the industry and from the expectations of the public. The industry relies on the rituals of regulation to make government behaviour predictable and to keep the regulator occupied in areas where interference can be tolerated. Inevitably, both regulator and regulated came to measure their effectiveness by their impact on each other; and they come to live, often quite comfortably, within a closed system.
>
> To what areas do the rituals of regulation tend to confine the attention of government? Often to matters internal to the regulated industry, such as restricting entry to the market, attenuating competition, preserving the institutional structure of the industry, and balancing competitive advantages among entities of different form sponsorship, or regional alliance. As a result, too much regulatory energy is diverted into policing the status quo in the regulated industry and into refereeing contests within it.
>
> These tendencies - to quarantine itself, to exalt ritual and detail and to become distracted with internal problems of the industry - are on the record, discernible in regulation of many kinds. It does not seem to matter what is being regulated or by whom or, in a narrow sense, how well. For the competent regulator the snare is not error; it is irrelevance."

Our preliminary examination of the federal and provincial systems of regulation would certainly seem to confirm some of the points made in the preceding paragraphs. This is an area that would benefit from further study. It is questionable if all the detail required by the federal authorities is strictly necessary or useful. Is the tremendously heavy emphasis on solvency always in the best interests of consumers? Again, one can ask if the provincial legislation is serving the real needs of the public with respect to insurance.

Stigler [11] has suggested that far from resenting regulation an industry may actually welcome it

> "A central thesis of this paper is that, as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit."

He points out that having acquired regulation there are a number of ways in which the industry can use the regulation to protect itself. One way is to suppress substitutes and complements and to seek to limit competition. As Stigler [12] observes

> "Competition, like other therapeutic forms of hardship, is by wide and age-long consent, highly beneficient to society - when imposed upon other people."

It is interesting to note that the insurance industry views itself as being highly regulated [3]

> "No other line of business in Canada is so rigorously regulated and so closely supervised as the life insurance business."

Pedoe [3] notes a page later that this regulation has benefitted the industry

> This supervision in Canada and the U.S.A. has undoubtedly been beneficial to the business, for these countries share the honours of having in force the largest amount of voluntarily purchased life insurance in the world in proportion to their national income."

If we accept Stigler's arguments concerning the regulatory process it is natural to ask why consumers have not provided input to the same extent as producer groups. This has been analysed by a number of authors including Trebilcock et al [9]:

> "...The explanation for this lies principally in the fact that the regulated industry has a highly concentrated stake in the regulatory outcome while consumer interests are widely diffused across the myriad of goods and services typically consumed in a lifetime."

For example, a telephone company can rationally spend vast sums of money promoting a rate increase while an individual consumer who stands only to save a few dollars on phone bills is not strongly motivated to fight the increase although consumers in the aggregate stand to lose the entire amount of the rate increase. It is difficult to organize effective coalitions of consumers partly because of the cost and partly because of the fact that consumers who do not contribute to the coalition stand to gain the same benefits. This is the so-called 'free-rider' problem. Trebilcock et al [9] have analysed this lack of consumer involvement in the regulatory process:

> "Thus at the levels of both legislative and regulatory decision-making, consumer and similar interests are likely to be undervalued through an absence of systematic and forceful articulation. It is important to emphasize here, in relation to the intention of inherent anti-consumer bias, that the view is grounded not on the assumption that regulators are anything less than high-minded but rather on the fact that they tend to be exposed almost exclusively to the viewpoints, arguments, perspectives and data of the industry and rarely to any countervailing views. If the problem were simply that some regulators are venal corrupt or incompetent, it would be easily solved merely by replacing them. But this is not, in general the problem."

The authors proceed to draw attention to the difficulties which thinly-spread low interest groups like consumers have in becoming involved in the process. In the case of insurance, the process is also hampered by the fact that a great majority of the technical experts in the area work for the industry. The various industrial and trade associations have access to well qualified experts to prepare their arguments. Sometimes these arguments invoke appeals to the public interest or the good of society. Adam Smith [13] a long time ago showed a somewhat less sanguine approach:

> "[Every individual] generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it ... he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end that was no part of his intention."

Stanbury [14] in a recent book has outlined a case study of how business interests in Canada have influenced government legislation and policy. He points out that lobbying has 4 main characteristics. First, much of the process is on an informal and to a large extent invisible basis. Second, the process of business-government interaction is continuous. Third, the intensity of the relationship between business and government varies over time. Finally, the site of business-government interaction is constantly shifting. Stanbury also analyses reasons why the consumer interest is in general poorly represented. It is safe to conjecture - and the available evidence appears to stengthen this view - that the insurance industry conforms to this general pattern.

3.5 Comments on the Current Situation

As mentioned several times in this report, this area has progressed considerably during the last few years, even though many serious problems remain. Much of the progress has been in response to or in anticipation of consumer pressure. In particular, increasing awareness of life insurance consumer problems in the United States has stimulated Canadian interest in these problems. Developments in the United States and elsewhere have prompted more disclosure and competition in the life insurance industry. In Canada consumer groups, governments, and the life insurance industry have expressed interest in the solution of consumer problems. While the underlying motivation of these three groups is different, each group has undertaken activities and embarked on initiatives aimed at reducing consumer problems.

The Ontario provincial government sponsored the Carruthers report which was discussed in Chapter I. More recently the Ministry of Consumer and Commercial Relations of the Ontario government has published proposals [15] which aim to implement some of the recommendations of the Carruthers report. In particular these proposals envisage the introduction of insurance brokers who would provide independent advice to the public. The role of the insurance broker is described as follows

"- The Broker will be the representative of the public

- A statutory duty is provided to represent the public in the placing of insurance to the exclusion of all other businesses and occupations and (the Broker) must

hold himself out as a representative of the member of the public for whom he acts to act at all times in good faith in an honest and prudent manner

- It follows that a Broker is forbidden to represent or enter into a contractual arrangement to represent an insurer or to own shares in an insurer and conversely no insurer may own shares as a broker

- A Broker may receive remuneration by way of commission but the amount must be declared in writing and set off in the event that any charge is made to the member of the public

- The Broker must act by way of a corporation and the officers and directors all personally liable for breaches of the Insurance Act committed by any of its officers, directors or employees."

The proposals implicitly provide for life insurance agents to be agents of the insurance company which sponsors them and not to represent themselves as being anything else.

> "Agents will not be entitled to use terms such as "independent", "consultant", etc., to the public which might cause confusion as to whom the agent's responsibilities are primarily due."

These proposals would make "twisting" no longer an offence. It will be interesting to evaluate how these proposals are received and to what extent they are adopted.

The insurance industry has introduced a number of innovations which are designed to improve the position of consumers. Some of these have already been alluded to. They include the introduction of a ten-day "cooling off" period and a recommendation that companies supply Interest Adjusted Net Cost Index figures to consumers. The Canadian Life Insurance Association seeks to increase the public's understanding of life insurance and of course improve the public image of the industry.

The Canadian Life Insurance Association has recommended a number of measures to its member companies which have as their objective [16]:

> "The improvement of service to policy holders and increase in the understanding of life insurance and the removal of areas of potential irritation to our customers."

Individual companies have introduced new facilities for dealing with consumer complaints and anticipating consumer problems in this area. The situation is much more encouraging than it was 10 years ago.

Consumer associations and in particular the Consumers Association of Canada have recently become actively involved in this area. Mention has already been made of the Shopper's Guide to Canadian Life Insurance Prices published by William E. McLeod for the Consumers Association of Canada. This represents an important step and it should help to stimulate price competition in the life insurance market. It will assist discerning consumers in comparing life insurance prices. The Consumers Association of Canada (CAC) has in recent years sent delegates to the meetings of the Superintendents of Insurance of the Provinces of Canada to articulate consumer interests. In addition the CAC played a critical role in persuading the federal authorities to amend the legislation regarding Registered Retirement Savings Plans. Bill C-56 which introduced amendments to the Income Tax Act received Royal Assent on June 30, 1978. Now the range of options available to a taxpayer when his RRSP matures has been extended beyond the traditional life annuity.

Consumer and Corporate Affairs has been concerned and has, in addition to its own work, helped by sponsoring research activity in the area, including this report.

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4. Consumer needs and sources of consumer problems in the life insurance area

This chapter examines a number of consumer needs in relation to life insurance. In particular, we shall discuss consumer needs under three broad headings; information needs with regard to the amount (and type) of life insurance required, information needs with respect to the types of products available and their principal features and consumer needs in relation to the distribution system. To some extent the topics under these three headings are inter-related and this will be reflected in the analysis. The preceeding Chapters provide useful background against which to carry out the proposed analysis. In Chapter 1, our literature survey pinpointed a number of consumer problems and concerns in the life insurance area. We are conscious that not all of these have been satisfactorily documented. Consequently, some limited additional empirical evidence, drawn from the Canadian life insurance market, will be presented in this Chapter. There is scope for additional research in this particular area; various points in this Chapter reference will be made to possible research projects. Our discussions of consumer problems in life insurance will also rely on Chapter 2 which analysed a number of the principal products and trends in the current Canadian life insurance market. In particular, the relationship between the savings and protection components of certain life insurance contracts is very important in the context of consumer problems. In the last Chapter, we surveyed the regulatory environment in which the life insurance business is conducted. Again, this has profound implications for the appreciation of consumer problems in the life insurance field. We saw there that the dynamics of the interaction between the regulatory authorities and the life insurance industry could produce and indeed preserve conditions that were not in the best interests of consumers.

The layout of Chapter 4 is as follows. First, there is an analysis of consumer needs along the three broad headings referred to earlier. Next, there is an examination of how these needs are met (or not met) under the present system and a discussion of potential consumer problems. Those features and characteristics of the present system which mitigate against informed choice by consumers will be examined. In particular, we shall examine a number of aspects of the current distribution system which can and do give rise to consumer problems. We shall also analyse a number of reasons why consumers find it very difficult to make meaningful comparisons across the various life insurance products that are available.

4.1 Analysis of consumer needs

In this section, we analyse consumer needs in relation to information requirements, product knowledge and the distribution system. As mentioned previously, these three topics have certain inter-relationships.

Perhaps the best place to start this discussion is with an analysis of the role and function of life insurance and an examination of what needs it is designed to satisfy. We have seen in Chapter II that the original purpose of the first life insurance contracts was to provide funds on the death of the life insured. As the product developed, certain contracts filled an ancillary role as savings vehicles. For the moment, let us concentrate on the pure protection role.

In order to evaluate his life insurance needs, a consumer should be able to assess his outstanding financial liabilities on death. In order to do this properly, a number of points have to be considered. In the last analysis, there is a considerable subjective element in this evaluation. However, once certain assumptions and personal preferences are articulated, there is a reasonably scientific method of carrying out the analysis. We shall return to this point later.

Let us examine the principal financial needs on an individual's death. First, funds are required to meet last expenses. These may include medical bills, funeral costs, unpaid debts, taxes, (income, property or capital gains) legal fees and perhaps succession duties. Second, funds are often required to pay survivors' benefits. This is particularly the case if the individual is married with a young family. Third, funds may be required for the education of children or the repayment of a mortgage. To properly evaluate his financial needs on death, an individual must make assumptions with regard to the amounts of money required to meet these needs and others that may be peculiar to his own situation. If it is assumed that most consumers are incapable of carrying out this analysis, then the provision of expert advice would be useful provided it is reasonably unbiased. Different families will have different needs and preferences with regard to these various items and so it is very dangerous to postulate rules of thumb. To take a

rather extreme example, an individual who wishes to be buried in a golden coffin will, ceteris paribus, require more funds for last expenses than one who desires a wooden casket. The amount of annual income deemed necessary to support a surviving spouse and two young children will vary widely among various families.

Thus far we have not mentioned price. There may be a considerable divergence between the funds an individual desires to have on death and the amount he can actually afford. Clearly, a trade-off has to be made here as in the many other purchases a consumer makes. We shall consider certain aspects of the cost of life insurance.

Another important point that needs to be stressed is that the consumer should not make the decision as to the appropriate amount of money required on death in isolation from a number of other considerations. For example, this decision should be made within the individual's overall financial plan which in turn should conform to his (or her) lifetime goals and aspirations. It may be that for many consumers, their personal financial plan is not well articulated. It is contended here that such a plan must be articulated in broad terms prior to the analysis of financial requirements on death. If this is not done, a sub-optimal decision is highly probable. The importance of taking the overall perspective is highlighted when we recall that many insurance contracts provide both protection and savings. The availability of an overall financial plan helps in determining the relative expenditures on these two items and in the evaluation of different investment vehicles. For a treatment of both consumer and household decision making and financial planning, the reader is referred to two recent studies [1] by J.V. Poapst.

In estimating the financial requirements on death, the individual must take into account his existing assets, including those such as existing life insurance contracts, which produce funds on death. To do this properly, one requires a considerable amount of knowledge and expertise. Personal assets can usually be evaluated at least approximately - in the case of most individuals. However, to make a complete evaluation, one has to include death and survivor benefits from the various benefit plans he may belong to. These may include employee benefit plans, trade or professional benefit plans and a number of

government benefit plans. To complete the job of estate planning, one has to estimate the probable death and retirement benefits payable from these different plans. Many of these plans are quite complicated and a considerable expenditure of time and energy, even for well educated individuals, would be required to ascertain the benefit levels and conditions of payment. In addition, a multitude of plans would have to be examined. Retirement income in Canada, for example, can arise from at least six different sources. These are private savings, (including life insurance policies), individual Registered Retirement Savings Plans, employee pension plans, the Canada Pension Plan, the Old Age Security Programme and the Guaranteed Income Supplement. In some provinces, there is a means-tested retirement benefit payable in addition to the Guaranteed Income Supplement. It takes considerable effort to acquire a basic understanding of some of these programmes. For example, the Canada Pension Plan provides not only retirement income but also survivor, orphan, and (modest) lump sum death benefits under various conditions. In addition, CPP provides benefits for the children of disabled contributors. It is contended here that to acquire a basic working knowledge of the Canada Pension Plan and its detailed provisions would represent a significant undertaking. In the same way, employee pension plans often seem very complicated and mysterious to the average member. The various provincial pension benefit acts contain certain provisions aimed at making these plans more comprehensible to participants. In the United States, one of the main objectives of the very comprehensive Employee Retirement Income Security Act (1974) is

> "To require the disclosure and reporting to participants and beneficiaries of financial and other information with respect to private pensions and other employee benefit plans and to provide for appropriate remedies, sanctions and ready access to the Federal Courts" [2]

Supposing that an individual has succeeded in obtaining reasonable estimates for his financial needs on death which are in harmony with his overall financial plan, there are two further critical matters that must be taken into account in arriving at a lump sum equivalent. These have to do with inflation (and a suitable discount rate) and taxes. The question of inflation is very much tied in with the choice of an appropriate discount rate and we have elected to deal with these together. The question of discounting arises because certain of the financial requirements at death will involve future series of payments. Thus, for example, the annual income required for survivors will be computed first. This amount need not be constant in each future

year but can change when children attain specified ages or when the surviving spouse reaches age 65. In the same way, the assets available on death from various benefit plans may consist of a series of payments (as in the case of a survivor's pension). Of course, in some cases the assets available from benefit plans may consist of a lump sum amount as in the case of many group life insurance plans. In general, both the assets and liabilities will contain periodic future payments and it is suggested that they should be converted to lump sum amounts on consistent bases.

To illustrate how this can be done and at the same time discuss the relationship between the expected future rate of inflation and the assumed discount rate, the following concrete example may be useful. Assume that individual A, currently earning $20,000 per annum estimates that the income his survivors would need, if he were to die today, would be $12,000 per annum for the next twenty years. For the moment, we ignore the question of income tax. If A estimates that the interest rate at which money could be invested in "fairly" safe investments is 9% p.a., he might proceed to calculate the lump sum equivalent of the 20-year stream as follows.

$$12{,}000 \quad [\ 1/1.09 + 1/(1.09)^2 + \ldots + 1/(1.09)^{20}\ ]$$

$$= 12{,}000\ a_{\overline{20}|} \quad \text{at } 9\% \text{ p.a.}$$

$$= \$109{,}543$$

This line of reasoning contains a flaw unless A only wishes to provide nominal income and not real income to his dependants. When interest rates are 9%, this means that investors expect a future inflation rate of say around 6% p.a. They require an inflation component in the yield as well as a real return. The magnitude of the real return has varied over time and across investments but we are assuming it to be 3% per annum. If there is continued inflation at the rate of 6% per annum, the amount of $12,000 payable in one year's time will not be able to purchase $12,000 worth of goods and services in terms of today's dollars. To achieve this objective, an amount of $12,000 X (1.06) = $12,720 must be available in one year's time. In the same way $12,000 X $(1.06)^2$ = 13,483 must be available at the end of the second year. This line of reasoning leads to the following expression for the lump sum equivalent of the payment stream

$$12{,}000 \left[\frac{1.06}{1.09} + \left(\frac{1.06}{1.09}\right)^2 + \ldots + \left(\frac{1.06}{1.09}\right)^{20} \right]$$

A useful approximation is obtained by replacing $\frac{1.06}{1.09}$ by $\frac{1}{1.03}$

this gives

$$12{,}000 \left[\frac{1}{1.03} + \frac{1}{(1.03)^2} + \ldots + \frac{1}{(1.03)^{20}} \right]$$

$$= 12{,}000\ a_{\overline{20}|} \quad \text{at 3\% per annum}$$

$$= \$178{,}530^{1}$$

As mentioned earlier, some payment streams from certain benefit plans may be tied to the consumer price index. Indexed and non-indexed benefit streams are quite different and this difference must be taken into account when they are to be discounted. For example, the indexed stream of payments could be discounted at 3% whereas the non-indexed stream might be discounted at a much higher figure, say 9% per annum. These interest rate values are arbitrarily assumed. It would be difficult to expect economists and investment experts to agree on any one interest rate.

The conversion of a future income stream to a lump sum has been stressed because it plays an important role in the estimation of financial needs on death. It would be possible to display needs as a series of amounts in each future year. It is very difficult for most people to grasp the significance of a series of payments. These calculations can, of course, be carried out very easily by means of a computer programme. However, it is important to emphasize that the underlying assumptions must be reasonable.

It should be remembered that the incidence of income tax has to be taken into account in these calculations. To carry out the estimation of survivors' needs, an estimate must be made of their effective tax rate so that the number of after tax dollars necessary can be estimated. The inclusion of appropriate tax assumptions adds further complications to the procedure.

1. This figure of $178,530 is substantially greater than the earlier amount of $109,543, highlighting the profound impact of making an allowance for inflation in these calculations.

Having discussed the consumer's needs, in relation to estimating his financial liabilities on death, we now turn to a discussion of his informational needs concerning the various methods of meeting these liabilities. There are different methods available for meeting these needs including life insurance, various benefit plans, saving and risk reduction programmes. Not only should the consumer be acquainted with the advantages and drawbacks of various methods, he must also have an idea of the cost of the alternatives. This is because the cost may cause him to revise some of his earlier assumptions in order to end up with a programme he can afford. Once again, it may be necessary for consumers to have access to expert advice on these matters. In connection with life insurance, the consumer must be able to obtain information on the various products available, their principal options and their costs. In addition, he should know the extent to which a particular product provides pure death protection and the extent to which it provides saving. He should be able to evaluate the savings component in relation to the other savings vehicles available according to criteria such as rate of return, risk, inflation protection, liquidity, tax status, etc. No doubt this seems a tall order but it should be remembered that here we are discussing a theoretically desirable scenario and not what occurs in practice. The message that comes through repeatedly is that the more informed and financially educated the consumer is in relation to these matters, the less likely he will be to run into problems.

Next, we turn to an examination of some of the characteristics of an ideal distribution system. A priori, there is no need for the main sources of advice and reference on consumers' life insurance needs to be closely linked with the distribution system. One can see potential conflicts of interest if the same person who evaluates your insurance needs and recommends a particular contract is compensated on the basis of the amount and type of insurance sold. For example, a physician diagnoses illnesses and recommends certain drugs and medicines. These drugs are purchased from another expert the pharmacist - who is independent of the physician. The physician recommends the amount and type whereas the pharmacist makes up the actual prescription. This provides one possible model for the distribution of life insurance. There are many others. However, it is important to stress that the system must enable consumers to have access to unbiased reliable information at reasonable cost. If the market was completely efficient and consumers could compare prices, there would not be very much price dispersion. If there are strong impediments to meaningful price comparison built into either the distribution system or the regulatory system, these are detrimental to consumer decisions.

4.2 Analysis of the Current Situation

The preceeding analysis has looked at consumers' needs with regard to information and product distribution system under ideal conditions. As such, it will provide a useful background for the discussions in this section which look at the current situation. We shall use the same broad topic headings as in the last section. A full analysis of the current situation would require a very comprehensive report and would need to be buttressed by empirical studies. The aims of the present section are much more modest.

It may be useful to commence with some general observations that have a bearing on the sequel. Most of the available evidence indicates that the majority of people regard life insurance as a mysterious and complicated subject. For most people the topic of death - particularily their own-is not a very pleasant one. It is not a favourite topic for conversation or contemplation. It is often suggested that this aversion presents a strong physchological barrier to the understanding and familiarity with life insurance on the part of most consumers. Coupled with this is the fact that the product is rather intangible. The purchase of a new sports car can excite the admiration and perhaps envy of one's neighbours. This is hardly the case with an insurance contract. It is widely claimed that the average consumer is not only hazy about his life insurance needs but is also unwilling to think about them or voluntarily take measures to find out more in the hope of satisfying them. There is a saying within the life insurance industry that life insurance is sold and not bought. On this basis, people do not appear to behave rationally - at least in terms of the discussions of the last section. The insurance industry contends that it requires an agent to convince - sometimes in quite dramatic terms - the average consumer of his life insurance needs. Very often this can be done on an emotional basis, by making the prospect feel guilty. Another technique that is sometimes used is to ask the consumer to envisage, in very concrete terms, the impact of his death on the family's finances. This is sometimes called "driving the hearse up to the door". There is a widespread belief that, without the persuasive presence of the life insurance agent, very few people would voluntarily purchase life insurance. The present author is not aware of any comprehensive statistical investigation of this proposition (and certainly none within a Canadian context). The available evidence does appear to support this proposition but it deserves a more thorough investigation. There is a very strong conviction within the insurance industry that it takes the agent to alert the consumer to his life insurance needs and that the most effective method of compensating the agent is by a percentage commission of premiums.

Thus, when we come to examine what actually happens, the scenario is markedly different from that envisioned in the first section. Most consumers, it appears, do not voluntarily make a rational determination of their life insurance needs and then search the market for an appropriate product that will satisfy these needs. What usually happens in the real world is described in the following quotation [3]:

> "To perform the first part of his job, which is to find potential customers, the agent must identify possible prospects, try to obtain some information about them, and then contact them. The purpose of the contact is to secure an appointment. A method frequently used is to offer some service, such as explaining the prospects' social security benefits. The sale at that point is one of convincing the prospect that the agent has useful ideas. It is not a sale of insurance. Although most people see insurance as a good thing in the abstract, they do not see themselves as needing any "now" and normally they are reluctant to see an agent."

The author describes how the agent proceeds once the appointment has been obtained

> "Once the agent has an appointment with a prospect, he will provide the service he has offered and then attempt to analyze the prospect's situation and identify his needs. The analysis will usually demonstrate a need for additional life insurance. At this point, the agent must sell the need and the specific solution. Although the prospect frequently will not understand the product, he will accept the agent's advice as to what type of policy is preferable - a point that is a source of potential conflict of interest, discussed later."

It would appear that the consumer's principal source of information concerning his financial needs on death and the range of products available is the life insurance agent. Although the insurance companies do advertise, these advertisements tend more to build up a favourable company image than give detailed product and needs information. Under the present system, the agent performs the very difficult dual role of trying to inform and sell at the same time. In view of the commission structure, he is paid on the basis of sales recorded. It is easy to see how there are strong pressures tending to put the educational role

into a subordinate position relative to the selling role. It would be irrational, indeed, for the agent to act otherwise. Furthermore, since it is more profitable for the agent to concentrate on the more affluent members of society, the current system tends to leave the agent with little time for large segments of the population.

One method of measuring what consumers estimate their life insurance needs to be is to examine what life insurance they have in force. There may, of course, be a gulf between what they actually have in force and what they perceive as their life insurance needs. The available evidence is conflicting and somewhat depressing. The Widows Study [4] referred to in Chapter I found that in most cases the families had inadequate insurance. In a different study, Maynes and Geistfeld [5] found that families in general carried too little (or too much) insurance. Ninety-five families filled out detailed life insurance planning work sheets. These included estimates of survivors' income needs and made allowance for existing assets. This procedure produced a life insurance surplus or deficit. A serious deficit was defined as an amount of $15,000 or greater below what the questionnaire responses indicated was needed. In the same way, excess coverage greater than $15,000 was defined as a serious surplus. The results indicated that 46 percent of families had a serious deficit with the median dificit being $40,000. Thirty-one percent had a surplus with the median being $48,000. Thus only twenty-three percent of the families appeared to have been covered for the appropriate amount. These results confirm the impression that families find it extremely difficult to assess their life insurance needs correctly. This study did not require the families to consider cost in their calculations and so perhaps this accounts in part for the deficits. However, such an explanation does not help to account for the substantial surpluses. Both these studies give disquieting results when it is realised that the life insurance programs were most probably formulated with the advice and assistance of life insurance agents.

Under the present system, there is little shopping for life insurance products. The agent who triggers the sale will normally suggest a specific product marketed by his own company. Even if another company sells a similar product at a much lower price, it is not likely that an agent will recommend the other company, particularly if it means that the agent will not receive a commission from a sale that he has both initiated and "closed". The fact that substantial price differences persist furnishes additional evidence that consumers do not generally engage in search in the life insurance market.

Some indication of the extent of price dispersion is illustrated in Table 19 which shows five year renewable term rates per $1000 in respect of a non-participating $100,000 contract. These rates are taken from the 1978 Shopper's Guide to Canadian Life Insurance Prices [6]. Table 19 indicates that considerable price variation exists for this type of contract among the 49 companies which are reported in the guide.

TABLE 19: 5-YEAR RENEWABLE TERM RATES PER $1000. $100,000 SUM INSURED

	MALE AGE			
	25	35	45	55
Average Rate	$2.58	$3.11	$6.11	$13.61
Maximum Rate	3.36	3.83	7.25	17.44
Minimum Rate	1.89	2.32	4.92	10.25
Range	1.47	1.51	2.33	7.19
Range as a percentage of the Average Rate	57.0%	48.6%	38.1%	52.8%

In the discussion of Anna Maria Rappaport's paper [3] Peter L. Hutchings drew attention to the lack of price competition and its relation to the current distribution system.

> "One of the many insights of this paper is the relating of field compensation practices to the lack of effective price competition in life insurance. Today's agent has an excellent understanding of his commission agreement; today's customer has, at best, an imperfect understanding of his insurance product. Companies compete for agents and agents compete for customers. In the past this imbalance led to abuse and abuse led to section 213. As the paper suggests no such regulation would be needed if the product were less confusing."

This same paper also draws attention to the role of a life insurance agent as a professional and points out how difficult this image is to live up to given the current system.

> "The life insurance agent has been taught to be, and is presented to the public as, a professional. This has both advantages and disadvantages. The agent is supposed to represent the interests of both the client and the

company, and he should put the interests of the client ahead of his financial interest. He is paid by commissions on what he sells rather than by fees on the work he does. Public opinion probably varies over a spectrum ranging from acceptance of the agent as a professional to belief that the agent is simply a salesman and can be expected to act in his own best interest. Advocates of this concept of professionalism say that it has created an obligation for the life insurance agent to act in the clients' interest over and above any obligation that normally rests on a salesman. The concept needs to be evaluated further. The agent is paid commissions by the company selling the policy and is not an independent, fee-paid professional. Equating the agent with an independent professional may create obligations that are impossible both for him and the company."

Rappaport notes that the present distribution system poses problems for the insurance companies and the agents as well as consumers. It should be pointed out that her paper dealt with the United States but it is believed that many of her observations are equally valid in a Canadian context.

"...the present system has a number of drawbacks.

1. It is very difficult for new agents to get started. On the average, not more than 15 per cent of the new agents hired become successful agents. Some companies experience higher retention rates and some have lower retention rates, but the total result is disappointing. A substantial number of agents have a very difficult time earning an adequate living.

2. Lapse rates are higher than desirable. First year lapse rates on ordinary business range from 7 to 25 per cent. Lapsed policies are costly to the company and the policyholder.

3. Minimum deposit insurance is often sold when term should be sold instead, and, if it lapses soon after issue at a high cost to the policyholder.

4. The rewards to the agent for selling very large and very small policies are unrealistic relative to the effort required to make the sale. This is a problem the industry has come to grips with in setting commissions for group insurance and single-purchase-payment variable annuities.

5. Vested commissions are paid to agents who no longer have any connection with the company and are no longer providing any service to policyholders.

6. Also a policyholder does not receive the service he is paying for when his agent leaves the business (unless another agent is assigned to provide this service for him), and his premiums are not reduced accordingly."

She is also very critical of the role played by renewal commissions.

"Since renewal commissions are never contingent on whether the agent actually performs the renewal service, and since they are not large enough to attract the agent's interest, many agents do not perform renewal service. Many agents feel that renewals are inadequate to compensate them for the time required to perform services. Those that do perform service are often motivated by the fact that they expect to make an additional future sale. Such service may be viewed as a form of prospecting. It is questionable to what extent renewals provide an incentive for agents to work to keep business on the books."

In summing up her paper Rappaport's main conclusions were:

"Product choice is a key consumer concern at the time of purchase. The consumer is strongly influenced in his choice by his agent's advice. But the agent is paid vastly different compensation for selling permanent and term policies (even if the premium amounts are similar). So the commission scale, affecting what agents want to sell, tends to influence product choice...

Agent compensation is a key factor in influencing agent behaviour. The present system provides strong incentives for production but very weak incentives for persistency. From the consumer's viewpoint, the system is weak at those points where the policyholder dollar is spent ineffectively. From the company's viewpoint, the system makes it difficult to build and rebuild its agency force in the current environment.

Renewal commissions in their present form, represent an ineffective expenditure of the policyholder dollar."

This reinforces our own earlier observations that in a market where consumers know so little about their needs and the products available consumers rely on their agents' advice. The agent's behaviour is strongly influenced by the compensation system. Rappaport claims that the commission system strongly favours so-called permanent insurance over term insurance. Clearly, it would be of considerable interest to investigate this empirically in a Canadian context. Although the published statutory returns do not permit one to carry out such an investigation, one can use them to obtain a rough estimate of the commission levels.

Table 20 displays the commission levels as percentage of premiums in respect of the ordinary business of Canadian companies. These figures relate to annual premium participating and non-participating business. This Table includes the foreign business of these Canadian life insurance companies since the Reports to the Superintendent of Insurance gave aggregate figures for domestic and foreign business combined. It was not possible from the returns to split up the commissions between foreign and domestic business.

TABLE 20: ANALYSIS OF COMMISSION RATES PAYABLE BY CANADIAN LIFE COMPANIES IN RESPECT OF ORDINARY BUSINESS (1975 business)

AVERAGE COMMISSION RATE	PARTICIPATING		NON-PARTICIPATING	
	First Year	Renewal	First Year	Renewal
10 largest companies	70.7%	5.20%	54.0	4.9
Remaining companies	90.5%	5.20%	67.3	5.1
All companies	84.8%	5.20%	63.7	5.1

This table demonstrates that first year commission rates for all companies in respect of participating business significantly exceed those for non-participating business. Table 9 of Chapter 2 shows that non-term business is mostly participating while Table 10 of Chapter 2 indicates that the term business is predominantly non-participating. These observations, taken in conjunction with the figures in Table 20, suggest that the commission rates on non-term business are significantly higher than those on term business. Comparing Table 20 with Table 2 of Chapter 1, we note that Canadian companies pay much higher first year commission rates than do United States companies on their domestic business. The State of New York places maximum

commission limits on various life insurance products and this is one factor which may account, at least in part, for the lower commission levels in the United States.

It is also of interest to compute the average commission rates for the 10 largest companies (in terms of premium income). In the case of participating business, the 10 largest companies account for 88.6% of total premium income. The corresponding figure for non-participating business is 73.2%. Table 20 demonstrates that the first year commission rates paid by the remaining companies (i.e., excluding the 10 largest companies) are much higher than those of the 10 largest companies. This differential exists for both participating business and non-participating business. While there may be a number of factors which may help to account for this we can suggest two possible explanations. First, it may be that the 10 largest companies simply have lower prices and one factor producing these prices is the agent's commission. We have some very preliminary evidence supporting this contention. A second explanation may be that the 10 largest companies write more foreign business and in particular United States business. Since United States commission rates are substantially lower than Canadian commission rates, this will lead to lower overall commission rates for the 10 largest Canadian companies. The statistics support this contention. In 1975 the percentage of ordinary life participating annual premiums attributable to the foreign business of Canadian companies was 41.4%. Domestic business accounted for the remaining 58.6%. However, the 10 largest companies accounted for virtually all of the foreign business - 97.5% by premium income. Furthermore, preliminary evidence suggests that those companies which wrote the least foreign business had the highest commission rates. This is illustrated in Table 21.

TABLE 21: COMPARISON OF FIRST YEAR COMMISSION RATES AND PERCENTAGE OF FOREIGN BUSINESS FOR ORDINARY LIFE PARTICIPATING POLICIES FOR 1975.
(10 LARGEST CANADIAN COMPANIES ONLY)

NUMBER OF COMPANIES	PERCENTAGE OF FOREIGN BUSINESS	AVERAGE COMMISSION RATE
2	0	98.8
3	40 - 50	64.1
2	50 - 60	66.7
2	60 - 70	59.0
1	over 70	65.6

Because Table 21 represents only one year and because the data are not as detailed as might be desirable, it is difficult to draw any definite conclusions.

The second explanation for the lower average commission rates found in the largest 10 companies is that this was a reflection of lower costs and would lead to lower prices. Again, we have some tentative evidence supporting this proposition. As we have seen in Chapter 1, it is very difficult to obtain a figure for the price of participating life insurance. For present purposes, we shall use the Interest Adjusted Net Cost Index over a 10 year period and a 20 year period for ages 35 and 45. The figures are displayed in Table 22 and have been extracted from the 1978 Edition of the Shoppers Guide to Canadian Life Insurance Prices.[6]

TABLE 22: AVERAGE INTEREST ADJUSTED NET COST INDICES. RATES PER $1000. $50,000 PARTICIPATING WHOLE LIFE POLICY

AGE 35	10 YEAR	20 YEAR
Largest 10 companies	$ 6.01	$ 5.37
Remaining companies	7.52	6.76
AGE 45		
Largest 10 companies	10.14	10.08
Remaining companies	12.24	12.14

Table 22 indicates that the prices charged by the 10 largest companies are, in fact, lower than those charged by the remaining companies. However, it should be emphasized that these are average figures and that there may be some of the remaining companies where prices compare favourably with those of the 10 largest companies. Conversely, some of the 10 largest companies may have prices which compare unfavourably with the more competitive smaller companies. Geehan (reference [7] in Chapter 1) found that larger firms in general set lower prices. However, to conclude that the lower average commission rates in those companies result from a lower cost structure may be hasty. Geehan's work suggests some evidence of statistically significant economics of scale but no evidence that economically significant scale economics exist.

4.3 Summary of Consumer Problems In the Life Insurance Area

We have already analysed the various consumer problems in this area in the earlier part of this report. The present section summarizes some of those problems.

Probably the basic problem is that the average consumer is ill-informed concerning his life insurance needs and the range of products that are available to meet those needs. Consumers in general do not know how much life insurance they should purchase nor do they know what type they should buy. Furthermore, they cannot, in general, make meaningful price comparisons or shop for life insurance products. We have identified a number of features of the current environment which tend to perpetuate this state of affairs.

In particular, the current distribution system leads to a number of consumer problems in this area. We have seen that agents are rewarded primarily on their production of new life insurance business. It is widely asserted that the present system is required in order to stimulate consumers into purchasing insurance. Life insurance agents are supposed to assess their clients' life insurance needs and recommend appropriate policies. The available evidence indicates that both these functions are performed in a manner which is less than satisfactory. The compensation system places tremendous pressure on the agent to recommend whole life contracts. Such contracts may or may not be appropriate in a given situation but they have certain disadvantages when compared to alternative savings media. In addition, the educational process undergone by the agent imparts a strong bias in favour of whole life contracts. For example, the following extract from the Study Manual [6] for life agents gives what are called 16 features of whole life insurance. Although the extract contains nothing that is incorrect, it hardly represents an objective evaluation of whole life insurance. Rather, it concentrates solely on the merits of this type of contract and does not mention its drawbacks.

> "Life insurance which accumulates guaranteed cash values is an asset, not a liability. It enables its owner to fulfil obligations both financial and moral.
>
> The following 16 features of life insurance should be fully understood by the life insurance agent
>
> Small Down Payment will Start the Plan
> Yearly Payments Usually not more than 2%, or 3% of the Principal
> Easy Payments and Systematic Accumulation
> No Further Payments Required if Disabled
> Convenient Units of Any Size or Duration Available
> Protected by Law from Claims of Creditors
> Free from Loss due to theft, misplacement, fire, etc.
> Freedom from all Management or Supervision

Control through Lifetime
Capable of Planned Distribution at Death
Guaranteed Market for Life Insurance Policy at all times
No Credit Restrictions
Collateral
Method to Create an Estate First and Save it Later
Value of the Annuity Principle..."

A leading life insurance salesman describes his attitude to whole life as follows [8]:

> "For the most part I rely on Whole Life. I believe we can do more with Whole Life than with anything else in the rate book. Whole Life is so flexible, there is hardly anything you can't do with it."

Whenever a prospect criticizes the investment aspect of whole life Mr. Feldman's response runs as follows

> "OBJECTION: I prefer to buy stocks and get a better return on my money.
>
> ANSWER: Life insurance doesn't offer you spectacular returns on your money, but it guarantees the return of your money.
>
> The stock market is where money makes money. Life insurance creates money where none existed before.
>
> You would have to live a long long time to keep a policy paid from capital from being one of the best growth investments you ever made."

This hardly represents an objective evaluation of the investment characteristics of whole life insurance.

Earlier in this Chapter, we saw that the current distribution system makes it very difficult for consumers to make meaningful price comparisons of life insurance products. In addition, many features of the products themselves make comparisons difficult. The dual role of whole life in providing death protection as well as savings makes it difficult to evaluate the prices of the separate components. Numerous options and riders can be added to the different contracts. Examples of these are

waiver of premium benefit
double indemnity (accidental death) benefit
family income rider

disability income rider
guaranteed insurability option
various dividend options
various settlement options
various non-forfeiture options.

While these benefits have their uses, the manner in which they are presented tends to complicate the basic product. Other practices make comparisons difficult. Some companies quote rates on the basis of age nearest birthday, others quote on the basis of age last (or next) birthday.

Companies may give what are essentially straightforward contracts very impressive titles. Typical of these are:

The Executive Income Builder
The Presidents Protective Investment Plan

Sometimes companies offer policies that are confusing combinations of increasing and decreasing insurance coupled with various options. Even the name of the product itself tends to be a source of confusion. Whole life is known variously as straight life, ordinary life, cash value life and permanent life. The names of the companies often sound alike. Points of the compass crop up frequently as do words like Provident, Prudent, Mutual and words like National, Canadian, American.

If the consumer ever manages to reach the stage of having two comparable products his difficulties are not over. In particular let us examine the comparison of two participating whole life insurance contracts. It is often misleading to look just at the annual premiums. The company with the higher annual premium may have higher cash surrender values or larger anticipated dividends (or both). Cash surrender values are guaranteed in advance whereas dividends are not. Cash value schedules vary from company to company. Not only do anticipated dividend scales vary from company to company, but the dividends actually paid may be greater or less than those assumed at the outset. Thus to compare prices the consumer has to evaluate two different payment streams, each comprised of some guaranteed components and some which are not. To proceed, the buyer has to make assumptions (explicit or implicit) concerning

(i) the appropriate discount rate
(ii) the mortality assumptions
(iii) the surrender (lapse) assumption

(iv) the individual's tax position
(v) the buyer's utility preference
(vi) the size of future dividends

As we shall see, there has been some progress in the construction of index figures to be used for price comparisons in this area.

We have already cited examples where the action (or inaction) of the regulatory authorities can tend to perpetuate consumer life insurance problems. Regulation can be used to protect the industry in the name of the public interest. Hitherto, the federal authorities have concentrated solely on ensuring that the companies stay solvent. These strict solvency regulations are responsibile in part for the disappointing returns obtained on the savings component of whole life policies. The provincial authorities have countenanced the persistence of regulations which favoured the industry at the expense of the consumer and practices which tended to inhibit meaningful competition.

Solutions to the various consumer problems discussed above should attempt to improve the performance of the market by removing barriers to both competition and meaningful price comparison. In addition, this report has identified a relative absence of empirical research on Canadian consumer problems in life insurance. Such research would be valuable in terms of identifying the extent of consumer problems in various areas. Such information would thus assist in identifying appropriate policy responses.

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