The Sales and Marketing Practices, Auditing and Accounting Procedures and Products of Insurers Utilizing the Home Service System

NAIC
National Association Of Insurance Commissioners
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**Introduction**

The Insurance Availability and Affordability (EX3) Task Force initially appointed the Home Service Working Group in March 1994 at the NAIC Spring National Meeting to analyze the availability and affordability of personal lines products sold through the Home Service system. This charge arose in response to issues raised by regulators over the sale and marketing of property and casualty insurance products to low and moderate income persons and to concerns over availability in underserved areas.

During 1994, the working group decided that an appropriate method for gathering information regarding products and activities of companies utilizing the Home Service system was to conduct a survey focused on property and casualty insurance. The working group developed the survey during 1994 and mailed it to insurers in early 1995 (Appendix A). At the conclusion of 1994 the working group also recommended that its work continue to address issues that were beyond the scope of availability and affordability of property and casualty insurance coverage. The task force decided that it was more appropriate that the work continue under the direction of the Market Conduct and Consumer Affairs (EX3) Subcommittee.

In 1995, the Market Conduct and Consumer Affairs (EX3) Subcommittee was charged to “Study and make recommendations regarding the marketing and sales practices of the Home Service insurance industry.” The Home Service Working Group was reappointed to address this charge. During 1995, the survey of property and casualty insurers was completed and at the NAIC 1995 Winter National Meeting the results were discussed but not distributed in order to protect the confidentiality of information provided by responding companies (Appendix B). The working group sent the survey to 15 property and casualty insurers identified as using the Home Service system. The survey requested information about the property and casualty products offered for sale and the accounting and auditing practices of insurers using the Home Service system. The intent of the survey was to determine information such as whether comprehensive homeowner insurance policies were available to consumers who purchased their property coverage through the Home Service system and the volume of premiums and number of property and casualty policies being written.

The charge to the working group was broadened in 1996 to “Study and make recommendations regarding marketing, products, pricing, sales practices and auditing and accounting procedures of the Home Service insurance industry and develop model legislation to address problems in these areas, if appropriate.” The working group focused in 1996 on completing a separate survey of life insurers to obtain information about the products, pricing, marketing, sales practices and audit and accounting practices of insurers utilizing the Home Service system. On March 6, 1996 the survey (Appendix C) was sent to 36 insurers. The survey was designed to collect information about life insurance policies marketed by the Home Service system. Of the 22 companies that responded, 13 companies provided responses to the survey questions, (Appendix D), and another nine insurers indicated that they did not use the Home Service system. The Life Insurers Conference (LIC) advised that the responding companies represented more than 80 percent of the premiums written in the Home Service market.
This final report contains observations, comments and recommendations based on the findings of both the 1995 property and casualty survey and the 1996 life survey.

NOTE: This report does not determine whether an insurer uses the Home Service system as defined in the purposes of this report. The use of this system by a particular company must be determined by each regulatory jurisdiction.

**Prior NAIC Activity**

The NAIC previously studied Home Service marketing and sales practices. From 1980 to 1982, the Home Service Insurance Task Force of the NAIC conducted a two year study of Home Service, culminating in 1982 with the NAIC’s adoption of a report entitled “Home Service Life Insurance: A Commentary,” which included a proposed model law on industrial life insurance.

The task force divided the commentary into seven distinct parts:

1. “Introduction,” which outlines the objectives that the task force attempted to accomplish in the study;
2. “Home Service Insurance – What Is It?,” which gives a thumbnail sketch of the definition, background, operation and products of Home Service Insurance;
3. “Agent Activity,” which examines the role of the agent in the system;
4. “Marketing,” which discusses the operation of insurers marketing through the Home Service system;
5. “Products,” which reviews the then proposed model law on industrial life insurance;
6. “Insurance Department Activity,” which considers the regulation of Home Service Insurance; and,
7. “Conclusion,” which briefly summarizes the Task Force Findings.

A complete recording of the activities of the Home Service Task Force and references to the 1982 commentary, including its conclusions and recommendations, may be found in the *NAIC Proceedings*.

**Definition of Home Service**

To study Home Service, it was necessary to reach a consensus on what activities constituted Home Service. The working group determined that at least two terms were unique to this study: 1. “Home Service,” a system described in this section; and, 2. “monthly account ordinary,” which is described in the Products section of this report. For purposes of the property and casualty survey, the definition of “Home Service” used was “any property, casualty, life, health or disability insurance policy where such policy is marketed, sold, issued, or delivered through the “debit system,” where premiums for such policy are customarily collected, on a regular basis, at the payor’s home or business by an agent of the company to whose account the company debits such premiums.” During the development of this report, the working group modified the definition of “Home Service.” The modification does not substantially change the definition used in the survey. During the development of this report, it was determined that this revision was necessary in order to explain the differences and standardize terminology among regulators, consumers and industry. In addition, it is recommended that this definition be used if model language is developed.
• “Home Service” is a method of distribution of any insurance policies or contracts through a system whereby initial and renewal premiums of the policy are collected in person by an agent of the company on a monthly or more frequent basis in the ordinary course of business. It should be noted that industrial life insurance is, by definition, marketed by the Home Service system.

As is prominently recognized in this definition, Home Service is a marketing and distribution system and must be distinguished from the products which are sold and serviced through this system. The industry adopted the term “Home Service” approximately 25 years ago as a substitute for the system sometimes referred to as “debit insurance.” This clarification was needed to more clearly define the system of marketing insurance for sales, service, and monthly or more frequent premium collections, which agents of the company provide prospective and existing policyholders at their homes and in person in the ordinary course of business.

Products

Life Insurance

Industrial Life Insurance

The NAIC has adopted two Industrial Life Insurance Model Acts. The most recent model resulted from the 1982 study. Both model acts provide the following definition of industrial life insurance:

“Industrial life insurance is that form of life insurance provided by an individual contract under which premiums are payable monthly or more frequently, and bearing the words “industrial policy,” or other such words approved by the Commissioner, printed upon the policy as part of the descriptive matter.”

While many states adopted this definition with the earlier model act, no state has found it necessary to adopt the revisions found in the 1982 version of the model. Generally the individual states vary the definition only by the maximum face amount. Some states have limited the face amount of the policy to less than $2,000. However, others restrict the face amount to less than $1,000. There are some minor variations in the definitions among the various state statutes, but this basic concept is consistent.

Insurance companies market industrial life insurance differently than ordinary life insurance. The plans were designed for individuals of limited income and minimal insurance needs. A method of marketing and distributing this insurance product to these consumers was devised, the debit system of marketing. This term “debit” initially was used to describe an accounting method used to account for premiums collected by the agent. It later become a term synonymous with industrial life insurance.

The industrial life insurance contract has provisions that are unique to the product. Among the unique provisions in an industrial life insurance contract are: a provision that states the mode by which premium payments are collected, a facility of payments provision, and a prohibition on assignability.
Generally industrial life policy premiums are collected by the agent on a scheduled basis. The facility of payments provision allows the insurer to pay, upon showing proof, the benefits of the policy upon the death of the insured to a person who submits proof of responsibility for the beneficiary or the final expenses of the insured. In addition, industrial policies generally prohibit the assignment of the policy. Unlike ordinary life insurance contracts, the exercise of policy options and rights are granted to the insured under industrial policies with no separate ownership provision.

In analyzing the life survey results, concern was expressed about the propriety of the continued sale and collection of premium on industrial life insurance based upon the statutory constraints placed on the maximum face amount for these types of contracts. The statutory maximum face amount permitted for any one industrial life insurance policy ranges from $1,000 to $2,000. This presents one of the major shortcomings of industrial life insurance in today’s economic conditions. For example, the statutorily restricted face amounts of industrial life insurance may not cover the cost of a “low cost” funeral and may not be sufficient to pay any significant final expenses related to the death of the insured. This concern led to the issuance of a second survey to ascertain the extent to which industrial life insurance is still viable in the insurance market.

To decide what companies still have industrial life insurance on their books, the survey questioned insurers whose Schedule T in their Annual Statement reflected premium receipts on industrial life products. Based upon the responses to the survey, conclusions about the current status of industrial life insurance can be made.

According to a pamphlet published by the Life Insurers Conference (LIC), “in 1989 there were 36.6 million industrial life insurance policies in force, representing $24.4 billion of insurance.” According to the survey responses, in 1995 the twelve (12) respondents with industrial life insurance business on the books had 12.7 million industrial policies in force, representing $11.6 billion of insurance in force. The average size policy was $912.96.

Based on the survey responses, the amount of industrial life insurance written declined from 1991 to 1995 because the number of companies writing new industrial life policies has declined as the market demand for the product has declined. In fact, 10 of the 13 survey respondents have indicated that they no longer write new industrial life insurance policies. However, during the 1991 to 1995 period, the amount of monthly account ordinary insurance sold increased as a percentage of the total sales by insurers using the Home Service system.

The following chart depicts this shift in products sold based on total written premium from 1991 to 1995:

<table>
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<tr>
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<th></th>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Industrial Life</td>
<td>$1,038</td>
<td>$0.907</td>
<td>$0.786</td>
<td>$0.687</td>
<td>$0.587</td>
</tr>
<tr>
<td>Monthly Account Ordinary</td>
<td>$191.3</td>
<td>$138.2</td>
<td>$140.1</td>
<td>$147.9</td>
<td>$133.7</td>
</tr>
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Note: Amounts shown in millions of dollars.

There has been a significant decrease in the volume of new industrial life insurance sales since 1989, as indicated by the survey. Companies that use the Home Service system have begun to
offer products that are similar to those offered by companies using the Ordinary system. The major difference in these products would be the system of delivery and the cost of delivery.

The companies that use the Home Service system often utilize a method of premium collection for their life insurance products called Monthly Account Ordinary (MAO), in which agents of the company collect premiums in person on a monthly basis. MAO products dominate the Home Service system according to a 1993 report written by Dr. Bruce A. Seaman, Ph.D. of Georgia State University (The Economic and Social Impact of the Home Service Industry, Appendix E). Dr Seaman reported that these products are “sold primarily to the downscale market with face amounts ranging from $1,000 - $15,000, with an average policy size of approximately $10,823 as of 1992.”

The life insurance products most often sold through the Home Service system are:

- Traditional Whole Life Insurance
- Universal Life Insurance
- Interest Sensitive Whole Life Insurance
- Term Life Insurance

The structure of these products is the same when sold by companies using either the Home Service system or the Ordinary system. The cost of the products varies between the two markets primarily because of the delivery system.

Consumers that rely upon the Home Service system pay for personal service. Premiums are structured to reflect the cost of the collection and servicing method. Lower face amounts are offered to make premium payments more attractive for the typical Home Service customer.

The “ordinary system” consists of consumers that are able to utilize bank draft, mail and a variety of other payment modes to pay premiums directly to the company. These methods decrease the need for personalized service and reduces the cost for the products.

**Monthly Account Ordinary**

Monthly Account Ordinary is one term to describe the method used to service term life insurance policies or traditional whole life, cash value, policies where premiums are collected and serviced monthly. The plan has a fixed premium, fixed face amount, and a fixed amount of time for payments. Cash value grows at a contracted rate. This can also be referred to as Monthly Debit Ordinary (MDO). MAO or MDO are not statutorily different than other ordinary insurance.

**Universal Life Insurance**

Universal Life is one of the terms used to describe a kind of flexible policy that lets the insured vary the premium payments. The insured can also adjust the face amount of the coverage. Increases may require proof that the insured qualifies for the new death benefit. The premiums paid (less expense charges) go into a policy account that earns interest. Mortality and expense charges, which change with the age of the insured and length of time the policy has been in force, are deducted from the account. If the yearly premium payment plus the interest the account earns is less than the charges, the account value will become lower. If it keeps dropping,
eventually the coverage will end. To prevent that, the insured may need to start making premium payments, or increase the premium payments, or lower the death benefits. Even if there is enough in the account to pay the premiums, continuing to pay premiums means that the insured builds up more cash value. Universal Life policies issued by companies utilizing the Home Service system do not differ from those issued by companies not using the system.

**Interest Sensitive Whole Life Insurance**

Interest Sensitive Whole Life is a term used to describe a permanent life insurance contract that credits the cash value with the current interest rate. The company may adjust the fixed level premium periodically to reflect historical and/or anticipated changes in interest rates, expenses and mortality cost. These changes may result in a face amount adjustment. Interest Sensitive Whole Life insurance policies issued by companies utilizing the Home Service system do not differ from those issued by companies not using the system.

**Regular Ordinary Life Insurance**

It should be noted that companies that market the aforementioned products via the Home Service system also market regular ordinary life insurance products, which are the same type of term and whole life insurance policies sold by those companies that do not distribute their products via the Home Service system.

**Fire Insurance and Other Home Service Property Insurance Products**

Initial interest with the Home Service system was based, in part, on concerns expressed by the NAIC Availability and Affordability (EX3) Task Force in 1994 that there might be problems with access, availability and affordability of property insurance in urban areas, including those products marketed via the Home Service system.

**Product Coverages and Cost**

In response to the property and casualty survey, only one insurer offered a homeowners product that provides coverage of the dwelling, contents, additional living expense, medical payments and liability. All 12 insurers offered a dwelling fire or industrial fire policy that includes extended coverage. Coverage for liability was available through one insurer as an endorsement, but was limited to $100,000. Two insurers indicated that limited additional living expense was provided with the industrial fire policy. Eight insurers indicated that coverage for burglary and theft is available as an endorsement at an additional premium.

Three insurers reported having a coinsurance provision (albeit all were different) and 10 insurers reported having standard fire policy language. Only one insurer offered any form of replacement cost coverage on the dwelling and contents; however, the coverage provided was very limited, compared to the standard homeowners policy.

Several insurers reported that discounts are available for premiums paid either by pre-authorized checking or in a manner less frequently than monthly. They indicated no other discounts or savings.

Premium comparisons between Home Service insurers, Fair Access to Insurance Requirements (FAIR) plans (if applicable) and other insurers were obtained from Maryland and Texas.
Arkansas previously conducted similar price comparisons. These price comparisons indicated that property insurance provided through the Home Service system often provided less coverage for higher premiums than the FAIR plans in those states.

**Health Insurance**

In the March 6, 1996 survey, there were several questions related to health insurance. The working group did not intend the questions on the survey pertaining to health insurance to gather any statistical data, but only to determine if the responding companies were writing any type of health insurance through the Home Service system.

According to a survey conducted by the Life Insurers Conference (LIC) in 1991, health insurance was sold through the Home Service system primarily as a supplement to life insurance. Sales of health insurance through the Home Service system have been declining due to the advent of managed care, thinner margins on the products and untimely approval of rates from state insurance departments. All companies responding in the 1991 survey indicated that they were in compliance with all loss ratio standards.

According to the 1991 survey, the primary health insurance products sold through the Home Service system were:

1. Accident Insurance – pays a level benefit for specific injuries or a daily benefit for each day of disability due to covered injuries.
2. Hospital Indemnity Insurance – pays a daily benefit for each day of covered hospitalizations.
3. Cancer Insurance – pays a level, daily and/or reimbursement benefit for the diagnosis and/or treatment of cancer.

About 2/3 of health insurance sales are on a monthly debit mode with a premium of $8-$28 monthly. The other 1/3 is sold with a premium notice issued. The market is middle and low to middle income households.

**The Home Service System**

During the development of this report, several areas of regulatory concern were identified. These include concerns with accounting, auditing and collection procedures; and with the licensing of agents. These concerns are identified in the following section of this report.

**Accounting Procedures and Records**

The working group was interested in the information field agents provided to the company and the degree of influence that information may have on the accuracy and completeness of the company’s records. Based on the survey responses, companies have several home office controls in place to assure that premium collections by agents are properly recorded and credited to the premium payor’s accounts. The majority of respondents indicated that accounting records are maintained at the home office rather than at a district office or with a field agent. This control removes key record reconciliation responsibilities from the agent and allows for proper premium
payment records to be kept by the insurer, which will give the company the ability to monitor both the number and quality of policies written. These controls are necessary because the accuracy and completeness of information, if provided solely to the company by the field agents, could potentially influence company records.

Auditing Procedures

Audits Performed
All of the companies responding to the survey indicated that they perform audits of district offices. Besides reviewing cash reconciliation procedures at those district offices, a common audit procedure among the companies involves the representative from the insurance company obtaining a list of policies for a given reporting period and comparing the information contained on this document to the actual premium receipt records. Sometimes, this audit may include a comparison with other evidence of payment held by the insureds or premium payors. This comparison includes a review of the premiums collected from the premium payor, the premiums actually remitted to the company and the paid-to-dates. This procedure can alert the company to irregularities, including premium overcharges, conversion or diversion of premiums, or failure to submit collections on a timely basis or at all. It is important to note that generally the company is ultimately responsible for the acts or omissions of the agents that are within the scope of their authority.

The performance of audits can be a particularly effective control since the audits serve to complement and strengthen other controls with which they interact. For example, the control related to the use of premium receipt books is enhanced when accompanied by the performance of periodic audits. However, this control is most effective when periodic audits are performed for each agent. Several companies indicated audits are done for every agent at least once a year, while others indicated audits are only done on an as-needed basis. As-needed audits are based on the review of financial control data and other company determined criteria.

Several companies indicated that they had an internal audit function that was responsible for the audit process, while at least two companies indicated they use the agent’s manager or supervisor as the only audit function. It is important that those performing the audit function are qualified for the task.

Postings to Premium Payor Records
Several of the companies responding to the survey indicated that they send collection reports or similar reports to the agent on a regular basis so that the agent may review the posting of the premium payments. This ensures that premiums are being posted correctly and is important because several of the companies have indicated that district office personnel receive the cash payments from the agents and enter the payments into the computer system. To aid in this process, several of the companies indicated that detailed agent deposit receipts are prepared for the agent after each collection period.

It is also worth noting that in several instances, agents may have access to records maintained in the insurance companies’ district offices. Some of these district offices have access via computer to individual premium payor information held at the home office as noted above. To prevent
Unauthorized persons from having inappropriate access to company records, minimum controls, such as password protection of computer systems, should be in place.

Based on complaints and market conduct examination results, regulators are concerned that audit systems used by Home Service companies are not properly structured to prevent short-term agents, who have access to cash payments from customers, from misappropriating funds. Regulators have suggested that a better audit system, including improved proof of payment methods for the customer, be provided.

**Collection of Premiums**

**Documents Prepared**

It appears from responses to the surveys that generally all companies produce some document or list containing policyholders’ names in each agent’s account or book of business. These documents show all premiums due from each premium payor the agent serves at that time. As the agent collects the premium from the payor, the agent must record, manually or electronically, the collection. This document is then forwarded along with the money to the district office and then to the home office. Either at the district office or at the home office, companies reconcile the total collections against the document. The reconciliations are also forwarded to the home office where they are used to update company records.

To create greater efficiency, some companies have developed electronic methods or other means to facilitate the recording and transmitting of premium collection data for reconciliation of premium collections. Larger companies have moved to the use of computers in recording premium collections, product pricing and illustrations by their agency force. Hand held or laptop computers are more common among the larger companies in the industry. Agency database information is sometimes loaded on by the home office and downloaded through the district offices. Many agents are also able to provide policy illustrations with their computer software.

**Policy Receipt Card or Book**

It appears that all but one survey respondent provides the premium payors with a receipt card or book or electronically printed receipt. This receipt serves as evidence of payment of the premium. While the printed receipt is generated from input to and data stored in a hand held computer device, the card or book has spaces which must be filled in for each month showing the amount of premium paid by the premium payor and signed by the agent at the time of collection. The receipt card or book, as well as the printed receipts, are also used in the audits performed by the insurance companies.

The one survey respondent who does not utilize premium receipt books or electronically printed receipts does use pre-numbered receipts, which the home office prepares. One copy of the receipt is given to the premium payor and the agent retains another copy that is submitted along with the proceeds. The home office monitors the pre-numbered receipts and they follow up any outstanding receipts with the agent and the insured to ensure that no irregularity has occurred. Assuming that follow-up has been performed not only with the agent, but also with the premium payor, the use of the pre-numbered receipts would appear to be highly effective.
It was noted that several of the premium receipt books contain warning messages, such as that checks or money orders should not be made payable to the agent and that premium payors should not pay strangers.

It is important that the premium payor must fully understand that this book is evidence of his or her premium receipt and understand the importance of maintaining the book to ensure that all premium payments are correctly recorded. For the consumer, the receipt book, or a cancelled check if the premium was paid by check, may be the only evidence to support the payment of premiums.

**Agent Licensing and Monitoring Procedures**

The survey revealed that the practice of using temporary licenses by insurers delivering products through the Home Service system still occurs. Provisions for temporary licensing have been included in the NAIC Agents and Brokers Model Act since 1973. The NAIC amended this model in 1989 to reflect the specific application of temporary licensing provisions to Home Service. Laws vary among the states as to the marketing restrictions of these licenses; however, most states allow agents in the Home Service industry to market for 90 days or longer without the same licensing requirements as other agents in the marketplace. Home Service agents with a temporary license in some states may perform their servicing activity without any required insurance knowledge. Some regulators have expressed concern with various problems that may be related to temporary licensing, including the possibility that the actions of inexperienced, unqualified agents may harm consumers.

High turnover of agents in the Home Service industry accounts for companies needing to have individuals licensed to prevent lapses in policyholder premiums, which often come due on a weekly basis. The 1982 study recommended licenses be restricted to full time agents in the Home Service system to facilitate this need for continuity. The report also recommended that these agents be required to complete an approved 40-hour training program as a pre-license education requirement. These requirements are not out of line with pre-licensing procedures for most states today.

A 1995 LIMRA report notes that carriers are using a variety of training programs for their agents. Classroom and self-study make up the source for pre-licensure preparation. The report indicates that nine of their reporting companies ran pre-debit training programs before placing agents in the field. The majority of companies typically use videocassettes to train Home Service agents.
Conclusions and Issues
There are two issues that merit particular attention: the economic benefit of products marketed through the Home Service system and the servicing costs. These issues are discussed below.

The Economic Benefit of Products Marketed Through Home Service
To consider the full impact of the Home Service system, one must consider the market served by this method of delivery since its inception in the mid-1800s. In *The Economic and Social Impact of the Home Service Industry*, (Appendix E), Dr. Seaman refers to the market served by the Home Service system as the “downscale market.” The market is made up of households with incomes below $35,000 per year, which makes up 57.9 percent of all households in America. Dr. Seaman observes that the black and Hispanic communities are especially vulnerable inasmuch as household income in 75 percent of black and 71.7 percent of Hispanic households falls below $35,000. This market does not always have access to other methods of delivery. There is a need for a marketing approach, such as Home Service, to serve these consumers who may not have access to products through other distribution methods.

The market most often served by the Home Service agent has historically consisted of individuals in the low and low to middle income brackets. Since this market is composed of the “downscale,” regulators are concerned that these consumers, with less education and less expendable dollars, be provided with the opportunity to protect their families. Because these consumers may lack knowledge of products or sophistication with insurance, consumers should be protected from agent misconduct and have access to reasonably priced products.

The Home Service industry has demonstrated that companies providing this mode of delivery are striving to improve the methods of serving their customers and to have procedures in place to supervise agents and premium collections. Improvements in auditing and management of field staff demonstrate the steps many companies have taken to address regulator concerns over potential misappropriation of funds by agents.

Companies are offering more products through more premium payment methods to allow customers to increase their coverages.

Future sales of the life insurance products distributed through the Home Service system, such as industrial life insurance, continues to concern regulators because these products may not be economical, particularly when premiums paid are likely to surpass the face amount of the policy.

Any evaluation of the Home Service system should consider the economic benefits of the products being marketed. Products traditionally sold though the Home Service system have generally involved small face amounts. The lower the face amount of the life insurance policy, the higher the relative cost of the policy. The inverse relationship between the volume and unit price is not unique in the insurance marketplace.

As previously stated, the market most often served by the Home Service system has historically consisted of individuals in the low and low to middle income brackets. These individuals often buy policies of relatively smaller face values. While these products are important to the persons that purchase them, there have not been any studies conducted regarding the products’ economic
benefit to the policyholder. The working group was unable to evaluate statistics on the Home Service system which could indicate higher mortality and lapse rates for Home Service policyholders. Historical information and data have not been compiled on the delivery system, only on the products within this system. There are known factors that would increase the cost of this insurance. The fact that the Home Service system is labor intensive would be one additional expense factor and it is important to distinguish the cost incurred by the method of marketing from the other costs affecting the products marketed and the economic benefit to the policyholder.

To determine whether the policyholder will receive economic benefit from products purchased through the home service system, it would be appropriate for states to conduct an actuarial study. Specifically of concern is the fact that in future sales there could be a disproportionate percentage of policyholders who have paid more in premiums than they will receive in benefits. This actuarial study should also determine if in future sales there should be a point at which a policyholder would receive a paid-up policy. A procedure would be needed to actuarially establish the point at which sufficient premiums have been paid to have a paid-up policy or increased benefits.

As a matter of clarification, the Home Service system is unique and this report is not intended to make recommendations with respect to other insurance products or methods of distribution.

Several of the issues raised during the three years the working group has been studying Home Service have resulted in inconclusive findings because of the lack of data available from standard sources. NAIC financial statements do not provide a distinction for products sold through Home Service. Also, the Complaints Database System (CDS) at the NAIC, that captures consumer complaint information from state insurance departments, does not separately track complaints based on the delivery system. Therefore, these data sources provide no conclusive information. This result demonstrates a need for data gathering sources to provide information on the distribution methods of companies.

**Servicing Cost**

The price structure contained within a policy includes both variable costs and fixed costs. The variable costs include the sale and collection expenses and the probability of loss. The fixed costs include policyholder service, taxes, licenses, fees, and general expenses. The cost of servicing a policy is built into the rate for that policy. Questions have been raised on two issues related to the cost of servicing products sold through the Home Service system. One issue is whether the variety of premium payment options available are being disclosed and offered to the consumer. The second issue is whether a Home Service company should consider providing a multi-policy discount when more than one policy is sold in the same household by the company.

**Modes of Premium Payment**

Products sold through the Home Service system, with its direct servicing approach as discussed elsewhere in this report, cost the consumer more. The consumer pays for servicing features,
which include premium collection. This feature, when added to the company’s Ordinary life insurance product, or fire insurance product, increases the cost of the products.

Concern for the consumers who comprise the “downscale” market causes regulators to question whether carriers educate about or provide sufficient disclosure of the premium payment options available. Exercising these various payment modes, such as direct billing through the mail, bank drafts, and quarterly, semi-annual and annual premium payments, creates lower expense charges, which should result in savings that could be passed on to the policyholder.

Some companies that have traditionally marketed through the Home Service system have indicated that this system is becoming a smaller part of their marketing methods, especially in the area of home collection of premiums. Some companies have moved to direct billing and premium lock box methods of receiving premium payments. Some companies stated they do offer discounts when the premium payment mode changes. However, other companies may have changed to a premium payment mode with a lower cost than home collection but not passed any savings on to consumers.

**Multi-Policy Discounts**

Some regulators have questioned whether when multiple policies are sold in the same household, the portion of the expense related to the servicing and premium collection on the policy built into the rate for the policy is duplicative. These regulators have argued that a family or consumer who buys multiple policies is paying the collection and servicing costs for those policies many times over. This practice has prompted these regulators to suggest that companies consider a price adjustment be given for the reduced collection and servicing costs built into each policy when multiple policies are sold in the same household. Other regulators have indicated that the issue of price adjustments for reduced servicing costs in multi-policy households is adequately addressed by existing rate and form filing requirements.

Several companies expressed concern regarding the foregoing suggestion of a price adjustment or discount being given for the reduced collection and servicing costs. According to these companies, this suggestion makes several assumptions that are not actuarially sound and the companies strongly disagreed with the assumptions in this statement.

Insurance companies argue that the application of discounts would increase the cost of insurance and would be unfairly discriminatory against the majority of policyholders. They point out that policy servicing costs are recovered through an actuarially determined factor embedded in the rate of insurance. This relatively insignificant factor is applied to all policies to recover the fixed overhead associated with policy servicing, regardless of the number of policies owned by an insured. Companies have stated that the proposal to provide a multi-policy discount would simply shift the cost allocation between two groups of policyholders, those households with multiple policies and those without. The companies indicate that if multi-policy discounts were required, an insurer would apply a higher cost recovery rate to single policy owners to allow for such a discount. As a result, the majority of consumers would pay a higher rate of insurance to
benefit a clear minority. Insurers believe that the suggested multiple policy discount would be unfairly discriminatory under most state insurance laws.

Recommendations

State Insurance Departments and NAIC
- State insurance departments and the NAIC should train appropriate insurance department staff to be familiar with the Home Service system.
- Individual state insurance departments and the NAIC should consider modification of their consumer complaint forms and databases to capture complaints related to the distribution method.
- State insurance departments should consider whether it is appropriate to issue a temporary license which gives an individual the ability to sell insurance products prior to meeting full licensing requirements.
- The NAIC should consider the development of a related model law or regulation which should define “Home Service.”
- The states and the NAIC Life Insurance (A) Committee or Life and Health Actuarial (Technical) Task Force should evaluate and make recommendations regarding whether future sales of policies marketed through the Home Service system provide an economic benefit to the policyholder.
- The NAIC should consider issuing a charge to evaluate the economic benefit of products marketed through the Home Service system by reviewing claims and loss data, and rates.
- The state insurance departments and the NAIC should develop educational materials that explain the rights and responsibilities of consumers using the Home Service system.

Insurance Companies
- Companies should consider developing pricing and accounting procedures to accommodate multiple policy discounts where savings on distribution or policy servicing costs are realized.
- Companies should have policies and procedures in place designed to safeguard and provide full credit for policyholder premium payments, claims and other contractual obligations.
- Upon request of the premium payor or insured, companies should supply information about his or her account, independent of the services provided by the insurance agent.
- A company should develop procedures to communicate to premium payors when a new agent is assigned to their account.
- Companies should investigate the feasibility of providing payment options to allow consumers to acquire a fully paid-up life insurance policy.
- Companies should have procedures to conduct audits periodically at the field level or premium payor level which reasonably ensure that the premium payors’ records accurately reflect the status of premium payments.
- Companies should consider developing and furnishing detailed premium receipt books to premium payors to provide increased control and to verify the terms of the insurance contract, including the premium to be charged, with the premium payor.
• Companies should include clear, adequate and easy-to-read disclosures on premium payment records stating that checks or money orders should be made payable only to the company, premiums should only be remitted to known representatives of or directly to the company, premium payment records are the premium payor’s evidence of payment and payments must be accurately recorded in the premium payment records at the time of payment.

• Companies should disclose the effect of various premium payment modes on the cost of the product to the premium payor.

• Companies should ensure that any reduction in costs due to changes in service or premium payment mode are realized by the premium payor.