Life Insurance and Human Nature

A Reflection Midway Through a Career in Life Insurance

By **Bill Boersma**

Let's say I'm midway through my career. Actuarially, I'm probably halfway through my life as well. I suppose this is as good a time as any to reflect on things. What have I learned so far? Am I still excited about this industry and my job? Is there an overall lesson my experiences have taught me?

To be clear, I am an insurance guy. I'm probably at the lower end of the age range for someone willing to be known as a life insurance guy. I'm not a financial advisor, wealth manager or estate planner, though these are things I deal with daily. I'm as close to an old fashioned insurance guy as you might find. Except that I'm not that at all. Too many old fashioned insurance agents scare me. But then again, so do many modern advisors. Admittedly, I have mixed feeling about aspects of this industry. I've had the pleasure of working with some great insurance professionals and the displeasure of dealing with scoundrels.

I'm cynical. Cynical of all of the players: the agents, the carriers, the marketing organizations, the non-insurance advisors... even the customers. Is that a bad thing? Might this be what makes me valuable to my constituency? On the other hand, I love this industry. I'm invigorated by helping people, dealing with daily challenges and keeping up with constant innovation. Life insurance is the only professional job I've ever had, starting a few decades ago soon out of college. Other industries are likely the same. After all, every one of them is run by humans, and what I see that fosters both the appreciation and the cynicism is the product of human nature, for better or worse.

When I write and speak about life insurance, I often feel I have to walk a tightrope. Beyond working to craft strategies and create portfolios, I'm called in to fix problems. The nature of my practice as a life insurance consultant is dealing with disasters: failing policies, tax nightmares, extracting consumers from disastrous strategies, litigation support and so on. When minimizing loss is the definition of success, the feeling of accomplishment can be fleeting, but no one wants to hang around a pessimist. The balance is to counterweight the war stories shared in an attempt to warn people into a state of attention with success stories illustrating the available opportunity. I work to expose the dark side of an industry while highlighting the merits and taking advantage of all the good it offers and to smoke out the scoundrels without tarnishing the reputations of the preponderance of professionals working hard every day to bring value and do what is right. I'm convinced the well earned cynicism is a productive trait.

Regarding my initial questions, the fact is I've learned a lot, more than I could have ever imagined, and the pace of learning continues to accelerate. The old adages are true: the more you know, the more you realize you don't know, and every experience is a new learning opportunity. I've stopped counting the times I've asked myself, "How could I be in this industry, in this capacity, for this long and never have been asked this question or seen that scenario?" It's the journey, right?

Though I feel jaded at times, I'm more excited about my job, what I do, the value I bring to my constituency, the industry and life insurance in general than ever. Excited about life insurance? I don't keep my calendar open waiting to be invited to career day but if others could experience the appreciation of the people I work with, they might be amazed.

When I think about why things happen and evolve the way they do, I keep coming back to human nature. Human nature drives everything. It's the source of what I see going right and wrong in my industry. It accounts for the glacial shift in comprehension of life insurance evolution over the years. It explains sales and marketing and consumer decisions regarding purchasing and management. It's the force behind product innovations and how competitors deal with each other. It even defines why consumers lie to themselves regarding what they really want and are willing to pay for.

Years ago, life insurance was very different. Pre-1970s, it was largely a fixed product. Permanent insurance consisted of traditional whole life, which had no moving parts. There were rate books to calculate the premium, cash value and death benefit year by year, and you knew exactly what you were getting. In the 1970s, with the advent of the computer, life insurance evolved into a product that was modeled based on assumptions regarding crediting rates and expenses. Furthermore, these assumptions were variable. Once variable assumptions were incorporated into modeled scenarios, ongoing management became critically important. Unfortunately, that aspect of life insurance ownership didn't take root. Agents sold, and consumers quickly accepted the attractive aspects of modern insurance but didn't subscribe to the new responsibilities. This became disastrous when the stratospheric crediting rates of yesteryear came plummeting down to reality. The irony is that variable assumptions allowed the illustration of projections, which in and of themselves, didn't incorporate variable returns. In other words, what was assumed at the point of sale would stay exactly the same forever with no variation. It's easy to laugh at that now except, for the fact that it's still the same decades later. Human nature is the little voice in our heads that causes us to ignore the weather report for rain this afternoon when it's sunny right now. If it's sunny now then, by god, it's always going to be sunny.

Running stochastic projections and incorporating historic variability modeling could revolutionize insurance selling, so why are product innovation and sales not firmly based in realistic assumptions? After all, don't consumers say that is what they want? Human nature. Reality isn't as attractive and doesn't always sell well. Consumers lie to themselves. They say one thing and vote the opposite with their actions. Everyone says they hate negative political campaigning but the candidates consistently do it. Why? It works. Life insurance can be so complicated, they give up hope of understanding and want to trust their agent. Just as in politics, they might not trust congress but often they trust "their guy."

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If market share could be gained by creating realistic products sold through a highly educated sales force to consumers who were willing to put in the time and effort to be educated to an extent they could be partners in the decision-making process, the industry would be tripping over itself to do so. But that is not how the world works because human nature will not allow it to be. Consumers say they will pay for objective advice but few will. Even if substantial and immediate benefit was demonstrated, a client might hesitate to write a modest check but willingly ignore a commission 10 times or 100 times larger. There is a reason the market is set up the way it is. That's the way it works. There are exceptions, but the human nature of consumers makes it exceedingly difficult to do things differently. The attractive improbability regularly sucks them in to making poor decisions. In competitive situations, succumbing to spreadsheeting and commoditization is inevitable, despite the inherent flaw of the strategy and the likelihood of the process ending in disappointment. My frustration stems from the fact that something that is so powerful when understood, properly procured and astutely managed can be so dangerous when the opposites are in play.

The difference between a factory produced, mass marketed product and an individually crafted piece of work is generally understood. While some are willing to spend the time and money to understand and appreciate customized craftsmanship, most are not. The cost of not understanding life insurance transactions sometimes is simply too great. I see the loss of entire portfolios at a point where no alternatives are available, policies crater with tax consequences that bankrupt the policy owner, the best laid estate and business succession plans fold without the expected financial backstop. Often, I don't even share the most dramatic examples of unmet expectations because they are simply unbelievable. Most of this isn't the result of intentional malfeasance. It results from a lack of knowledge and laziness on the part of the sales force and the consumers.

Another example of human nature that fascinates me is the power of institutional indoctrination. An insurance company teaches its sales force what it needs to foster sales of the products in which it specializes. This isn't unexpected and runs true across many industries, but it should be realized and accounted for nonetheless. Some carriers specialize in whole life, some in term, some in securities based products, etc. Regardless, the goal is to build up the attributes of your product and why it will fulfill your needs and, sometimes, that includes undermining the competing products and posturing them as either old fashioned and stodgy or newfangled and untrustworthy. It shouldn't be a surprise that anyone would defend his own and attack that which is different, but do consumers have an ability to see through this and objectively understand the differences? The truth is, it's generally not the products that are the source of the problems, it's the application of the products and the lack of understanding and ongoing management.

An unbiased and even-handed presentation of the various alternatives doesn't seem too much to ask but the market suggests otherwise. A balanced analysis of product features and contract terms should be par for the course. To sell a traditional whole life policy in one situation and a guaranteed universal life in the next, term where it's appropriate and an equities based product to a suitably educated and risk tolerant consumer in another engagement shouldn't seem like much of a stretch. I don't expect every portfolio to incorporate the insurance equivalent of Modern Portfolio Theory, but building a diversified life insurance portfolio shouldn't be a foreign concept. If the sales reps of a dealership can sell a pick up, a minivan, a hybrid and a sports car to different consumers according to their needs, it shouldn't be unreasonable to expect the same from an insurance professional. Agents too often fall into one product camp or another. They might have been born and raised in a mutual company career shop, where whole life is the solution to all insurance needs or they might be an independent selling the hot product of the day, which the carriers are marketing. Either can be dangerous. One seems unfairly critical of modern evolutions of products with potentially beneficial attributes and the other ignores the track record of some traditional policies and seems too eager to jump on whatever new product rolls out.

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The fault isn't entirely with the carriers and the agents. The reality is that marketing follows recent history because it's effective. Human nature makes it so. When interest rates skyrocketed, whole life looked stodgy so the carriers rolled out current interest rate products. When the stock market soared, the sales of securities based products rose. When those policies largely failed, guaranteed products took over. When the markets and new regulations affected the pricing of those products to a point where they weren't as easily salable, rolling out the equity indexed products with improbable assumptions took over. Companies create products and craft marketing strategies around what people will buy. That's fine if done responsibly, but a product created with the ability to illustrate it unrealistically will be sold that way too often, and the entire cycle of disappointment will continue.

What is the solution? Limit product illustration parameters to a point where no one will buy them? Allow improbable projections that will be sold irresponsibly? Create more regulation in the name of consumer protectionism, which many feel has been so counter productive to date that more will only make it worse? Accept a buyer beware market? Elevate agent responsibility to a fiduciary level? Every possibility has upsides and downsides, and the power of human nature on both sides of the transaction will find a way to circumvent the best-laid plans.

Incentive based selling is one of the best and worst aspects of the life insurance market. It facilitates activity, which brings unparalleled value and is responsible for some of the worst of what transpires. It drives replacements that can be objectively beneficial, as well as replacements that are irresponsible. While I greatly appreciate the benefit of a commission driven sale that brings value, I also believe the currently prevalent compensation system is largely responsible for many of the problems we've experienced. Gravitating towards a compensation structure that rewards ongoing service and management as much as incentivizing new sales could be exceedingly beneficial to consumers, as opposed to the currently predominant system, which tends to feed the less honorable aspects of human nature.

Fee-only consulting, while easy to posture as an obvious choice, isn't the answer either. It can be fantastically beneficial, just like with some commission-based processes. However, many consultants make their mark and their money mocking commissions, and that can be dangerous. They often pander to what a portion of the market wants to hear, and the results aren't always productive. A sales system is built around demonizing a particular constituency that may represent some of the best products and solutions available. Anything less than a balanced and open-minded approach can be equally dangerous.

What about the insurance carriers? The companies have brought an amazing amount of value to the market, and they are adept at filling needs. They are ingenious in their product evolutions, and they are as varied in their markets and specialities as there are constituencies to serve. Without them, many strategies and solutions wouldn't be available. However, marketing to the agent community can be somewhat reckless; instilling indoctrination and providing incentive to sell what is primarily in the company's self interest. There needs to be responsibility for creating products with too great an opportunity for misuse. Additionally, an adept practitioner can dive into the details of products and come to the realization that some are built to sell more than to sustain, with unrealistic assumptions regarding crediting and expenses. Though it can't be dismissed that they are constrained by the human nature of their consumers and they can only offer what will sell, it shouldn't be more difficult for an insurance professional to build a product to perform under realistic market conditions than allowing it to shine in improbable circumstances.

I've related horror stories about life insurance and detailed the potential of a thoughtfully crafted portfolio. I spend time identifying the faults of the system and holding up examples of innovation that makes it better. I vacillate from despair to euphoria based on my experiences in the field. One day this is a rotten industry and the next it's a privilege to be a part of it. Reflecting on this brings me to an overriding realization at this point in my life insurance career.

The real lesson is accepting human nature and operating within reasonable parameters. Realizing that both terrorists and saints are products of human nature is helpful. Expecting and appreciating the best of it while being prepared for the worst is probably a sensible balance. There will always be people who suffer due to the actions of others or themselves, and we can always try to improve the system, but reducing the speed limit to 10 mph so no one dies in car accidents isn't a solution either. This is a truism throughout life.

While I do get frustrated, I keep the faith when I see the emergence of a new breed of insurance professionals and consultants. They are more of the artisan class, and consumers need to be willing to value and pay accordingly to experience the results. They have to be willing to expend requisite effort. A certain degree of faith is necessary, but leaning too heavily on it is dangerous. Deliberate and thoughtful regulation rather than reflexive and politically motivated rules need to be advanced. An alternate compensation system should be prevalently available. Practitioners need to be challenged. Stress testing and historic variability modeling should be commonplace rather than considered a high end service.

Demanding anything is silly. Products have to be profitable to the insurance carriers, and they won't offer what agents won't sell and consumers won't buy. Consumers should step up to the challenges or their experiences will not change. The resources are available, but they need direction from their advisors. The "ounce of prevention prevents a pound of cure" saying couldn't be more true.

Well, this has been cathartic. I've always wanted to blame someone but that's kind of the problem. Human nature can be disappointing but it is what it is, the good and the bad. I've come to the realization that if it's an accepted aspect of life and accounted for accordingly, things seem to turn out better. That's the lesson. ■

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