Home Service Distribution System: A Method Of Marketing Life Insurance To The Poor

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Industrial life insurance sold through the home service marketing system has been criticized for years. Small face value life insurance policies, though less popular than in the past, are currently sold to low-income consumers by agents collecting premiums in their homes. Because of the high cost associated with the home service industry, low-income consumers are paying a high cost for inadequate life insurance protection. This article provides an overview of life insurance products sold by the home service industry, examines the pros and cons of this industry, and suggests implications for financial counselors.

Key Words*: Industrial life insurance, Home service, Low-income, Insurance*

The home service method of marketing insurance is one of the oldest methods of insurance distribution. This method of insurance distribution began in the 1800s and is still used by many insurance companies today. Insurance companies that market their products in this manner are often referred to as home service insurance companies (Blicksilver, 1990; Dalzell, 1993; Life Insurers Conference, 1995).

The National Association of Insurance Commissioners (NAIC) defines the home service method of marketing insurance as "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" (NAIC, 1997, p. 5). Insurance of various types (e.g., life, health, homeowners, etc.) is sold through the home service system of distribution (Dalzell, 1993; Quinn, 1995). In a survey conducted by the NAIC, 11 insurance companies reported using the home service method to sell property and casualty insurance (NAIC, 1995). However, life insurance makes up the majority of home service sales (Quinn, 1995). According to the Life Insurers Conference, a trade association, in 1995 the home service insurance industry "encompassed 80 companies, $6 billion in premium, $287 billion in force, 32,000 agents and 27,000 other employees" (Life Insurers Conference, 1995, p. 1). Home service companies represented 14% of the life insurance industry, and the home service life insurance sales of these companies represented approximately 29% of all life insurance policies sold in the U.S. (Dalzell, 1993; Life Insurers Conference, 1995; Savitz, 1990; Seaman, 1993).

Prior to the 1970s, industrial life insurance was the most popular product sold by home service insurance agents (Dalzell, 1993). These policies were typically sold to cover funeral expenses; the buyers were primarily low-income people who worked in factories (Life Insurers Conference, 1995; Savitz, 1990). Industrial life insurance, as noted by the NAIC, " 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" (NAIC, 1997, p. 5). Each state may vary the definition of industrial life insurance slightly; however, the basic definition remains the same. For example, some states limit the face value of industrial life insurance policies to less than $1,000 while others limit the face value to less than $2,000 (NAIC, 1997). Industrial life insurance policies usually have provisions that are not found in other life insurance policies. For example, the facility of payments clause is a provision not typically found in other life insurance contracts. The provision gives the insurance company the authority to pay the proceeds of the policy to someone other than the beneficiary when the insured dies. If a person can prove that he or she is responsible for paying final expenses of the insured and/or taking care of the beneficiary, then that person can receive the life insurance proceeds. Further, industrial policies are

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usually not assignable, meaning the policyholder cannot use the cash value of the policy as collateral for a loan (NAIC, 1997). Even though industrial life insurance policies are not sold as often today, there are still many in force. Further, the home service marketing method used to sell these policies still exists. Small face value life insurance policies are still marketed to low-income households by life insurance agents collecting premiums in their homes (Savitz, 1990).

The small face value life insurance policies introduced in the 1970s and still being sold today are called monthly account ordinary (MAO) or monthly debit ordinary (MDO) life insurance policies (Dalzell, 1993). MAO or MDO are actually terms that describe the method of premium payment for various types of life insurance such as term, whole, universal, and other interest sensitive whole life insurance policies; the premiums for the policies are collected monthly at the policyholder's home. These life insurance policies are the same regardless of whether they are sold using the home service or conventional (i.e., bank draft, mail, and other direct methods of payment to the insurance company) system of distribution with the exception of the face values, cost, and method of delivery (NAIC, 1997). The face values of MAO or MDO life insurance policies are somewhat higher than the face values of industrial policies (Savitz, 1990), but are still lower than the face values of life insurance policies sold using the conventional system. In 1992, the average face value of MAO or MDO life insurance policies was $10,823 (Seaman, 1993).

Home service companies still sell a substantial number of small face value life insurance policies. Many are sold to low-income consumers, especially in the South. Home service agents in the South sell approximately half of all life insurance contracts bought in the U.S. each year (Savitz, 1990). The home service distribution system is also still used frequently in other parts of the country; Savitz (1990) identifies "California, the Mid-Atlantic states, the Southwest, and around the Great Lakes" (p. 14) as areas with frequent sales. Therefore, the home service marketing system still has a tremendous impact on a large number of consumers, especially low-income consumers in these regions. Table 1 provides an overview of the differences between the home service and conventional life insurance industry with respect to the market served, the mode of premium payment, premium collection method, and products offered.

Pros and Cons of MAO or MDO Life Insurance and the Home Service Industry

Industrial and MAO or MDO life insurance, as well as the system by which these policies are marketed, have been criticized for many years (Savitz, 1990). In 1979, the Federal Trade Commission (FTC) issued a report indicating that the home service industry was issuing policies that were "too costly for policyholders and too profitable for insurers, had an unacceptably high lapse rate, and often were sold by agents who utilized unethical sales practices" (National Association of Life Companies [NALC], 1979, p. 19). The FTC also noted that these policies were marketed to low-income consumers and because of the high costs associated with this industry, low-income consumers were paying more for life insurance than high-income individuals (Savitz, 1990).

Table 1
Differences Between Home Service and Conventionally Marketed Life Insurance Policies

	Home Service	Conventional
Market	Under $50,00 household income	Over $50,000 household income
	69% of U.S. population	31% of U.S. population
Mode	Weekly 5% Monthly 50% All other modes available 45%	Mostly bank draft and annual
Premium Flow	Most debit premium is still collected at the home, but mail-ins have reached 28%	All premium notices- no collections
Products (premium)	Whole Life 70% Term 6% Universal 13% Interest Sensitive 11%	Whole Life 51% Term 14% Universal 22% Variable 3% Variable Universal 10%

Source: Dalzell, 1993.

On the other hand, the National Association of Life Companies (NALC) felt that the claims made by the FTC were unfair and inaccurate. The NALC stated that industrial life and MAO or MDO life insurance, as well as the home service method of distribution, "(1) meet important needs and desires of many citizens; (2) are fairly priced and are not unreasonably profitable for insurers; (3) do not have an unacceptable lapse rate; (4) are sold through a highly convenient home service method by responsible agents who do not engage in improper or unethical sales practices; and (5) can continue to be effectively regulated by state authorities whenever evidence shows problems exist" (NALC, 1979, p. 19). Because of the criticism of industrial life insurance during this period, sales decreased. However, sales of MAO or MDO life insurance policies increased. Thus the home service industry was virtually unaffected (Savitz, 1990).

A more recent article described an investigation by the Arkansas Department of Insurance with very disturbing results. A policyholder had purchased a policy and he had paid more money into the policy than it was worth. In other words, the total premiums paid during the four years were greater than the death benefit of the policy. The policy had a $750 face value and a premium of $3.81 weekly. Thus, he had paid $792.48 for a death benefit of $750. Even though this was only one policyholder, this was a typical example of the industrial life insurance policies owned by low-income consumers (Quinn, 1995). Further, in many cases proper receipts were not given to the policyholder, and some of the policies had a facility of payments clause. In addition, the policyholder had purchased 25 or more very small face value policies on relatives; many of the policies had lapsed because the policyholder could not afford the premiums. No cash value had accumulated in these policies, so the policyholder received nothing when these policies lapsed. The State Insurance Department in West Virginia conducted a survey and found that a little over half of all policies sold through home service agents lapse within the first couple of years (Quinn, 1995).

Another frequent criticism of the home service industry is that policyholders continue to pay higher costs for personal service even when the premiums are no longer collected by the agent in their home. Today, premiums for both industrial and MAO or MDO life insurance policies are sometimes mailed in or collected via automatic bank drafts. In 1990, approximately 55% of premiums paid for insurance sold by home service agents was paid by bank drafts (Dalzell, 1993; Savitz, 1990). Thus, consumers who can least afford it continue to pay a high cost for services not received.

While conducting workshops on the home service marketing system in a small southern city, the author of this article examined several life insurance policies owned by low-income consumers. Three different workshops were given with approximately five low-income persons participating in each. Each person participating had at least one life insurance policy that was purchased from a home service agent. Some participants had more than one life insurance policy on themselves, while others had only one policy on themselves, but several on other family members. More than 15 policies were examined. The following is typical of the policies owned by these policyholders.

In this particular case, the policyholder was 51 years old and had several life and health insurance policies that were sold to her by home service agents. She had life insurance coverage for herself and all her children. One of the policies in which she was the insured was a whole life insurance policy with a face value of $5,000. It had additional benefits for loss of life by accidental injury and for loss of limb or sight. The premiums were payable for life. The policy was purchased when she was 43 years old with a monthly premium of $15.89. She had owned the policy for 8 years.

The most disturbing thing about this policy was the small amount of cash value the policyholder would receive or the amount of paid-up insurance coverage if the policy was dropped. Total premiums paid into the policy to date equaled $1,525.44, but the cash value or paid-up insurance she would receive did not come close to this amount. Table 2 provides an overview of the policyholder's nonforfeiture values.

Since the policyholder owned the policy for 8 years, and it had a face value of $5,000, the amount that would be received if the policy was surrendered is $550 ($110 x 5). The amount of paid-up insurance coverage would be $1,330 ($266 x 5). Thus, at this point in the life of the contract, the policyholder had paid $1,525.44 for a savings of $550 or paid-up life insurance protection of $1,330. If the policy remained in force until the insured was 65 years old, the applicable cash value would be $1,980 ($396 x 5), and the amount of paid-up insurance would be $3,315 ($663 x 5) with a total premium of $4,194.96. In addition, the total premium paid at age 65 is only $805 less than the $5,000 death benefit. Thus, the cost of this policy far outweigh the benefits.

When comparing the cash value in the policy to what the consumer could have received if the premiums had been invested, the results are quite different. Assuming monthly compounding and deposit frequency, the $15.89 monthly premium paid by the consumer over the 8 year period would be worth $1,800 if it had been invested in an account at the beginning of each month earning a 4% rate of return. This amount is $1,250 ($1,800-550) more than the cash surrender value of the policy and $470 ($1,800-1,330) more than the amount of paid-up insurance coverage. Assuming the monthly premium will be invested until the consumer is age 65 (22 years), the account would grow to $6,731 (Table 2). This amount is $4,751 ($6,731-1,980) more than the cash surrender value of the policy and $3,416 ($6,731-3,315) more than the amount of paid-up insurance. Thus, the consumer could have earned more by investing her money instead of purchasing this type of insurance.

It is worth noting that if the consumer had invested the monthly premiums instead of purchasing the life insurance policy, she would not have the $5,000 life insurance protection in the event of her premature death. Many low-income consumers purchase industrial, MAO or MDO life insurance policies for this protection. They want to have money available to cover their funeral expenses (Life Insurers Conference, 1995; Savitz, 1990). With the cost of funerals constantly increasing, however, $5,000 may not be adequate life insurance protection. If life insurance is preferable to investing for this income group, purchasing it using the conventional system would yield greater benefits. Based on information obtained from an insurance company, the consumer in the above example could have purchased a $10,000 whole life policy for $16.95 a month, only $1.06 more than she was paying per month for $5,000 worth of coverage. Further, the face value of this policy would increase over the years to $11,110 in 8 years and $15,150 in 22 years. The policy not only provides better coverage for the dollar, it also provides coverage sufficient to cover funeral expenses. The company did not sell whole life policies with face values less than $10,000.

In a survey that NAIC conducted with life insurance companies who sell and/or service industrial life insurance, the following question was asked "For industrial insurance, in what percentage of policies in force as of 12/31/95 does the amount of premiums paid to date equal or exceed the policy face amount" (NAIC, 1996, p. 7)? Some companies' percentages were as high as 47.4% (NAIC, 1996).

Seaman (1993) noted that the home service industry has an economic impact on society. Using government statistics and industry data, he noted that the home service industry targets the low- and middle-income consumers who are often ignored by other insurance companies. According to Seaman, the home service industry provides this large segment of the population with financial products that are important to their economic well-being. Based on the data provided in the report, the majority of low-income households (less than $25,000) do not have adequate life insurance. Thus, the fact that this industry is targeting low-income households should help them acquire adequate life insurance protection. This, in turn, may reduce their dependence on public financial resources (Seaman, 1993).

Table 2
Example of a Policy: Nonforfeiture Values for Each $1,000 Amount of Insurance: Cash and Paid-Up Insurance Values for an Amount of Insurance greater or less than $1,000 will be proportionately increased or decreased.

End of Year (Policy Age)	Cash Value	Paid-Up Insurance	Extended Term Insurance Years	Days
AGE 43				
1	$ 0	$ 0	0	0
2	0	12	0	247
3	21	59	3	62
4	38	104	5	50
5	55	146	6	237
6	73	187	7	333
7	91	227	8	330
8	110	266	9	279
9	129	303	10	161
10	148	338	10	350
11	168	373	11	145
12	188	405	11	264
13	208	436	11	351
14	228	466	12	45
15	248	493	12	79
16	269	521	12	107
17	290	548	12	111
18	312	575	12	109
19	333	598	12	76
20	354	621	12	27
(60)	290	548	12	111
(65)	396	663	11	268

Source: Policyholder's Life Insurance Contract
The periods of Extended Term Insurance will be the same for any Amount of Insurance. Age is age at issue shown in the Policy Schedule.

Seaman also noted that the home service industry provides other economic benefits to society. The home service insurance companies employ many African Americans and females in professional positions. These companies also provide cash contributions to various social causes and/or organizations (Seaman, 1993).

Summary and Conclusion

This paper provides an overview of industrial and MAO or MDO life insurance, as well as the home service distribution system used to market these kinds of insurance. The products and the marketing methods used to sell these contracts are supported by some and criticized by others. It is also evident that some problems may exist with these types of insurance, as well as the marketing system. Research is necessary to determine if these types of insurance and the home service marketing system are reasonable alternatives for low-income consumers to obtain adequate life insurance protection or if there are other life insurance or investment options more beneficial to this population group.

Based on the limited information above, financial counselors working with low-income consumers can provide some guidance in this area. Counselors can warn clients of the possible pitfalls of purchasing this type of life insurance through this particular marketing method. For those clients who already have these types of policies, counselors can advise them on the benefits of surrendering the policies and investing the money in other types of life insurance or investments if possible. Counselors can examine the actual policies of clients' and show them their total cost and returns as well as the cost and returns of alternative life insurance contracts or investments. Clients who have not yet purchased MAO or MDO life insurance could be warned about the high cost of this type of insurance and the method by which it is sold and counseled on other alternatives beforehand.

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