1994-2 NAIC Proc. 549

The Life Disclosure Working Group was given the additional charge of considering options that would authorize non-guaranteed elements to be projected into the future. Commissioner Lyons said it would be up to Mr. Wright to decide whether an interim meeting is necessary before exposing the drafts in September, but he asked Mr. Wright to seriously consider this option.

comments. He said another reason for postponing exposure until September was because there were some disclosure provisions in the Second Standard Nonforfeiture Law being developed by the Life and Health Acturial (Technical) Task Force, and the working group wanted to be sure that the two models were consistent. Mr. Wright said the working group might develop two alternative models, one with guarantees only, and one with projections of non-guaranteed elements in an understandable format. Mr. Wright asked those who were interested in making suggestions to work through the technical resource advisors as much as possible, and he introduced George Coleman (Prudential), the chair of that group.

1994-2 NAIC Proc. 549

Ted Becker (Texas) distributed to the members of the working group a statement from Commissioner J. Robert Hunter (Texas) (Attachment One-A). Mr. Wright asked if there were any other regulators that wished to comment. Allan B. Roby Jr. (Conn.) said that his commissioner objected to adoption of any model that did not allow projection of non-guaranteed elements into the future. He said Commissioner Robert R. Googins (Conn.) did not consider that to be consumer oriented.

Next, Mr. Wright invited comments from others in attendance at the meeting. John Booth (American Council of Life Insurance -- ACLI) said he was commenting on the May 1, 1994, draft of the life insurance illustration

He said Subsection D, the definition of "net increase," was not used consistently throughout the draft. Mr. Coleman also said that he did not think Subsection E, the definition of"past performance," was clear. He thought this section placed an extremely difficult burden on the insurers, so it was important that it be clear exactly what was required. Mr. Wright asked about a statement made earlier, that most companies did not have records of past performance. He asked how a company got information in case of a court case, complaints, etc. Mr. Koenig said in the examples Mr. Wright had provided, his company would pull up the records for each individual involved. The problem was reconstructing for all of the policies his company sold. Mr. Wright reiterated that the question was not whether the information was available, but rather if it was accessible.

Mr. Wright asked if there were any comments on Section 1, Purpose. Barbara Lautzenheiser (Lautzenheiser & Associates) said the issue goes beyond understandability to understandability for what purpose. She said an individual looking at a policy that shows guarantees only cannot tell how the policy works. She said in the last 20 years there has been a great deal more emphasis

Mr. Ashwill responded that if it was a new policy there would not be any numbers to use. He also questioned the use of numbers from a period when interest rates were so much higher than is currently the case. Mr. Higgins reminded the group that the charge was to develop a regulation using guarantees and past performance, and he suggested looking at these other issues at a later time.

Michael DiPiazza (Metropolitan Life) said that an appropriate use for past performance was to compare policies from different companies. He said it was like a consumer purchasing a mutual fund and comparing the performance of the various funds to determine which one to purchase. George Coleman (Prudential) asked how to fill in the gap when it was possible to show 40 years of guarantees, but a company might only have past performance for two or four or six years.

there would be in the instance where illustrations showed improving mortality. He said he understood the purpose of the working group's project was to eliminate imagination and to show actual demonstrable numbers. Ms. Lautzenheiser asked what a consumer would do with all these numbers. She said too many numbers were as bad as too few.

Mr. Higgins reminded the group that its charge was to move forward with guaranteed elements. He said this effort by the technical resource advisors made giant steps forward from the earlier efforts, but it was not the charge of the group today. John Dinius (AEtna) said that in some sense using past performance was a projection into the future. Mr. Morgan said the current proposal of the working group left it to the buyer to draw inferences; using the illustrations currently in practice, the agent or insurer has drawn the inferences for the consumer.

Scott Cipinko (National Alliance of Life Companies--NALC) said that the information presented so far ignored the death benefit. He said using a consumer price index focuses on the wrong thing because the illustration does not show the death benefit. He said it was not appropriate for the insurance industry or the regulators to encourage consumers to look at insurance as an investment rather than a death benefit.

Mr. Koenig asked whether this illustration would apply to in-force business, for example if a consumer asked how his policy was doing. Mr. Morgan replied that the model applies to "the sale of life insurancepolicies."

Next attention was turned to Section 4C, "interest credited." Commissioner Wilcox pointed out that the draft throughout used the term "interest" for anything that increased value. Ms. Lautzenheiser said this terminology also reinforced the idea that insurance was more like an investment. Mr. Dinius said the terminology was not accurate; rather than saying "increase" it should say "net increase" because there would be some pluses and some minuses.

. Mr. Ashwill also asked why it was important to include the percentage of insureds covered by a particular form as required in Section 5C(1). Mr. Strauss responded that if only 1% of the insureds get that rate, that is useful information to have. Mr. Dinius suggested changing this to "this class or better" because if a person were to see that 30% got that class it might be misleading because 70% got a better class.

Ms. Cobb said that the Section 7 provisions requiring guaranteed performance were not understandable. She suggested an appendix to demonstrate what the working group was looking for.

Mr. Wright then asked for comments on Section 8, Prohibitions. Ms. Griffin pointed out there was no penalty in the regulation. Mr. Wright said the penalty provision was generally found in a statute. Mr. Fisher said the provisions of this section were much too sweeping, and it would be impossible to talk about the policy without using some of these prohibited elements. Ms. Lautzenheiser said the provisions of this section would have a major impact on policy design. She said if regulators wanted to limit product design they should do so directly.

Discussion next turned to Section 9, Annual Report. Mr. Koenig asked if this report was a new illustration. Mr. Wright responded that it was intended to be a report of what had actually occurred during the prior year. Mr. Coleman questioned the purpose of this report. Mr. Wright responded that it would allow the policyowner to compare the actual performance with the guarantees that he had been shown.

The working group next looked at the illustration of guarantees. Commissioner Wilcox said this part was already done because it could be copied from the Second Standard Nonforfeiture Law, which is being considered by the Life and Health Actuarial Task Force. Since the Second Standard Nonforfeiture Law has not yet been adopted, the working group decided it would not be appropriate to reference that model, but instead should copy the standards into the illustrations model regulation.

From: J. Robert Hunter, Commissioner of Insurance, Texas Department of Insurance

Re: Life Insurance Illustrations of Future Values

With all the discussion about misleading sales practices in the marketing of life insurance, we as regulators must take a position that does justice to the buying public. Ironically, all the columns, figures, pages, disclaimers, and disclosures do not tell consumers what they really want to know -- What does the insurance cost? Below are my suggestions for what an illustration should tell a consumer. When their policy out-performs the illustration, policyholders will feel they got a good deal instead of feeling ripped-off! !

- Illustrations of future values must reflect only policy guarantees.

- Any illustration of past performance must include an economic point of reference.*

- All expenses, costs, fees, mortality charges, profits, commissions and the amounts allocated to interest accrual should be itemized by year.

- Annual guaranteed cash values should be illustrated net of all surrender charges.

- An updated illustration should be provided to the policyholder annually.

- Any "enhancement" of figures through the use of persistency, mortality, Washington, D.C.

May 1 - 3, 1994

The Life Disclosure Working Group met at the Embassy Suites Hotel in Washington, D.C., at 1 p.m. on May 1, 1994. The meeting was called to order by Bob Wright (Va), chair, and the following working group members were in attendance: Don Koch (Alaska); Roger Strauss (Iowa); Lester Dunlap (La.); Noel Morgan (Ohio); Tony Higgins (N.C.); and Fred Nettle (Wis.).

Bob Wright (Va.) stated the purpose of the meeting was to work on a draft of a model illustrations regulation to implement the vote taken at the March meeting of the working group to allow projections into the future only of guarantees, and to show past performance in conjunction with an index such as the Consumer Price Index. Roger Strauss (Iowa) distributed a memo (Attachment One-E1) from Commissioner David Lyons (Iowa), chair of the Life Insurance (A) Committee, for discussion. He said there had been some misunderstanding on the part of the life insurance industry, which the memo was designed to address. Mr. Strauss said that some individuals had the impression that the working group would not consider illustrations of current scale and planned to adopt the guarantees-only model in June. The working group agreed that it would continue to follow the instructions of the A Committee, which was to work on the guarantee-only provisions, but to keep the door open for suggestions for understandable illustrations based on projections of current scale.

Mr. Wright listed the core elements to be included in the draft: (1) a cover sheet; (2) financial rating of the insurer; (3) signature requirements; (4) illustration of guarantees and past performance; and (5) a yearly update requirement. Noel Morgan (Ohio) asked if the illustration would be made part of the policy. The working group decided to table that issue until later in the

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The working group next discussed the appropriateness of including a requirement for a consumer signature on the document. The group decided it was important not to imply consumer understanding of what was in the illustration but just an acknowledgment of receipt of the illustration.

He said the technical resource advisors had submitted an illustrations document that showed substantial progress toward meeting the working group's goals. He said sample illustrations also were attached to the working group minutes. Commissioner Wilcox reported that, while the model drafts that allowed illustrations of guarantees only were in virtually final form, the working group had decided to table consideration of them

3. Consider Exposure of Drafts Requiring Illustration of Guarantees Only

Commissioner Wilcox asked what the working group wanted to do with the drafts that they had prepared that allowed for illustrations only of guarantees into the future and illustration of past performance. Roger Strauss (Iowa) said he would recommend that the drafts be tabled while the working group considered the illustration of nonguaranteed elements. Upon motion duly made seconded, the working group adopted a motion to table the drafts on guarantees only for the present time.

6. Guarantees Only - The Consumers Union and Merrill Lynch proposals call for illustrating guarantees only. This requirement would effectively end the sales of universal life, economatic type polices or any other policy that provides significant benefits via policy dividends or other nonguaranteed elements. Companies could not demonstrate how such polices work if they cannot illustrate nonguaranteed elements. Such a requirement would put an end to the life insurance industry as it operates today and force all companies to offer only non-participating policies similar to those offered prior to the rise in interest rates experienced in the 1970s. These policies have proven to be vastly inferior in value to both traditional participating policies and the more modern interest sensitive policies of today.

7. Lapse Supported Pricing - The Guardian proposal suggests banning lapse supported pricing. It is the only proposal that does so, but this idea has a good deal of support among other companies. Support is by no means universal, however.

Analysis of Illustration Proposals

Technical Resource Committee

September 1, 1994

Illustration Criteria	TRC	NAIC	John Hancock
1. Is discipline imposed on nonguaranteed elements (NGEs)?	Yes - based on Disciplined Current Scale (DCS)	Actual historical experience or guarantees	Yes - based on Disciplined Current Scale (DCS)

Bob Wright (Va.) said the goal of the Aug. 21 session was to review the comments that had been received in response to the drafts of the Life Insurance Illustrations Model Act and Regulation providing for illustrations of

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6. Plans for the Fall National Meeting

Ms. Van Leer said she was concerned about the past performance section of the model draft that the working group had been considering. She asked the working group to reconsider exposure of this draft until the alternative draft allowing future projections was ready or combining the two versions into one. Mr. Wright responded that the current plan is to pursue the guarantees only because some states are interested in adopting such legislation and the working group feels obligated to assist them. He said he was encouraged by the better proposals being put forth by the technical resource advisors and he saw potential for real reform. He said whether the working group actually goes forward to expose and adopt the past performance and guarantees-only draft would depend on the progress of the ASB and the continuing progress of the discussion between the regulators and the interested parties. Mr. Coleman said he was concerned because exposure had often given a life of its own to proposals that might not have been very good. He said he would like to see both models developed together, compared honestly, and the best one chosen. He thought it was better to wait with exposure of one until the other was ready. Mr. Foley said that if the technical resource advisors brought a proposal in September to Minneapolis with the i's dotted and the t's crossed, it would be very difficult to proceed with the guarantees-only draft. Mr. Wright said that he believed the guarantees-only provisions in the model draft were close to complete, and another alternative was to take out the section on past performance.

. Ms. Lanam said it should include definitions Mr. Higgins asked the interested parties what elements they thought were important to include in a draft containing disciplined current scale that were broad enough for all the products that would be illustrated. Commissioner Willis said he hoped they would focus on the positive beneficial impact on consumers. Mr. Cipinko said that if states adopt a guarantees-only draft, it would mean less informed consumers. Ms. Lanam said that her biggest concern was the past performance part of the draft. She said, if the working group intended to go with a guarantees-only draft until a usable disciplined current scale draft was produced, she was motivated to work on that project. Ms. Van Leer asked if the working group could focus on the technical resource advisors' proposal and go through it section-by-section. Ms. Lanam said that one of the issues that was confusing to the resource group was whether the working group intended to encourage standardization of the illustrations or company innovation. Mr. Wright responded that the working group wanted to standardize the format to the extent of uniform definitions, serialized page numbering, and a structure that would be the same for all of the types of illustrations. Mr. Koch asked the technical resource group to provide them with various options for an illustration and also an analysis of which option was preferred. Mr. Coleman said the technical resource advisors were working to incorporate good suggestions from any other proposals into their draft. They were also attempting to get the "puff" out of illustrations. He said the technical resource advisors would be meeting on Aug. 24 and would incorporate the suggestions into their proposal for the working group.

Mr. Wright announced Virginia would be resigning as chair of the Life Disclosure Working Group but would continue as a member of the working group. He indicated that Commissioner Robert

Willis, chair of the Life Insurance (A) Committee, would be appointing a new chair. Commissioner Willis thanked Mr. Wright for his able leadership. He said it had required great patience to get to the point where the working group was today.

The working group continued its discussion of the suggestion to standardize the assumptions after the first five years. Mr. Peavy suggested that this might increase company game-playing during the first five years so that the numbers would look better. Commissioner Wilcox thought that going for a longer period than five years might be better. Mr. Wright said that if there were actuarial standards, perhaps standardized assumptions for illustration were not necessary. Commissioner Wilcox suggested that the working group prepare a paper outlining the standards that it wished to see in a draft of a model allowing projections into the future of non-guaranteed elements

When Mr. Wright summarized the discussion on standardized assumptions, Mr. Montgomery agreed that standardized assumptions would serve the purpose of showing how the policy works, which is the main purpose of an illustration. Fred Nepple (Wis.) said he had discussed this approach with some of the technical resource advisors and saw real progress in coming to an agreement on an approach

. Noel Morgan (Ohio) suggested the working group communicate to the industry ideas that would help them focus on the issues on which the working group wanted to hear comments. Roger Strauss (Iowa) agreed that this was a good suggestion. He said it was important to finish the guarantees only drafts before working on the non-guaranteed elements. Mr. Wright said he thought the working group needed to spend some time on the past performance section of the draft.

b. How to Provide for States That Want to Use Guarantees Only Commissioner Wilcox said that Texas had asked that the model provide a method for states that want to use guarantees only. Commissioner Wilcox said he had talked with Commissioner Robert Hunter (Texas) and he had agreed that the inclusion of drafting notes to identify changes for states that wanted to use only guarantees would be acceptable. Tom Foley (Fla.) asked if this was in any way an endorsement of guarantees only. He said that in his estimation guarantees only was misleading and he did not want to endorse it in any way. George Coleman (Prudential) said he thought the NAIC sent a confusing message if it adopted provisions that were meant to serve the needs of a small minority of states

Commissioner Robert Wilcox (Utah) explained that the purpose of the statement of standards being developed by the working group was to outline the 2. Consider Statement of Standards

provisions that would be included in a model regulation. He emphasized that the specific language that would be included in the regulation was not yet developed.

. Mr. Strauss said that it was Iowa's opinion that the illustration should not be mandated.

. Judy Faucett (Coopers & Lybrand), an NAIC consultant on the illustrations project, asked if it would suffice to deliver the illustration with the policy. Commissioner Wilcox responded that in his opinion presenting the illustration at the time of delivery was acceptable, but he emphasized this was still an open question. Scott Cipinko (National Alliance of Life Companies -- NALC) agreed that a requirement to provide the illustration with policy delivery was appropriate. He said at some times the agent would not have brought along an appropriate illustration and if the requirement was for the illustration to be presented at the time of sale he would not be able to proceed with the sales call.

<u>Mr. Becker suggested bifurcating Subsection E to make clear that some states would be limiting illustrations to guarantees only</u>. He also suggested putting a statement at the beginning of the standards document that some states would want to use guarantees only and not provide for the illustration of nonguaranteed elements.

The working group considered several comments that had been received on Subsection K and discussed whether an appointed actuary should be required. Mr. Irish said an important factor was that the illustrations was representative of recent experience rather than the overall health of the company. He said it was a different kind of information than the appointed valuation actuary would ordinarily consider. Mr.

Aetna Life & Casualty

RE2K

151 Farmington Avenue

Hartford, CT 06156

November 28, 1994

We have reviewed the latest version of the Second Standard Nonforfeiture Law for Life Insurance (M10).

We believe that it imposes unnecessarily confining restrictions on the design and pricing of legitimate Universal Life (UL) insurance products. To comply, our entire portfolio of such products would have to be repriced and refiled; if other companies are similarly affected the resulting non-productive effort and expense on the part of the industry and regulators alike could be considerable. We also believe M10 contains a loophole that would allow for abusive products of the sort it was meant to prevent.

We recommend that M10 be modified along the lines of the attached proposal, which we believe will provide equity between terminating and persisting policyholders while avoiding the above problems. Attachment A contains a description of our alternative proposal; Attachment B contains specific revisions to M10.

We ask you to consider this proposal seriously. We are prepared to discuss it at any time and provide any additional examples or testing necessary. Thank you for your consideration.

Sincerely,

Alastair G. Longley-Cook

Exhibit 1

Prohibit unconscionable premiums

Limit guaranteed maturity premium to 120% of net level premium, based on 3% interest, and 1980 Commissioners Standard Ordinary (CSO) or acceptable modifications for substandard or special underwriting basis.

Retain SNFL2 limits on mortality and interest. These items are regulated for both UL and traditional plans. Comparable limits are already in effect in many states.

Reduce initial expense allowance by excess expense loads in all early years

Under both SNFL2 and UL Model Regulation, the initial acquisition expense allowance is reduced by any excess of

. expense charges actually made in the first year, over

. average expense charge in years 2-20

This implicitly assumes that excess expense charges will occur in the first year only. But high loads in the early renewal years circumvent the restriction, so that the sum of front-end and back-end charges can exceed the intended maximum.

To close this loophole, we propose reducing the initial allowance by the excess of

. sum of expense charges years 1-20, over

. 20 times lowest expense charge years 1-20

and explicitly requiring the result to be nonnegative.

Example 1. Premium load is 80% for one year, 5% thereafter. Reduction in surrender charge:

75% of allowance, under current method 80% - 5%

same under proposed method: (80% + 19 x 5%) - (20 x 5%)

Example 2. Premium load is 20% for five years, 5% thereafter. Reduction in surrender charge:

11.84% of allowance, under current method: 20% - (4 x 20% + 15 x 5%)/19 = 11.84%

75% under proposed method: (5 x 20% + 15 x 5%) - (20 x 5%) = 75%

In Example 2, the 75% load is simply spread over five years, although it is still just an initial excess load. Under current law, increasing the front-end load in years 2-5 paradoxically increases the maximum back-end load: if the premium load were 20% for one year and then a level 5%, the surrender charge scale would be reduced by 15%, not 11.84%. The result seems contrary to the principles of nonforfeiture, yet it is perfectly legal under the UL model regulation and SNFL2. Closing this loophole should be entirely non-controversial.

Summary

Our proposals are more restrictive than any current or proposed law, but they would not disqualify legitimate products. By adopting them in place of SNFL2's specific renewal expense limits, the Task Force can accomplish its goals without creating an unfair competitive advantage for any form of insurance.

Exhibit 2

Hal Phillips (Calif.) asked whether it was appropriate to include the term "dividend" as a nonguaranteed element. He said the dividend was derived from nonguaranteed elements, so he saw this as a semantic problem.

Mr. Morgan asked if the basic illustration required that each premium that was to be paid should be shown and that there should be no vanishing premiums. Mr. Foley said he recognized this was the working group's intent, but he did not know either where this was in the draft. Mr. Coleman asked if this could be an item kept open for discussion.

. The majority of the working group felt that guarantees only was not a good idea. Mr. Strauss suggested that Texas or any other state that so desired use the guarantees only draft that the working group had prepared earlier, even though it had not been formally adopted. Mr. Wright said he thought it was too early to decide this issue, because the working group did not know what the draft allowing nonguaranteed elements would look like. Upon motion duly made and seconded, the working group voted to table the issue

At a minimum, the model should say that every year there is a cost of insurance that cost should be shown, and the model should also ban the use of terms like "vanishing