LIFE INSURANCE (A) COMMITTEE

Reference:
1993 Proc. 1Q p. 249
1993 Proc. I p. 779

David J. Lyons, Chair—Iowa
Gary Weeks, Vice Chair—Ore.

CONTENTS

MINUTES

The Life Insurance (A) Committee met in Salon F/G of the Marriott Hotel in Chicago, Ill., at 9 a.m. on June 23, 1993. A quorum was present and David Lyons (Iowa) chaired the meeting. The following committee members or their representatives were present: Gary Weeks, Vice Chair (Oregon); James H. Dill (Ala.); John Garamendi (Calif.); Robert M. Willis (D.C.); James H. Brown (La.); Harold T. Duryee (Ohio); Claire Korioth (Texas); and Steven T. Foster (Va.).

1. Old Business

Commissioner David Lyons (Iowa) read a resolution commending former Commissioner Mike Weaver (Ala.) for his able leadership as chair of the Life Insurance (A) Committee. Upon motion duly made and seconded, the resolution was adopted (Attachment One).

2. Determine How to Implement Charge of the Executive Committee to Revisit the Issue of Low-Value Life Insurance

Commissioner Lyons summarized the activity of the Life Insurance (A) Committee in this area. He said that disclosure requirements had been added to the Life Disclosure Model Regulation a couple of years ago and last year a buyer's guide was added to the model to explain the disclosure form. The Life Insurance (A) Committee has been charged to consider the issue further. Commissioner Lyons noted that previously the committee had chosen disclosure, but that was not the only route. He called on Melodie Bankers (Wash.) to enlighten the group on the Washington approach (Attachment Two). Ms. Bankers explained that Washington had adopted a regulation in 1989 prohibiting certain low face-value policies. This rule was challenged, but the state Supreme Court unanimously upheld the commissioner's authority to promulgate the rule. The Washington rule was adopted in response to complaints about policies where the premium paid exceeded the death benefit in just a few years.

Commissioner Lyons asked the committee members if they wanted to proceed with a working group to develop a model using the Washington approach or whether more time should be allowed to see if the disclosure approach would eliminate the abuses. Mary Alice Bjork (Ore.) suggested that the committee allow time to see if disclosure would work, but retain the issue on the agenda so that the committee could move forward with a ban if it did not. Ms. Bankers said the target market of senior citizens was

vulnerable and the marketing was being done by slick operators. She thought the products were inherently unfair.

Upon motion duly made and seconded, the committee voted to continue evaluating the disclosure approach and to review the progress at the December National Meeting. Commissioner Lyons reminded the members that there would be nothing to evaluate if states did not adopt the disclosure requirements.

Bonnie Burns (California HICAP Assn.) expressed disappointment that the committee had decided not to move forward on low face-value life insurance. She expressed the hope that the commissioners would act on the project soon.

3. Consider Charge of the Executive Committee to Review the Issue of Charitable Gift Annuities

Commissioner Lyons asked Carolyn Johnson (NAIC/SSO) to report on the various approaches taken by the states. Ms. Johnson referred the committee to a memo summarizing the various approaches (Attachment Three). Upon motion duly made and seconded, the committee voted to further research the issue and determine whether the states are having any problems. The charge would be retained so that the committee could act if research showed further regulation was appropriate.

4. Consider Results of Survey on Unfunded Checking Accounts

The issue of unfunded checking accounts was added to the charges of the Life Insurance (A) Committee at the request of the Insurance Department of Vermont. Ms. Johnson reported on a survey of the states she had conducted indicating that the majority of states responding had not received a significant number of complaints, but they did see the potential for problems (Attachment Four). Superintendent Robert Willis (D.C.) suggested setting up a working group to define the available options to respond to the issue. Upon motion duly made and seconded, the Life Insurance (A) Committee voted to set up a new working group to make recommendations on the issue of unfunded checking accounts. Commissioner Lyons appointed Oregon (chair), Texas, Washington and Vermont to the working group.

5. Consider Implementation of Charge of the Executive Committee to Survey Consumers to Evaluate the Effectiveness of Life Insurance Buyer's Guide

Commissioner Lyons drew the group's attention to a draft of a letter he suggested sending to the Consumer Participation Board of Trustees to solicit its assistance and advice on how to survey consumers. Upon motion duly made and seconded, the committee voted to ask for suggestions from the consumer representatives on the most expeditious way to accomplish the charge.

6. Report of Viatical Settlement Working Group

Roger Strauss (Iowa) reported that the working group had made revisions to the model act on viatical settlements and was recommending it for exposure, with the goal of final adoption at the September meeting. Mr. Strauss emphasized that the act provided a broad overview, and that the working group thought a regulation would be necessary. Upon motion duly made and seconded, the Viatical Settlement Working Group report was received and the draft model released for exposure (Attachment Five).

7. Report of Life Disclosure Working Group

Bob Wright (Va.) reported that the Life Disclosure Working Group had been gathering information from a variety of sources and is now ready to proceed. He reported that states are seeing increased numbers of complaints, so the working group is committed to moving forward. Mr. Wright said it is a challenging assignment, but the group would have a report by the fall National Meeting on their progress. John Montgomery (Calif.) said this issue was a high priority for the Life and Health

Actuarial Task Force, and he thought it should also be a high priority for the Life Insurance (A) Committee. Mr. Montgomery indicated that he would designate a staff person to ensure coordination between the Life and Health Actuarial Task Force and this working group. Upon motion duly made and seconded, the report was received (Attachment Six).

8. Report of Life and Health Actuarial Task Force

Mr. Montgomery presented the report of the Life and Health Actuarial Task Force and asked the Life Insurance (A) Committee to adopt 10 recommendations.

1. Recommend that proposed Actuarial Guideline GGG, entitled "Determining Minimum Reserves for Individual Two-Tier Policies/Contracts" be exposed for comments. This recommendation relates to Project 2n Annuities.

2. Recommend that proposed Actuarial Guideline CCC, entitled "Statutory Valuation of Group Annuity Contract Exempt from CARVM Requirements" be exposed for comments. This recommendation relates to Project 2o Reserves For Group Annuities Exempt from CARVM Requirements.

3. Recommend deletion of Project 2q Actuarial Opinion for Canadian Companies from the actuarial task force's agenda because work on that project has been completed.

4. Recommend that proposed Actuarial Guideline HHH, entitled "Reserve for Immediate Payment of Claims," be exposed with the intent that it be recommended for adoption in September 1993. This recommendation relates to Project 2s Reserve for Immediate Payment of Claims.

5. Recommend addition of Project 2t Need for New Individual Annuity Tables to the actuarial task force's agenda, as a number two priority project.

6. Recommend that the proposed new model Second Standard Nonforfeiture Law for Life Insurance be exposed for comments with comments requested by Sept. 1, 1993, with the possibility that a version of this model law can be adopted in December 1993. This recommendation relates to Project 3g Revision of Standard Nonforfeiture Law for Life Insurance.

7. Recommend that the report on possible future changes to current nonforfeiture laws on annuities be exposed with all comments requested by Sept. 1, 1993. This recommendation relates to Project 3H Revision of Annuity Nonforfeiture Law.

8. Recommend deletion of Project 4bb Certain Annuities with Bail-Out Provisions from the actuarial task force's agenda because work on that project has been completed.

9. Recommend that the proposed revision of Schedule S-Part 4 of the life insurance company annual statement blank be exposed for comments with all comments requested by Sept. 1, 1993. This recommendation relates to Project 5 Reinsurance.

10. Recommend deletion of Project 13 Non-Guaranteed Element Annual Statement Interrogatories: from the actuarial task force's agenda because any remaining work can be done under Project 14 Disclosure and Sales Illustration Practices.

Upon motion duly made and seconded, the report was adopted. A joint report to the A and B Committees was received also.

9. Prioritization of Projects

Commissioner Lyons said the Life Insurance Committee should prioritize the issues before it and complete the top three priorities first. The opinion of the committee was that the top three priorities should be life insurance illustrations, viatical settlements and unfunded checking accounts.

Having no further business, the Life Insurance (A) Committee adjourned at 10:05 a.m.

David J. Lyons, Chair, Iowa; Gary Weeks, Vice Chair, Ore.; James H. Dill, Ala.; John Garamendi, Calif.; Robert M. Willis, D.C.; James H. Brown, La.; Harold T. Duryee, Ohio; Claire Korioth, Texas; Steven T. Foster, Va.

ATTACHMENT ONE

RESOLUTION

WHEREAS, Mike Weaver served as a member of the Life Insurance (A) Committee for more than two years; and

WHEREAS, Mike Weaver served as chair of the Life Insurance (A) Committee for 16 months; and

WHEREAS, during that time the Life Insurance (A) Committee considered and developed positions on gifts of life insurance to charities, corporate owned life insurance, and disclosure related to low-value life insurance; and

WHEREAS, during the period of chairmanship of Mike Weaver, the Life Insurance (A) Committee began formulating a position on viatical settlements, unfunded checking accounts, and life insurance illustrations;

THEREFORE, BE IT RESOLVED that the Life Insurance (A) Committee thanks Mike Weaver for his able leadership in consideration of life insurance issues during the period of his membership and chairmanship of the Life Insurance (A) Committee.

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ATTACHMENT TWO

REPORT TO THE (A) COMMITTEE ON WASHINGTON'S HIGH-PRICED LIFE (LOW-VALUE LIFE) RULE
by Melodie Bankers,
Deputy Commissioner for Special Projects, Washington State

Re: WAC 284-23-550—Relationship of death benefits to premiums—unfair practice defined (effective date: 7-1-89)

(1) It is an unfair practice for any insurer or fraternal benefit society to provide life insurance coverage on any person through a policy or certificate of coverage delivered on or after July 12, 1989, to or on behalf of such person in this state, unless the benefit payable at death under such policy or certificate will equal or exceed the cumulative premium . . . paid for the policy or certificate, plus interest thereon at the rate of five percent per annum compounded annually to the tenth anniversary of the effective date of the coverage.

1. Purpose of the Rule

The rule was adopted after the commissioner received a number of complaints and inquires concerning the high cost associated with life insurance policies with low face amounts and, associated with this, high expense loads concerned the commissioner. Of particular concern was the question asked by more than one owner (or owner's family): Should I continue to pay premiums on this policy, a policy for which the premiums paid to date already exceed the death benefit? It's very difficult to answer that question.

2. Overview of the Rule

A rule was adopted under the commissioner's broad unfair practices rule-making authority to prohibit a class of policies characterized by: low face values (usually with a non-level death benefit), target-marketed to senior citizen population often using celebrity pitchmen, and having very high expense loads coupled with high mortality charges.

This was accomplished by adopting a rule affecting policies with face amounts of less than $25,000. The rule sets up a relationship between death amount and premiums—the death benefit must equal or exceed the cumulative premiums plus interest at the rate of five percent per annum compounded annually to the 10th anniversary.

Exceptions include group contracts (unless the individual pays all or substantially all of the premium), level premium limited pay whole life insurance where the death benefit exceeds the total of the premiums paid at any time, and a universal life contract with specified terms and conditions.

3. Challenge to the Rule

The commissioner was sued by a number of life insurance companies (including Omega National Life) and the American Council of Life Insurance. The NAIC entered an *amicus* brief on the limited subject of the history of unfair practices statutory authority.

The Washington state supreme court unanimously upheld the commissioner's authority to promulgate the rules as an unfair practice in *Omega v. Marquardt*, 115 Wn.2d 415 (1990). The court found that the rule was a reasonable attempt to solve the problem addressed and that the commissioner could reject the solution based on disclosure, having concluded that in this situation disclosure was both ineffective and unenforceable. Further the court held that the rule does not violate due process, equal protection or the takings clause, nor does it unconstitutionally discriminate against the elderly. The court held that the rule constituted a rational solution to a perceived problem: the rule applied to all buyers when the premium/benefit relationship violated the rule; the expense load for policies under $25,000 is higher, and the court concluded, "The rule seeks to protect all buyers from purchasing policies which are inherently unfair." Finally, the court held that the rule was not confiscatory (that is, it did not result in a taking of property of the insurers). "It is unclear what property interest has allegedly been taken. By its terms, the rule applies prospectively only and does not affect existing insurance policies. A party has no vested right in the continuation of existing statutory law."

4. Where we are today in Washington State

In our view, the rule has worked. Low-value, high-priced life insurance policies are not sold to residents of the state of Washington.

We had hoped that insurers who specialized in this market would take advantage of the two exceptions (limited premium and universal life models), but we have not seen more than a handful of filings.

We were told that these low-value life policies were necessary for persons so that they could put aside money for funerals and last expenses. We have seen the cost of funerals and last expenses top $25,000 and, therefore, feel that the $25,000 face amount is an appropriate and effective cut-off point (particularly given the high expense load of high mortality policies).

A copy of the opinion in *Omega v. Marquardt* and of WAC 284-23-550 have been give to Carolyn Johnson (NAIC/SSO) if a state wishes a copy.

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ATTACHMENT THREE

TO: Life Insurance (A) Committee
FROM: Carolyn Johnson, CLU, NAIC
DATE: June 23, 1993
RE: Regulation of Charities That Issue Annuities

On April 5, 1993, the Executive Committee charged the Life Insurance (A) Committee to determine whether the NAIC had ever studied the issue of charities issuing annuities and if not, to take up the issue.

A charitable gift annuity is an annuity arrangement issued by a non-profit organization whereby the charity accepts a transfer of money on the condition that an annuity is paid to the transferor or some other beneficiary. Absent a specific insurance code provision, it could be argued that these non-profit associations are transacting the business of insurance and should be so regulated.

I have reviewed the *Proceedings of the NAIC* and found no indication that the NAIC has considered this issue previously.

Commissioner Lyons asked me to summarize the manner in which states are currently handling the issue. Maryland recently sent a PROFS request to all the states requesting information on whether and how states regulated charitable gift annuities. Those responses are summarized below.

1. No specific references to charitable gift annuities in insurance code: Alaska, Alabama, Michigan, Missouri, Nevada

2. Department issues special permit or certificate to charity: Arkansas, Florida, Maryland, New Jersey, New York, North Dakota, Oregon, Washington, Wisconsin

3. Treat same as any other annuity product: Idaho, Illinois

4. Specific exemption from insurance laws: Kansas, Kentucky, South Carolina, Utah

5. Have been permitting, but will look into issue: Rhode Island

6. Do not permit: Texas

The variety of approaches to this issue have created difficulties for some states, so it has been requested that the NAIC recommend a standard approach by way of a model law.

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ATTACHMENT FOUR

TO: Life Insurance (A) Committee
FROM: Carolyn J. Johnson, CLU, NAIC
DATE: June 23, 1993
RE: Unfunded Checking Accounts Survey

At the March 1993 meeting of the Life Insurance (A) Committee, it was requested that a survey be mailed to all state insurance departments requesting opinions on the issue of unfunded checking accounts, also known as retained asset accounts or asset preservation accounts.

The survey was accompanied by a department memorandum (Exhibit 1) written by Rick Barrett (Vt.) setting out problems he observed and suggestions for possible solutions.

Responses to the following questions were received from 27 jurisdictions:

1. Is the practice of using unfunded checking accounts common among insurers operating in your state?
   Yes 7 No 11 Don't know 7

2. Do you consider this to be a problem?
   Yes 14 No 5 Potential Problem 3 Don't know 2

3. Why or why not?

Issue of payment of interest on the amount concerns the department.

When the unfunded checking account is used without the prior approval of the insured/owner in the dispersement of death proceeds, I believe the practice is totally inappropriate.

If practices are being carried out in the manner described in the memorandum, we consider it a problem.

Claim is not paid until the draft is actually honored. Since the proceeds are no longer a part of the insurance contract, the guaranty association may not consider these proceeds covered claims.

Money is being used by the company to the beneficiary's detriment.

Adequate protection of the funds is questionable; there is lack of disclosure. In the event of a consumer complaint, this would be a violation of the contract and an unfair trade practice.

Concur with observations in memo.

Currently, it sounds as though accounting for these transactions is not properly done. Also, the beneficiary appears at risk in an insolvency.

Are concerned with unfunded accounts. Have approved funded checking accounts as an option.

The option can be beneficial. A large check may be the last thing the beneficiary needs. This requires a quick reinvestment decision that can be unwise and often irreversible.

This long-standing practice appears to be clearly extra-contractual. Issuance of unfunded drafts does not satisfy the company's responsibility to pay the claim.

It imposes an unnecessary delay on the use of the funds by the beneficiary. Funds are not protected by the guaranty association.

We are not satisfied that there is adequate disclosure with either funded or unfunded accounts.

As long as this is presented as an alternative, we see no problem.

The unfunded account is often a "negative response"—the beneficiary has no way to affirmatively request or reject this.

The funds are not properly accounted for by insurers and may be subject to forfeiture in case of financial difficulty of the insurer.

The practice is a violation of the "entire contract" provision. It is not a settlement option.

Not held as a due and unpaid claim by the insurer; held as a general liability.

Negative option—beneficiary does not have an informed choice.

We see the possibilities of problems, but as of now the practice has not generated complaints.

4. If you consider this a problem, do you think the practice should be prohibited?
Yes 5 Regulated 9 No 8 Not sure 2

5. What should be the form of any regulatory safeguards to prevent possible abuses?

We call such an unfair trade practice.

Violation of entire contract provision.

Proper liabilities need to be established.

The bank should not assess any fees without explicit consent from the beneficiary.

The guarantee association issue must be clarified.

I would favor a model act which requires adequate disclosure, requires this to be a settlement option, requires a supplemental contract be issued along with the "checkbook," requires identification of reserves for the liabilities, requires guaranty fund coverage, and requires interest on the funds held under such a program.

Require funded account with a financial institution giving the beneficiary Federal Deposit Insurance Corporation protection.

This should be a settlement option within the policy.

Require the accounts be 100% funded and disclosure to beneficiaries that the entire proceeds can be accessed by cashing one check/draft.

Legislation should prohibit the practice.

Adequate disclosure is required.

We would strongly support regulatory safeguards in the form of an NAIC model act.

We would support regulatory safeguards that would hold the insurer liable for such accounts and which adequately protects or insulates the beneficiary in the event of the insurer's failure.

Need account guidelines and disclosure requirements.

Accounts should either be funded, or if not funded, that must be made clear.

It should not be a negative option.

In summary, the majority of those who responded had not received significant numbers of complaints, but did see potential for abuse if the practice was not regulated.

The conclusions which can be gleaned from the comments are:

A. The unfunded checking account should be presented as an option available to the beneficiary.
B. Consumers should have more complete disclosure of what the option means and any associated costs.
C. Guaranty fund coverage should be available.
D. Reserves should be set aside to cover the obligations as claims due but unpaid.

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EXHIBIT 1

To: Shawn Bryan
From: Rick Barrett, Vermont Division of Insurance
Date: Jan. 28, 1993
Re: Death Benefits Payable Via: "Unfunded Checking Accounts"
A/K/A "Reserve Asset Accounts"
"Retained Asset Accounts"
"Asset Preservation Accounts"

As you are aware I have been concerned about the current, wide spread practice of life insurers to unilaterally require beneficiaries to accept the death benefit proceeds from life policies as a checking account. I would like to suggest that you and

Commissioner Costle present the issue of unfunded checking accounts/reserve asset accounts as a subject worthy of task force investigation and worthy of regulation by all states.

Carolyn Johnson (NAIC Associate Counsel) suggested that contact with David Simmons (NAIC Executive Vice President) within the next few days might be enough time to enable him to charge a task force or committee at the Commissioners Conference which begins Feb. 7, 1993, in Washington, D.C.

Let me summarize my discoveries which were accomplished with a tremendous amount of help from Melodie Bankers (Assistant Deputy Commissioner of Washington state). Then I would like to state some of its implications and finally what solutions the NAIC might consider.

SUMMARY

An alarmingly large portion of the industry employs a method of paying death claims, a variation of which I believe was first used by John Hancock.

Hancock's Method:

(1) Offer the beneficiary an opportunity to open a mutual fund account which would be managed by Hancock and which was fairly liquid.

(2) Or offer the beneficiary an opportunity to elect one of the standard options, which was to leave the funds on deposit with Hancock; the new feature being to pay interest at rates closer to the market return.

The Current Twist:

(1) A company unilaterally sets up an unfunded checking account with State Street Bank (Boston). In most cases the death benefit has to be in excess of $10,000.

(2) The beneficiary gets a "checkbook." However, the account is a draft account because there are no funds deposited with the bank until the beneficiary drafts against the account. At that time the company, upon notice from the bank, wires the funds to cover the draft. Until that time the funds stay with the company, the account is empty. In some cases, the funds reside in wholly owned subsidiaries of the company.

(3) The companies have not included any language in the contracts which identifies the unfunded checking account as a settlement option. This means the option exists outside of the contract and in many cases does not have regulatory approval.

(4) Most of the insurers do not show the "funds on hold" as liabilities, except in a few states which have performed financial examinations and have subsequently required that annual reports show the accounts as liabilities. Melodie Bankers believes that North Carolina and Maryland have done this on a case-by-case basis.

Melodie also directed me to Arkansas. John Shields (Director - Life & Health Division of Arkansas) confirmed the fact that they issued Bulletin No. 26-91 (addressing "negative option" claim payments) which was withdrawn (in part) after strong opposition from the American Council of Life Insurance (ACLI). John said that Arkansas' concern was more with the method of payment in this way and less with the concept. At one time, during the Executive Life insolvency, the banks froze such accounts.

I met, jointly, with Julie Spiezio (Counsel For The ACLI) and Brian Vachon (National Life's Vice President Of Communications). It is clear that they continue to favor the practice and would prefer to be allowed to go on doing so.

There are 17 other states (of which I am aware) which have also expressed an interest in this issue.

As it is now:

Although the practice may have some merit, as it currently exists, my perception is that reserve asset accounts benefit the bank and the companies more than the beneficiaries:

- The bank gets the fees and sometimes a compensating balance in another account.
- The company gets the use of the money.
- The company maintains contact with the beneficiary, in hopes of making future sales (perhaps an annuity in exchange for the death funds).

Problems:

(1) The issuance of the checkbook is not stated in the policy as a settlement option. As such, the practice is exercised outside of the contract provisions, a violation of the entire contract provisions of most statutes.

(2) The action of issuing the checkbook should constitute a violation of the unfair trade provisions of most statutes, because:

(a) It is a unilateral action.

(b) It imposes a delay on the beneficiary; rather than receiving a check which can be deposited he has to write a check (draft) and wait for processing through the company (again) as well as the bank.

(c) It imposes the administrative policies and fees of the State Street Bank on the beneficiary.

(d) By not stating this as a settlement option in the contract, it amounts to a negative option; that is, the beneficiary is precluded from choosing this option on his own.

(3) This issuance of the check does not, in my opinion, create a supplemental contract. There is no document which states the offer and acceptance, nothing to create the fiduciary responsibility; no stated terms or conditions and no way for the beneficiary to affirmatively accede to terms and conditions.

There may be an implied contract (which is the tack that John Stotler [Chairman Vermont Life & Health Insurance Guaranty Association] and Julie Spiezio [ACLI] take), but certainly nothing express. As such, I fear that there is the possibility that the benefits remaining in the company's general account could find themselves unprotected by the various guaranty associations.

There never was a contract between the beneficiary and the company. It was between the insured and the company. However, if a beneficiary elects one of the settlement options in the insurance policy or if the insured designated a settlement option, then there is a newly created contract between the beneficiary and the company. A "book of drafts" just does not seem to do it.

(4) Conceivably, during an insolvency, a bank could once again elect to freeze the monies deposited in general accounts or accounts of wholly owned subsidiaries.

(5) By accepting a "checkbook," the beneficiary may no longer be afforded the protection from creditors or actions of the court; as he might be under the provisions of a supplemental contract.

(6) The checks are, in fact, not checks at all. They are drafts. Calling them checks violates disclosure standards. By calling them checks and implying that there are funds residing in a bank account, there is an implication that the money is protected by the FDIC. This is misleading and deceptive.

(7) By automatically issuing these "checkbooks," the provision which already resides in most contracts and which allows the funds to remain on deposit with the company, at interest and under a supplementary contract (with appropriate trust provisions), is effectively rendered moot. If the beneficiary needs time to determine how best to handle the death benefit, then he could have elected this option (and the funds would continue to show as a liability on company books).

(8) As item #7 (above) alludes, many of the companies are not holding these funds out as liabilities. The funds may well be commingled in the general account and there may not be the appropriate reserves set up for them.

(9) Competitive Interest Rates should not be at issue in the payment of death benefits. If a company wants to compete with the financial market place, then we might consider having the program registered with the Securities and Exchange Commission and state securities divisions. Theoretically, "leaving funds on deposit" is a provision which was created solely to give the beneficiary a safe harbor for the death benefit, until he figures out what should be done.

If a company offers too much of an incentive for people to leave funds on deposit or to accept the checkbooks, then the company also creates an environment which could result in a run with a rise in interest rates.

SUGGESTED ACTION:

The NAIC could promulgate a model act which would:

(1) Prohibit the practice as a negative option, outside of contractual provisions.

(2) Prohibit the practice as unilateral and an unfair trade practice.

(3) Prohibit the practice as potentially threatening to company solvency.

OR

(1) Require adequate disclosure and the opportunity for beneficiaries to make an affirmative choice among settlement options;

(2) Require that this procedure be filed as a "settlement option" in the text of all insurance policies.

(3) Require that there be a supplemental contract issued to a beneficiary, along with the "checkbook."

(4) Require that insurance contracts provide protection from the beneficiaries' creditors, if the funds are held in such an asset account.

(5) Require that all companies identify all "Reserve Asset Funds" held in the General Funds as a liability be reported as "claims due - as of yet unpaid";

(6) Require that the guaranty fund specifically cover funds held in such accounts;

(7) Require that there be interest paid on any funds held under such a program and that the rate be similar to that paid on funds held on deposit or a little higher, if such an increase would benefit the beneficiary without jeopardizing company solvencies.

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ATTACHMENT FIVE

Viatical Settlement Working Group
Chicago, Illinois
June 21, 1993

The Viatical Settlement Working Group met in Salon A/B of the Marriott Hotel in Chicago, Ill., at 2 p.m. on June 21, 1993. A quorum was present and Roger Strauss (Iowa) chaired the meeting. The following working group members were present: Reginald Berry (D.C.); Mary Alice Bjork (Ore.); Rhonda Myron (Texas); and Bob Wright (Va.).

1. Adopt April 7 and May 19, 1993, Conference Call Minutes

Upon motion duly made and seconded, the minutes of the April 7 and May 19 conference calls were adopted. (Attachments Five-C and Five-B, respectively).

2. Comments From Interested Parties

Roger Strauss (Iowa) summarized the activities of the working group during the past three months. Copies of the draft of the Viatical Settlement Model Act prepared last year were mailed to interested parties with a request for comments. After receiving comments, the working group identified three categories: (1) suggestions it chose to incorporate in the draft; (2) suggestions it rejected; and (3) items on which it thought further input was needed before a decision could be made.

Commissioner David Lyons (Iowa) told the group that the charge to the Life Insurance (A) Committee was to have a model ready to adopt by the fall meeting. He asked the working group members if they were comfortable with that time frame. He pointed out that the details would be included in a regulation to be drafted later. The working group members agreed the charge could be accomplished.

Mr. Strauss then requested comments from individuals who wished to speak to the issues presented in the draft. He reminded the audience that the working group was not focusing on the philosophical issues of whether viatical companies should be regulated or allowed to operate, but rather on the specifics of the model that it had been charged to develop.

Mr. Strauss also listed a number of items on which the working group needed further input: whether it was appropriate to include group policies, what the model should say about brokers, licensing requirements for companies, standards for payments to viators, and the usefulness of a witness to the statement of the viator.

The first speaker was Bill Crust (National Viatical Association) who spoke of free enterprise and the right to privacy. He said that remedies already exist for breach of contract, and property rights are damaged by over-regulation.

Steve Simon (National Association of Viatical Settlement Organizations) said his association is 100% in favor of regulation for the viatical industry. Then he addressed the items enumerated by Mr. Strauss. He stated that the majority of the policies purchased by the company with which he was affiliated were group policies, so he encouraged inclusion of group policies in the model. Mr. Simon commented that brokers should be included in the model and should be required to disclose the source of funds. He encouraged the same standards for brokers and companies. He expressed no opinion as to whether there should be a different license fee for companies and brokers. On the subject of witnesses for the consent document described in Section 9A(2), he opined the witness was useful because he or she assisted the viator in understanding the importance of his or her actions. Help from an independent third-party was most appropriate. Mr. Simon said that his company required witnesses and a notarization. He stated his opinion that disclosure was very important so that the viator understood the alternatives to sale of his or her policy and thanked the NAIC for its attention to the industry.

Peggy Wallace (Affirmative Lifestyles) said there were several issues that had not been addressed in the draft that she thought were important: (1) solicitation, (2) tracking methods, and (3) funds confirmation. It was the opinion of Ms. Wallace that telemarketing should be discouraged or maybe prohibited. An individual should not be subject to continued solicitation. She stated that her company made clear to the viator at the time of the transaction that it would be necessary to track to know when death occurred. Ms. Wallace suggested a limit of one contact per month which should be non-obtrusive. The third issue

which she thought should be addressed, was that funds should be set aside in a trust fund while the contract was being finalized. In addition, she commented that discount limits were not helpful as the viator was protected by the free market and increased competition. She suggested, as an alternative, disclosure of recent offers.

Chris McDonald (United Health Services of Ohio) noted her agreement with the comments provided by Mr. Simon. In response to the comments of Mr. Crust, Ms. McDonald said that it was also a part of the American tradition to protect the weak and sick. She stressed the importance of disclosure and praised the draft as it now stands.

Mr. Strauss then asked the working group members if they had any questions for the persons who had made comments. He first asked whether there was a confidentiality problem with a person going to his employer to get a release for a group certificate. Mr. Simon responded that the greatest problem with group policies was inconsistency. Some did not allow a certificateholder to assign the policy irrevocably. His company required the policy to have a conversion feature, otherwise the policy could be canceled at the whim of the employer. Mr. Simon said confidentiality was a significant problem. The insured gives up his right to confidentiality, but Mr. Simon did not know of an alternative. Ms. McDonald said that the Americans with Disabilities Act did provide protection for the employee who disclosed his medical condition to the employer.

Mr. Strauss noted that Mr. Simon had referred to standards in the viatical settlement industry and he requested that Mr. Simon provide those in writing. While the model act would not include specifics, the regulation might, so it would be useful to have that information.

Mary Alice Bjork (Ore.) asked why the group policy should be so important when so many of the viators would probably have already terminated employment by the time they sold their policies. Mr. Simon said many were on long-term disability so maintained the benefits of employees. He said 70% of his company's purchases were of group policies.

Ms. Bjork asked whether it might be a good idea to have the beneficiary required as a witness. Mr. Simon said it was not a good idea in his opinion, because the viator might not want a person to know he was beneficiary or that the viator was ill. However, most viators did seem to have someone in whom they confided who could serve as a witness.

Reginald Berry (D.C.) asked Mr. Simon how he classified himself and Mr. Simon replied he was a buyer. He also noted that some brokers are also buyers and some have a funding source. The broker and funding source should be disclosed and regulated. He said his association was working on a uniform disclosure form based on the California requirements.

Mr. Berry asked if one component of the offer price was a fee and Mr. Simon responded that if a broker was involved, approximately 3.5% of the negotiated purchase price was paid to the broker. His company paid no fee to financial planners, doctors, attorneys or insurers who made referrals.

Tony Higgins (N.C.) said he thought the disclosure should include the fact that viaticated funds were no longer shielded from the claims of creditors. Mr. Simon said his company disclosed that a viatical settlement was not a good idea for an individual who had filed or was contemplating filing bankruptcy.

3. Drafting Session (Regulators Only)

After these comments were received, the working group went into closed session to revise the draft.

The regulators decided to add group policies to the model.

It was decided to include brokers in the model and provide authority for including licensing requirements in the regulation.

After some discussion on ways to assure the availability of funds, the regulators agreed to add an escrow requirement and authority for the commissioner to require a bond.

A requirement was added to Section 3F to require review of a detailed plan of operation so that the commissioner was aware of the type of operations being conducted. It was also decided to add a section referring to the Unfair Trade Practices Act.

In Section 4, the subsection detailing procedures for a hearing was deleted and left with a reference to the states' administrative procedures act.

A new provision was added to Section 8 to require disclosure that the proceeds could be subject to the claims of creditors. The disclosure requirements of Section 8 were revised to require disclosure of the funding source.

A requirement was added to Section 7 for the viatical settlement provider to maintain records of the viatical settlement transactions.

The working group agreed to present the draft (Attachment Five-A) to the Life Insurance (A) Committee for exposure and to continue to solicit comments before the fall meeting.

Having no further business, the Viatical Settlement Working Group of the Life Insurance (A) Committee adjourned at 4 p.m.

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ATTACHMENT FIVE-A

VIATICAL SETTLEMENTS MODEL ACT
Exposure Draft: 6/21/93
Underlining and overstrikes show changes from 6/8/93 draft.

Table of Contents

Section 1. Short Title

This Act may be cited as the Viatical Settlements Act.

Section 2. Definitions

A. "Viatical settlement broker" means an individual, partnership, corporation or other entity who or which for another and for a fee, commission or other valuable consideration, offers or advertises the availability of viatical settlements, introduces viators to viatical settlement ~~companies~~ providers, or offers or attempts to negotiate viatical settlements between a viator and one or more viatical settlement ~~companies~~ providers. "Viatical settlement broker" does not include an attorney, accountant or financial planner retained to represent the viator whose compensation is not paid by the viatical settlement ~~company~~ provider.

B. "Viatical settlement contract" means a written agreement entered into between a viatical settlement provider and a person owning a life insurance policy or who owns or is covered under a group policy insuring the life of a person who has a catastrophic or life threatening illness or condition. The agreement shall establish the terms under which the viatical settlement provider will pay compensation or anything of value, which compensation or value is less than the expected death benefit of the insurance policy or certificate, in return for the policyowner's assignment, transfer, sale, devise or bequest of the death benefit or ownership of the insurance policy or certificate to the viatical settlement provider.

C. "Viatical settlement provider" means an individual, partnership, corporation or other entity that enters into an agreement with a person owning a life insurance policy or who owns or is covered under a group policy insuring the life of a person who has a catastrophic or life threatening illness or condition, under the terms of which the viatical settlement provider pays compensation or anything of value, which compensation or value is less than the expected death benefit of the insurance policy or certificate, in return for the policyowner's assignment, transfer, sale, devise or bequest of the death benefit or ownership of the insurance policy or certificate to the viatical settlement provider. Viatical settlement provider does not include:

(1) Any bank, savings bank, savings and loan association, credit union or other licensed lending institution which takes an assignment of a life insurance policy as collateral for a loan; or

(2) The issuer of a life insurance policy providing accelerated benefits under Section [refer to law or regulation implementing the Accelerated Benefits Model Regulation or similar provision].

D. "Viator" means the owner of a life insurance policy insuring the life of a person with a catastrophic or life-threatening illness or condition or the certificateholder who enters into an agreement under which the viatical settlement ~~company~~ provider will pay compensation or anything of value, which compensation or value is less than the expected death benefit of the insurance policy or certificate, in return for the viator's assignment, transfer, sale, devise or bequest of the death benefit or ownership of the insurance policy or certificate to the viatical settlement ~~company~~ provider.

Section 3. License Requirements

A. No individual, partnership, corporation or other entity may act as a viatical settlement provider or enter into or solicit a viatical settlement contract without first having obtained a license from the Commissioner.

Drafting Note: Insert the title of the chief insurance regulatory official wherever the term "commissioner" appears.

B. Application for a viatical settlement provider license shall be made to the Commissioner by the applicant on a form prescribed by the Commissioner, and the application shall be accompanied by a fee of $[insert amount].

C. Licenses may be renewed from year to year on the anniversary date upon payment of the annual renewal fee of $[insert amount]. Failure to pay the fee within the terms prescribed shall result in the automatic revocation of the license.

D. The applicant shall provide such information as the Commissioner may require on forms prepared by the Commissioner. The Commissioner shall have authority, at any time, to require the applicant to fully disclose the identity of all stockholders, partners, officers and employees, and the Commissioner may, in the exercise of discretion, refuse to issue a license in the name of any firm, partnership or corporation if not satisfied that any officer, employee, stockholder or partner thereof who may materially influence the applicant's conduct meets the standards of this Act.

E. A license issued to a partnership, corporation or other entity authorizes all members, officers and designated employees to act as viatical settlement providers under the license, and all those persons must be named in the application and any supplements to the application.

F. Upon the filing of an application and the payment of the license fee, the Commissioner shall make an investigation of each applicant and ~~shall~~ may issue a license if the Commissioner finds that the applicant:

(1) Has provided a detailed plan of operation; and

(~~1~~2) Is competent and trustworthy and intends to act in good faith in the capacity involved by the license applied for; and

(~~2~~3) Has a good business reputation and has had experience, training or education so as to be qualified in the business for which the license is applied for; and

(~~3~~4) If a corporation, is a corporation incorporated under the laws of this state or a foreign corporation authorized to transact business in this state.

G. The Commissioner shall not issue any license to any nonresident applicant, unless a written designation of an agent for service of process if filed and maintained with the Commissioner or the applicant has filed with the Commissioner, the applicant's written irrevocable consent that any action against the applicant may be commenced against the applicant by service of process on the Commissioner of Insurance.

Section 4. License Revocation

A. The Commissioner shall have the right to suspend, revoke or refuse to renew the license of any viatical settlement provider if the Commissioner finds that:

(1) There was any misrepresentation in the application for the license;

(2) The holder of the license is otherwise shown to be untrustworthy or incompetent to act as a viatical settlement provider;

(3) The licensee demonstrates a pattern of unreasonable payments to policyowners;

(4) The licensee has been convicted of a felony or any misdemeanor of which criminal fraud is an element; or

(5) The licensee has violated any of the provision of this Act.

B. Before the Commissioner shall deny a license application or suspend, revoke or refuse to renew the license of a viatical settlement provider, the Commissioner shall conduct a hearing in accordance with [cite the state's administrative procedure act]. ~~In lieu of revoking or suspending the license for any of the causes enumerated in this section, the Commissioner may, after the hearing, subject the licensee to a penalty of not more than $[insert amount] for each violation, when the Commissioner finds that the public interest would not be harmed by the continued operation of the provider.~~

Section 5. Approval of Viatical Settlements Contracts

No viatical settlement provider may use any viatical settlement contract in this state unless it has been filed with and approved by the Commissioner. Any viatical settlement contract form filed with the Commissioner shall be deemed approved if it has not been disapproved within sixty (60) days of the filing. The Commissioner shall disapprove a viatical settlement contract form if, in the Commissioner's ~~discretion~~opinion, the contract or provisions contained therein are unreasonable, contrary to the interests of the public, or otherwise misleading or unfair to the policyowner.

Section 6. Reporting Requirements

Each licensee shall file with the Commissioner on or before March 1 of each year an annual statement containing such information as the Commissioner by rule may prescribe.

Section 7. Examination

A. The Commissioner may, when the Commissioner deems it reasonably necessary to protect the interests of the public, examine the business and affairs of any licensee or applicant for a license. The Commissioner shall have the authority to order any licensee or applicant to produce any records, books, files or other information reasonably necessary to ascertain whether or not the licensee or applicant is acting or has acted in violation of the law or otherwise contrary to the interests of the public. The expenses incurred in conducting any examination shall be paid by the licensee or applicant.

B. Records of all transactions of viatical settlement contracts shall be maintained by the licensee and shall be available to the Commissioner for inspection during reasonable business hours.

Section 8. Disclosure

A viatical settlement provider shall disclose the following information to the viator no later than the date the viatical settlement contract is entered into:

A. Possible alternatives to viatical settlement contracts for persons with catastrophic or life threatening illnesses, including, but not limited to, accelerated benefits offered by the issuer of the life insurance policy;

B. The fact that some or all of the proceeds of the viatical settlement may be taxable, and that assistance should be sought from a personal tax advisor;

C. The fact that the viatical settlement could be subject to the claims of creditors;

D ~~C~~. The fact that receipt of a viatical settlement may adversely effect the recipients' eligibility for Medicaid or other government benefits or entitlements, and that advice should be obtained from the appropriate agencies;

D. The policyowner's right to rescind a viatical settlement contract within thirty (30) days of its execution or fifteen (15) days of the receipt of the viatical settlement proceeds, whichever is less, as provided in Section 9C; and

E. The date by which the funds will be available to the viator and the source of the funds.

Section 9. General Rules

A. A viatical settlement provider entering into a viatical settlement contract with any person with a catastrophic or life threatening illness or condition shall first obtain:

(1) A written statement from a licensed attending physician that the person is of sound mind and under no constraint or undue influence; and

(2) A witnessed ~~and authorized~~ document in which the person consents to the viatical settlement contract, acknowledges the catastrophic or life threatening illness, represents that he or she has a full and complete understanding of the viatical settlement contract, that he or she has a full and complete understanding of the benefits of the life insurance policy, releases his or her medical records, and acknowledges that he or she has entered into the viatical settlement contract freely and voluntarily.

B. All medical information solicited or obtained by any licensee shall be subject to the applicable provision of state law relating to confidentiality of medical information.

C. All viatical settlement contracts entered into in this state shall contain an unconditional refund provision of at least thirty (30) days from the date of the contract, or fifteen (15) days of the receipt of the viatical settlement proceeds, whichever is less.

D. Immediately upon receipt from the viator of documents to effect the transfer of the insurance policy, the viatical settlement provider shall pay the proceeds of the settlement to an escrow or trust account managed by a trustee or escrow agent in a bank approved by the Commissioner, pending acknowledgment of the transfer by the issuer of the policy. The trustee or escrow agent shall be required to transfer the proceeds due to the viator immediately upon receipt of acknowledgment of the transfer from the insurer.

~~D~~E. Failure to tender the viatical settlement by the date disclosed to the viator renders the contract null and void.

Section 10. Authority to Promulgate Standards

The Commissioner shall have the authority to:

A. Promulgate regulations implementing this Act;

B. Establish standards for evaluating reasonableness of payments under viatical settlement contracts. This authority includes, but is not limited to, regulation of discount rates used to determine the amount paid in exchange for assignment, transfer, sale, devise or bequest of a benefit under a life insurance policy~~.~~; and

C. Establish appropriate licensing requirements and fees for agents and brokers; and

D. Require a bond.

Section 11. Unfair Trade Practices

A violation of this Act shall be considered an unfair trade practice under Sections [insert reference to state's Unfair Trade Practices Act] subject to the penalties contained in that act.

Section ~~11~~ 12. Effective Date

This Act shall take effect on [insert date]. No viatical settlement provider transacting business in this state may continue to do so after [insert date] unless it is in compliance with this Act.

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ATTACHMENT FIVE-B

Viatical Settlement Working Group of the
Life Insurance (A) Committee
Conference Call
May 19, 1993

The Viatical Settlement Working Group of the Life Insurance (A) Committee met by conference call on May 19 at 10 a.m. Participating in the call were Roger Strauss (Iowa), Chair; Reginald Berry (D.C.); Mary Alice Bjork (Ore.); Rhonda Myron (Texas); and Bob Wright (Va.). Also participating was Carolyn Johnson (NAIC/SSO).

Roger Strauss (Iowa) called the meeting to order and stated the purpose of the conference call was to consider comments received by the working group on the model draft prepared last year by the Insurable Interest Working Group. During the conference call the working group members hoped to identify issues on which they agreed, and ones on which further discussion was needed.

1. Section by Section Discussion of Draft

Section 1. Title: Several comments were received concerning the title "Living Benefits Model Act" which was used in the draft prepared last year. The universally accepted term for the industry is "viatical settlements." Some of the working group members agreed with one comment that this could be confused with accelerated benefits. The working group agreed to change the title to Viatical Settlements Model Act and to revise all references to living benefits in the draft.

Section 2. Definitions: A comment was received suggesting the language of Section 2A be changed so that it no longer referred to the person owning the policy, because this prevented persons with group policies from taking advantage of the model's protections.

Members of the working group discussed the advantages and disadvantages of including group contracts in the definition and decided to seek further input at the June meeting in Chicago.

One suggestion was that Section 2A(2) should refer to the Accelerated Benefits Model Regulation instead of describing the methods of payment of accelerated benefits. The working group agreed this would be clearer and voted to make the change.

Several comments were received relating to the role of viatical settlement brokers. One writer suggested an exemption for brokers and another suggested defining brokers separately. Yet another suggested a separate provision on brokers with a smaller license fee. One of the commenters suggested that a broker be required so that the viatical company was not representing both buyer and seller. Mary Alice Bjork (Ore.) spoke in favor of keeping brokers in the model because there was a potential for abuse in the fees they collected. Reginald Berry (D.C.) saw no need for continuing education and other regular agent and broker requirements and favored a limited license. The working group agreed to add a definition similar to that in a pending New York bill and to consider the other issues relating to brokers at the June meeting in Chicago.

Section 3. License Requirements: It was suggested that the application for a license be a uniform application attached as an appendix to the draft. Roger Strauss (Iowa) stated he thought that suggestion was more appropriate for a regulation and recommended the working group consider that issue after the model act had been completed.

A suggestion was made that the fee be *pro rata* or renewable a year from the date of application. Mr. Strauss asked the working group members about the procedure in their states. Some renewed all licenses on the same date, and some renewed a year after application. The group decided to change the draft to make the license renewable on the anniversary date, with the understanding that states would probably change the provision, if necessary, to be the same as the practice for other types of licenses.

One writer suggested that employees be exempted from Section 3D. The working group members could not see any reason to do this, so left the provision in the draft.

Another comment received suggested that the authority to investigate stockholders, officers, employees, etc., was too broad and encouraged "fishing expeditions" by the commissioner. The working group members thought the commissioner needed broad authority to investigate and did not foresee the commissioner having time for "fishing."

It was suggested that the paragraphs of Subsection F were too broad and allowed the commissioner to make moral judgments. The working group decided to leave the language, which was generally found in state licensing statutes.

One commenter suggested that Subsection F(3) required a viatical company to form a separate corporation for every state in which it operated. Mr. Berry spoke against modifying the paragraph so that corporations licensed by the State Division of Corporations or similar entity could avoid the licensing requirements of the insurance department. Mr. Strauss suggested each working group member solicit input from the licensing division in his or her own state and be prepared to discuss the issue further in June.

Section 4. License Revocation: The comments received on Section 4 related to the term "unreasonable payments" used in Subsection A(3). One writer suggested the term was too vague and the language should be changed to: "The licensee demonstrated a pattern of payments to policyholders not consistent with viatical settlement industry standards." The working group members were interested in discovering what these standards were and after that would determine whether to change the draft.

Another commenter suggested removing Paragraph (3) completely because competition in the marketplace would assure reasonable payments. The working group members voted to keep the unreasonable payments provision as a reason for revocation.

Section 5. Contract Approval: It was suggested that it was a waste of time for insurance departments to review contract forms. The working group members thought it served as a valuable consumer protection, and it was also useful to have this information available to the public.

Section 6. Reporting Requirements: In response to a suggestion that a uniform reporting form be devised, the working group members agreed the concept was good. However, they did not think it appropriate to delay development of a model act or regulation while a reporting blank was developed. They chose to ignore a comment that financial reporting was an invasion of privacy.

Section 7. Examination: One commenter on this section suggested that an examination could be incriminating and therefore a Fifth Amendment violation. Another suggested that the licensee be required to pay for the examination only if violation of the public trust were found. Both comments were considered and rejected.

Section 8. Disclosure: A comment on this section pointed out that the draft didn't say who should receive the disclosure of information. The working group added that to the draft for clarity. It was also suggested that a provision be added to require the purchaser to either have the money in hand or to disclose the outside date by which funds would be available. The working group considered this and asked Carolyn Johnson (NAIC/SSO) to draft a sample provision for its consideration.

Several comments were received regarding the impact of a viatical settlement on taxes and entitlements. It was suggested that the viatical settlement provider was not necessarily qualified to give advice in these areas. Mr. Berry suggested language similar to that in the Accelerated Benefits Model Regulation be added urging the viator to seek professional advice. The working group agreed this was a good approach.

The working group considered whether the viator ought to be required to sign a waiver to indicate he had received the disclosures. It was agreed that this would be in a regulation, rather than a statute, so consideration was tabled.

Two comments were received in opposition to the disclosure of and requirement for a 30-day period to rescind the transaction. The working group thought there was some merit to this argument and concluded the amount paid to the viator might actually be lower because the transaction would not be final for that period of time. The working group voted to include a provision like that contained in the draft New York law, with a two-part requirement. Bob Wright (Va.) suggested that by making the right the greater of 30 days from date of contract or 15 days from date of payment as contained in the New York bill, companies were actually encouraged to hold the funds longer. The working group decided to make the model provision for the lesser of those two time periods.

Section 9. General Rules: A suggestion was made that this section include a provision that insurance companies be required to cooperate with viatical settlement companies and brokers by supplying needed information in a timely fashion. The working group chose not to consider this issue here, since it would be inappropriate for a law regulating life insurance companies to be placed in a chapter on viatical settlement companies.

One writer suggested the word "first" should be removed from Subsection A. The working group rejected this suggestion, considering it appropriate to require these steps before entering into a contract.

The working group considered a comment on the requirement in Subsection A to have the statement witnessed. One commenter suggested this was unnecessary and even a violation of privacy. Mr. Strauss asked what the duty of the witness was in this case; was he to make sure the viator was getting a good bargain? Mr. Berry replied that it was the duty of the witness to testify that the viator was acting of his own free will and had the mental capacity to sign the contract. This

testimony protected all the parties. The working group agreed that the witness should be a disinterested third party, if a witness was needed. It was decided to seek further input on this in June.

One comment suggested that Subsection C was unclear because it allowed for a refund period of "at least" 30 days. The writer suggested states might extend the period because of these two words. The working group decided to leave the words in place because that language gave the viatical company the option of providing a longer period. If a state wanted a different length of time, the law would simply be written with a different time period.

Section 10. Regulation: Several comments were made about the regulation of discount rates. One suggested that there were already viatical industry standards, which the working group decided to review. Since this whole issue is more appropriate to discuss while drafting a regulation, action was deferred. Pending comments to be received at the June meeting, the language was not changed.

2. Future Activities of Working Group

Ms. Johnson was asked to revise the draft in keeping with the decisions made by the working group. Another conference call was scheduled for June 8 at 10 a.m. to review the draft. The draft and minutes would then be mailed to the interested parties so they would be able to comment on the revised draft and outstanding issues in June. After the June 21 drafting session, an exposure draft would be referred to the parent committee.

Having no further business, the conference call adjourned at 11:30 a.m.

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ATTACHMENT FIVE-C

Viatical Settlement Working Group of the
Life Insurance (A) Committee
Conference Call
April 7, 1993

The Viatical Settlement Working Group of the Life Insurance (A) Committee met by conference call on April 7 at 10 a.m. A quorum was present and Roger Strauss (Iowa) chaired the meeting. Also present were Beth Hill (Texas); Ken Kattner (Texas); and Bob Wright (Va.). Carolyn Johnson (NAIC/SSO) also participated.

Roger Strauss (Iowa) called the meeting to order and summarized the timetable under which the working group was charged to complete its task. He said the working group was to make final recommendations for a model law by the fall National Meeting.

The first agenda item was to discuss the draft which had been prepared by the Insurable Interest Working Group last summer. Bob Wright (Va.) reported the draft had drawn from a California law and had not been circulated to the viatical industry or had any input from them.

The members of the working group reviewed a list of those who had expressed an interest in the product of the working group and decided it would be most appropriate to solicit input from any interested parties. They directed Carolyn Johnson (NAIC/SSO) to mail a copy of the draft to each person on the list and request comments and suggestions. Then Ms. Johnson would incorporate the comments into one document for the working group to consider during the next conference call.

The schedule devised by the working group was: April 8, mailing to interested parties; May 7, comments returned to NAIC; May 13, comments summarized and mailed to members of working group; May 19, conference call of working group to consider comments; Chicago summer National Meeting, open meeting to hear further comments and closed drafting session.

The next conference call was scheduled for 10 a.m. May 19.

Having no further business, the conference call adjourned at 10:45 a.m.

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ATTACHMENT SIX

Life Disclosure Working Group
of the Life Insurance (A) Committee
Chicago, Illinois
June 21, 1993

The Life Disclosure Working Group of the Life Insurance (A) Committee met in Salon A/B of the Marriott Hotel in Chicago, Ill., at 1 p.m. on June 21, 1993. A quorum was present and Bob Wright (Va.) chaired the meeting. The following working group members or their representatives were present: John Montgomery (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); and Noel Morgan (Ohio).

1. Report on Metzenbaum Hearing

Commissioner David Lyons (Iowa) reported on the hearings held at the end of May and his testimony before Senator Metzenbaum. Commissioner Lyons said the senator thought insurance illustrations were not properly regulated by the states, particularly with regard to disclosure of what is guaranteed and what is not. Senator Metzenbaum did not seem to be interested in pursuing federal regulation if the states would deal with the issue in a timely manner. Commissioner Lyons said Senator Metzenbaum and his staff were familiar with what the NAIC and the industry and professional associations are doing.

Commissioner Lyons asked the working group to prepare a report by the NAIC fall National Meeting detailing the proposals and progress of the NAIC that could be passed along to Senator Metzenbaum.

2. Presentation by Technical Advisors

George Coleman (Prudential) reported that after the discussion at the March meeting of the working group, the group of technical advisors concluded that it needed to aim for a more simplified approach. The document Mr. Coleman distributed to the working group (Attachment Six-A) was a preliminary draft of information that should be included on a cover page to an illustration. Mr. Coleman said the technical advisors thought it was important that regulators address the problems caused by lower interest rates which caused a failure of policy performance to meet the expectations of consumers.

Mr. Wright asked if it was the group's intent to have the narrative accompany the current illustration. Mr. Coleman replied that such was their intent, because it would present critical information in an understandable way. He also noted that the last bullet at the end of the draft was not meant to be optional. In addition, Mr. Coleman said the technical advisors agreed with the changes to illustrations being recommended by the American Academy of Actuaries.

Mr. Coleman stated that the technical advisors do not favor a standardized disclosure format and do not propose adoption of a rigid set of rules for policy illustrations. Mr. Coleman said that the technical advisors favor flexibility in how insurers prepare illustrations.

John Montgomery (Calif.) said that insureds could be misled by a variety of formats. He distributed to the working group a draft of an illustration regulation being considered in California (Attachment Six-B). He said the Life and Health Actuarial Task Force is also working on this issue and incorporating some of the California draft in its recommendations. Mr. Wright asked what the status of the California draft was. Mr. Montgomery said the draft was on hold while they waited to see what the NAIC would do. If the NAIC waited too long, California planned to proceed.

William B. Fisher (Mass. Mutual) stated his opinion that a great deal of flexibility is needed because of the variety of products. Mr. Fisher commented that the technical advisors had first thought it would be appropriate to require more numeric disclosure, but for consumers who are not number-oriented, that would add to the confusion.

Mr. Montgomery said the California draft contained a guide to understanding the ledger illustration; it is important to explain what the different elements mean. Mr. Fisher replied that the agent did that when presenting the illustration. David Langenbacher (Calif.) pointed out that when the agent leaves, the applicant may forget or wish to review the information, so he needs some written documents.

G. Reed Ashwill (National Association of Independent Life Brokerage Agencies) said, in his opinion, there were two problems to be addressed. One was the agent who pulled members off the ledger to make his own illustrations, and the second problem was that some company illustrations had lapse rates built in. Tony Higgins (N.C.) said he thought persistency bonuses should be kept separate from the basic illustration.

3. Future Activity of Working Group

Mr. Wright said the working group had been gathering information and should now proceed with recommendations on how to make illustrations more comprehensible. He suggested a conference call of the working group during the next few weeks. Mr. Coleman committed to having the industry product completed and to the working group by July 12.

Mr. Wright noted the complaints in Virginia were increasing in number and complexity, mostly due to a lack of understanding about what the consumer had purchased. Other states reported that they also had increased numbers of complaints and Mr. Langenbacher pointed out that there was no evidence to support the complaints if no paper had been left with the consumer. He also noted that the documents could serve to vindicate the insurer that had provided disclosure.

4. Any other Matters Brought Before the Working Group

Mr. Wright appointed Don Koch (Alaska), Tony Higgins (N.C.) and Fred Nepple (Wis.) to the working group.

Having no further business, the Life Disclosure Working Group of the Life Insurance (A) Committee adjourned at 2 p.m..

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ATTACHMENT SIX-A

The Prudential

June 21, 1993

The Honorable Steven T. Foster
Commissioner of Insurance
Commonwealth of Virginia
Richmond, Virginia 23209

Re: Recommendation from the Insurance Industry Committee On Life Insurance Disclosure

Dear Commissioner Foster:

The members of the former Advisory Committee to the NAIC Life Disclosure Working Group have continued to meet in furtherance of the goals of improving life insurance policy disclosure. At the March 8, 1993, meeting of the Working Group we presented our views concerning the recommendations made by the American Academy of Actuaries concerning illustration practices. In the discussion of the Working Group which followed our presentation and the presentations by the representatives of the Academy and National Association of Life Underwriters (NALU), we were struck by a common theme. That theme was that life insurance policy illustrations were too complicated and that too many consumers misunderstood what they were buying. Indeed, there was comment that some policyholders didn't even realize that it was life insurance they were purchasing.

Those of us who have been in the business of life insurance or in the business of regulation of life insurance for any period of time know that these are complex financial instruments. However, even complex financial instruments can be explained in such a way as to make their key elements understandable to most consumers. While we can't wave a magic wand and uncomplicate complicated policies, we can work to make them more understandable.

With that in mind, we approached the subject of policy illustration from a new direction. We decided that we could help uncomplicate the mysteries of sophisticated life insurance policies by improving the disclosures accompanying policy illustrations. Our idea was to require illustration cover pages which would include certain essential information about the policy being illustrated and the illustration itself. This information would have to be clear and it would have to be concise. Otherwise, we fear that it would not be read.

The model advertising regulation would establish the requirements. Companies could use their own language as long as it conveyed the required information. Certain essential life insurance policy information would be common to all illustration cover pages whether they related to plain vanilla whole life policies or very sophisticated modular policies. The more sophisticated policies would require additional disclosures.

Our preliminary recommendations for Working Group consideration are included as Exhibit A. These recommendations are preliminary and would have to be further refined and reduced to model life insurance advertising act format. However, we believe the exhibit will give you a good idea as to the direction in which we have been going.

Our committee is hopeful that you will carefully review our recommendations. We are prepared to address any questions that you may have today or at any time in the future. Because this issue is so important to us, our committee intends to stay together to see this process through to a successful conclusion. We believe that improved regulation in this area will be of real benefit to insurance consumers and to the life insurance industry as well.

Sincerely,
George Coleman

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EXHIBIT A

REQUIREMENTS FOR ILLUSTRATION COVER PAGES
June 21, 1993

Each life insurance policy illustration shall include a cover page containing the following information:

Policy Description

- A heading for the face page which would include a statement that the policy being illustrated is a life insurance or an annuity contract (as applicable). If additional benefits are provided they can be described in the body of the face page information.

- The generic name of the policy being illustrated. The generic name is a short title that is descriptive of the premium and benefit patterns of the policy.

Premium Requirements

- A statement as to the length of time that premiums are required to be paid under the terms of the contract.

- If the policy is universal life, a statement as to when coverage will lapse using the illustrated premium and assuming a worst case scenario, i.e.,: guaranteed interest crediting rate, guaranteed mortality and guaranteed expense charges, and what additional premium is required to guarantee coverage for life.

Benefits Payable

- A statement describing when or under what circumstances death benefits or annuity benefits are payable.

Variance of Actual Benefits and Values From Illustrated Benefits and Values

- If non-guaranteed benefits are illustrated, a statement to the effect that the illustration is based on certain assumptions which are not guaranteed and actual results may be less or more favorable.

- A statement recommending that the policyholder periodically check the status of policy values.

Policy Features or Options Affecting Actual Benefits or Values

The coverage page shall also include a more specific brief description of policy features or options, either guaranteed or non-guaranteed, that have or will have a material impact on the values, benefits or costs of the policy and what impact they will have. Examples of such features and required disclosures with respect to them, are as follows:

- Scheduled changes in premium levels or benefits.

- Persistency bonuses affecting cash values.

- The details of any modular premium structure, including the significance of the proportion of whole life and term, and a statement that the non-guaranteed elements are subject to change.

- Multiple benefit streams arising from policies variously described as two-tier, multiple benefit or the like, including those with life and annuity components. With such policies the varying availability of benefits must be disclosed.

- Changes in cash value upon the first death for a second-to-die or multiple life policy. If values do change, the insurer would describe when the first death is illustrated to occur and why this assumption was made.

- Where premiums are illustrated on an abbreviated (vanishing) payment schedule a statement must be included that out-of-pocket premium payments will not cease as illustrated if actual experience is less favorable than that assumed in the illustration. The statement must advise that in such a case additional premiums may need to be paid out-of-pocket in order to maintain policy values and to keep the policy in-force. Further, it must be disclosed that reaching a point where out-of-pocket premiums are no longer required under an abbreviated payment schedule does not mean that the policy is paid-up.

- At the very end, a statement to the effect that the illustration is intended to assist the applicant (policyowner) in understanding how the policy works; that illustrations are not to be used by themselves to compare different policies; and that for comparison purposes other factors are important, such as the insurer's financial condition, historic performance record, the services that policyholders expect to receive and the individual policy features themselves.

RESOURCE COMMITTEE ON LIFE INSURANCE DISCLOSURE

William N. Albus, The National Association of Life Underwriters
Bruce E. Booker, F.S.A., Life of Virginia
Chair, George T. Coleman, The Prudential Insurance Company of America
Jim Ellis, General American Life Insurance Co.
Judy A. Faucett, Coopers & Lybrand
Mark Feldman, Mark Feldman Associates
William B. Fisher, Mass Mutual Life Insurance Co.
Anne Flanagan, Teachers Ins. And Annuity Assoc. College Retirement Equities Fund
Edwin F. Jackson, Mitchell, Williams, Selig, Gates & Woodyard
William C. Koenig, Northwestern Mutual Life Insurance Co.
Linda Lanam, Life Insurance Company of Virginia
Barbara J. Lautzenheiser, Lautzenheiser & Associates
Suzanne Logan, Confederation Life
Diana M. Marchesi, Transamerica Occidental Life
Bartley L. Munson, Coopers & Lybrand
Thomas B. Phillips, American General Life Insurance Co.
Cosette R. Simon, Lincoln National Corporation
Stephen W. Still, Torchmark Corporation
Paul J. Tidwell, CIGNA
Galen F. Ullstrom, Mutual of Omaha Insurance Company

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ATTACHMENT SIX-B

California Discussion Draft

Requirements for Ledger Illustrations Used in the Sale of Life Insurance and Annuity Policies

Section 1. Purpose

The purpose of this article is the following:

A. To regulate the preparation and use of ledger illustrations in sale of permanent life insurance and deferred annuities.

B. To establish standards to be used in preparation of ledger illustrations used in the sale of permanent life insurance and deferred annuities.

C. To help educate the purchaser as to the understanding of and proper use of a ledger illustration.

Section 2. Application of Article

This article is applicable to all life insurance and annuity sales where a ledger illustration is used in the solicitation.

Section 3. Definitions

A. "Ledger illustration" means a year by year extension into the future of values and benefits on a guaranteed (G) and non-guaranteed or illustrated basis (NG), the latter (NG) on the assumption that current experience factors such as interest, mortality and expense will continue unchanged into the future. (Note the statute imposes a maximum interest rate after 10 years.)

B. "Current scale" means the current dividend scale for participating insurance or the current set of interest, mortality and expense factors used in the illustration of non-guaranteed charges or benefits.

Section 4. Insurance and Annuities Excluded from Article

Unless otherwise specifically included, this article does not apply to the following:

A. Credit life insurance.

B. Term insurance.

C. Non-contributory group life insurance where a ledger illustration is not used in the solicitation of the business.

D. Reinsurance.

E. A solicitation where a ledger illustration is not used.

Section 5. Requirements for the Preparation of Ledger Illustrations

Every ledger illustration prepared for delivery in this state shall meet the following requirements:

A. The ledger illustration must be based on factors not more favorable than what the company is paying under the insurer's current scale.

B. Each ledger illustration must state that it is neither a guarantee nor an estimate of future results, that it is based on current pricing factors which can change and that as these factors change, the scale will change and that it is a virtual certainty that actual results will differ from what was illustrated.

C. Current dividends shall be illustrated with the use of experience factors consistent with current experience. Non-guaranteed charges and benefit factors shall be illustrated with the use of experience factors consistent with the currently anticipated experience.

D. Within 120 days from the date it is determined that the currently illustrated scale cannot be supported by current experience or currently anticipated experience, the illustrated scale shall be reduced to that which can be supported.

E. The development of current scales and ledger illustrations shall be consistent with the principles and standards of performance as promulgated by the Actuarial Standards Board of the American Academy of Actuaries.

F. Ledger illustrations may not assume ongoing changes that would increase the scale (e.g., improving mortality). Ongoing changes that would reduce the scale are permitted (e.g., increasing unit expenses or decreasing interest rates).

G. Projection of experience trends is not permitted beyond one year. Consistency between current scales and ledger illustrations is required. Ledger illustrations shall be related to scales actually being paid on in-force plans in an equitable and justifiable manner.

H. Ledger illustrations shall appropriately reflect the current financial results of the company.

I. Each company shall have a written current policy on file at its home office (available to the commissioner on request) for determination and redetermination of dividends and non-guaranteed charges and benefits currently being paid and illustrated.

J. In the redetermination of non-guaranteed charges and benefits for current payment or illustration, past losses are not permitted to be used. Past gains may be used for the determination of current payout but not for illustrations.

K. The projected interest rate of return for non-guaranteed benefits for durations beyond 10 years shall not exceed the rate of return on 30-year treasury bills rounded to the lower .25%, or the guaranteed rate, if higher. For the current calendar year the rate on October 1st of the previous calendar year shall be used. Where an interest margin is used to cover expenses, such 30-year treasury rate shall be reduced by such margin.

L. Where an interest margin is used to amortize initial expenses, the interest rate credited may increase after the expenses are fully amortized. However, such increase may not be illustrated.

M. A ledger illustration based on the current scale shall accompany each form filing.

N. The ledger illustration shall show with equal or greater prominence the guaranteed values and benefits along with those not guaranteed. Each column must be designated G—guaranteed, or NG—not guaranteed.

Section 6. Regulations

The commissioner may issue regulations to support this article. Such regulations shall cover items such as smoothness tests, forward pricing, lapse supported ledger illustrations, supportability, enhancements and other related topics.

Section 7. Additional Requirements

A. A ledger illustration shall be provided that is consistent with the policy actually issued (the amount of coverage, premium, mortality class, etc.)

B. The applicant shall sign a statement that he or she has reviewed the ledger illustration and that he or she understands its limitations. This acknowledgment, along with a copy of the illustration, shall be retained with the original application by the insurer.

C. The insurer shall notify the policy owner each time there is a decrease in scale below what was originally illustrated. Upon request, the insurer shall provide new illustrated values based on the current scale.

D. The following Guide to Understanding of Ledger Illustrations shall be presented with each ledger illustration

Section 8. Administrative Penalties

Same as Section 10509.9 of California Law.

Section 9. Effective Date

This article shall become effective January 1, 1994.

Guide to Understanding of Ledger Illustrations

This guide is being provided to you so that you can better understand what a ledger illustration is and is not. This is required by law.

What is a ledger illustration?

It is an extension into the indefinite future of current experience factors affecting interest, mortality and expense. These factors reflect current experience. As experience with the factors that affect the performance of a product change, the numbers and results that are non-guaranteed will also change. The ledger illustration also shows with equal prominence values that are guaranteed. The company cannot pay less than these. (Note: the statute imposes a maximum interest rate after 10 years.)

What are the chances that a company will pay exactly what is illustrated?

Nil or zero. If nothing changes in all the experience factors the company will be able to pay exactly what is illustrated. However, we know that these factors will change as experience changes. Interest rates go up and down. Mortality experience changes: it is helped by medical breakthroughs and hurt by things similar to AIDS. Unit expenses: helped by increased productivity and hurt by inflation.

What are the chances that the company will be able to pay more than illustrated?

It depends on how likely it is experience factors will be better in the future. For example, if interest rates increase and are greater than those in effect at the time of purchase, chances are very good that the company will pay more.

What are the chances that the company will have to pay less than illustrated?

It depends on how likely it is experience factors will be poorer in the future. For example, if interest rates decrease and are lower than those in effect at the time of purchase, it is very likely the company will pay less.

Should I rely on the number in the illustration?

"Yes" for the guaranteed numbers. For the non-guaranteed numbers—"not at all": these are to show you how the plan would work and help you understand the plan based on an extension into the future of current experience factors which will change as experience unfolds.

What is a ledger illustration not?

The non-guaranteed portion of a ledger illustration is:

(a) Not a guarantee to pay what is illustrated.
(b) Not a promise to pay what is illustrated.
(c) Not a most likely scenario of what will be paid. It might be the least likely.

Remember: The purpose of a ledger illustration is to help you understand how the product works. The better you understand the product the better you will be able to compare similar products of other companies.