

LIFE INSURANCE (A) COMMITTEE

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

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MINUTES

The Life Insurance (A) Committee met in the Republic Room of the Sheraton Hotel and Towers in Boston, Mass., at 1 p.m. on Sept. 21, 1993. A quorum was present and David J. 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); and Steven T. Foster (Va.).

1. Discuss Low-Value Life Insurance: Response of the States

Commissioner David Lyons (Iowa) called on Carolyn Johnson (NAIC/SSO) to report on the survey she had conducted of the states (Attachment One). Ms. Johnson reported that of the 27 jurisdictions that responded, nine states limit or prohibit sales of low-value life insurance with one more state planning to adopt a prohibition; seven plan to adopt the model provisions with one state already having the model in place; and nine states responded that no action was planned. Commissioner Lyons summarized the concerns which had been raised that caused this item to be placed on the agenda. He said some thought that if the low-value life insurance provisions of the Life Disclosure Model Regulation were not put in place by the states, it would be appropriate for the NAIC to draft a model to ban the product. Of the states Commissioner Lyons spoke with, many were focusing on other issues, primarily accreditation, and plan to deal with disclosure at a later date. Commissioner Lyons said that states had requested information on how to proceed and he suggested the following approach: The Life Insurance (A) Committee should send an outline to the Executive Committee showing the alternatives available to the states: disclosure, such as developed in the model regulation; a ban on the sale of products as done in Washington; and a review of options followed by other states. Bob Katz (Ohio) asked that Ohio be added to the list of states that will consider the model next year. This information was added to the memo from Ms. Johnson.

Upon motion duly made and seconded, the Life Insurance (A) Committee voted to send a report to the Executive Committee at the winter National Meeting.

2. Discuss Charitable Gift Annuities Summary of State Concerns

Commissioner Lyons called on Ms. Johnson to summarize the results of the survey sent to the states. She said the Life Insurance (A) Committee asked the NAIC staff to survey the states to determine whether there have been reports of problems with charitable gift annuities. None of the 28 states responding to the survey reported any significant problems, although several expressed the opinion that consumers would not be likely to voice their complaints to the insurance department since that agency did not have any authority over charitable organizations.

Ms. Johnson said some of the states did not experience problems because they already regulate charitable organizations, and others do not permit charities to issue annuities. From the information the states provided in response to the questionnaire, Ms. Johnson prepared a chart (Attachment Two) showing the position of the states. Commissioner Lyons said the summary of state positions will become part of the minutes of this meeting so that states will be able to review and see what other states' positions are. If any state wants further information, it will be able to gather data from this chart.

3. Discuss Consumer Evaluation of Life Insurance Buyer's Guide

Commissioner Lyons stated that the Executive Committee occasionally asks appropriate committees to review buyer's guides that are part of the NAIC materials. The Life Insurance (A) Committee was given the responsibility of reviewing the Life Insurance Buyer's Guide with consumer input. At the spring NAIC National Meeting, the committee voted to contact consumer groups for help. Only one response was received with a suggestion for assistance. Commissioner Lyons asked committee members for any resources and also suggested that the consumer representatives in the audience might be able to lend assistance. He said he would be contacting the consumer representatives again asking for their assistance. Mary Alice Bjork (Ore.) offered the consumer organization in Oregon to assist and Mr. Katz volunteered the Ohio consumer organization. Commissioner Lyons said that Iowa's senior health program could also assist in this area.

4. Report of Unfunded Checking Account Working Group

Ms. Bjork reported that the working group met Sept. 20 and considered the proposed outline of a model law on unfunded checking accounts. There was a good discussion of the issues and many of the working group's questions and concerns were addressed, but the group still was not clear on treatment of unfunded checking accounts by the guaranty associations. The working group recommended to the Life Insurance (A) Committee that it would be appropriate to defer a decision on whether or not to develop a model until after contact with the National Organization of Life and Health Guaranty Associations (NOLHGA) and the Guaranty (EX4) Fund Task Force. Upon motion duly made and seconded, the report of the working group was adopted (Attachment Three). Commissioner Lyons said there was good reason to defer a decision until there had been input from these parties. He said that a decision would be made at the winter National Meeting.

5. Report of Viatical Settlement Working Group

Roger Strauss (Iowa) reported that the working group has two recommendations for the Life Insurance (A) Committee. The working group is suggesting adoption of the Viatical Settlement Model Act and authorization to begin work on an accompanying regulation. He also wished to make one correction to the model before adoption. In Section 8E and again in Section 9C the working group had changed the word "less" to "later" at the Sept. 20 meeting. After further discussion among working group members, they determined that "less" was the terminology they wished to retain because this would encourage payment of the proceeds earlier to start the free-look period running. Upon motion duly made and seconded, the model was amended to include the provision described by Mr. Strauss (Attachment Four). Upon motion duly made and seconded, the report of the Viatical Settlement Working Group (Attachment Five), including the Model Viatical Settlement Law, was adopted. Commissioner Lyons suggested one variation to this adoption. He said a number of states, including North Dakota, Arkansas, Florida and Utah, had expressed concerns over the concept of adopting a

model for viatical settlements. They were concerned that development of this model might close off other options to the states including approaching insurance companies and encouraging accelerated benefits, banning viatical settlement companies, taking actions under the Unfair Trade Practices Act, etc. Commissioner Lyons said that there was no intent to foreclose other actions by the states by development of this model law. He suggested that, to give an opportunity for all of the states to discuss the model, a request be made to take the Viatical Settlement Working Group minutes off the consent agenda for the next Executive and Plenary Session. This would allow discussion of the model by all of the states. Commissioner Robert Wilcox (Utah) expressed support for this option. He said it was appropriate to allow debate on the whole concept because he thought it was contrary to public interest. He also thought it was not appropriate to give this concept the stature of a model act, but more appropriate to take a strong position against the viatical settlement companies because the model gives credibility where it is not deserved. Commissioner Lyons said that Mr. Strauss had a paper pointing out some of the various problems of viatical settlements, and he offered this to any interested parties.

6. Report of Life Disclosure Working Group

Bob Wright (Va.) said the working group met Sept. 20 to discuss the position paper developed by the working group with possible solutions to the problems it saw with life insurance illustrations. He said there was good attendance at the working group meeting, possibly because Sen. Howard Metzenbaum (D-Ohio) attended and expressed support for the working group's proposals. He said many insurance groups and agent groups also expressed their support for the work product prepared. He did want to suggest one change to the minutes of the working group meeting because he thought they reflected an inaccurate timeframe for the working group's product. Commissioner Lyons said he had misspoken at the working group meeting and outlined the intended timeframe for the working group's activity. Commissioner Lyons asked that written responses to the position paper be sent to Ms. Johnson by Oct. 15. He hoped these suggestions would include possible solutions, ways to implement them, and proposed language for model legislation. It would be expected that the working group would have an exposure draft of a model act by December, with adoption at the March National Meeting. The Life and Health Actuarial Task Force has agreed to provide definitions by the December National Meeting and work on a regulation would begin in December with those definitions. Interested parties would have an opportunity to respond to the definitions by Feb. 1 to Ms. Johnson, and by the March National Meeting the working group would be expected to have a position paper further designating the direction it wished to go. A regulation would be ready to expose in June. Commissioner Lyons invited those who were interested in getting information, both regulators and others, to provide their names to Ms. Johnson so they would be able to receive all of the information about the working group's activity. Upon motion duly made and seconded, the report of the Life Disclosure Working Group was adopted (Attachment Six).

7. Discuss Issue of Synthetic GICs

Larry Gorski (Ill.) reported as a representative of the Life and Health Actuarial Task Force. He said that John Montgomery (Calif.), chair of the task force, had sent a letter to Commissioner Lyons on June 8 raising concerns about a new financial arrangement termed "synthetic guaranteed investment contracts (GICs)." He asked the Life Insurance (A) Committee for guidance on the legal issues involved in these products. Mr. Gorski asked to have a working group appointed to address the fundamental legal questions. Superintendent Robert Willis (D.C.) asked if synthetic GICs would be unallocated annuities. Mr. Gorski replied that these products ran the gamut of designs, so he was not really able to answer that question. Terry Lennon (N.Y.) reported that his department had been working on a draft of a circular letter and was nearly ready to issue it. He thought it would be difficult to issue a legal opinion because states' laws vary on this issue. He said that concern over the issue of separate accounts led to the development of this product, which retains assets outside of the insurance company to avoid the problem of separate accounts. He thought it would help the synthetic GICs issue to clarify the separate account issue. Mr. Lennon said that the Separate Accounts Working Group of the Examination Oversight (EX4) Task Force was looking at the issue and would have a legal opinion to present. Carol Ostapchuk (Fla.) clarified that the working group would not be issuing a legal opinion. Mr. Lennon suggested that the charge to the working group should be less than a request for

a legal opinion and Mr. Gorski agreed. Commissioner Lyons asked for volunteers to be on a working group and asked Mr. Gorski and Mr. Lennon if they would serve on it. They agreed and Commissioner Willis also offered the District of Columbia to be on the working group. Commissioner Lyons asked the members of the working group to have an update letter to the Life Insurance (A) Committee members by Nov. 15 so that they would be informed on the progress on the issue.

8. Report of Life and Health Actuarial Task Force

Sheldon Summers (Calif.) gave the report of the task force. He recommended three proposals for adoption. They were:

- (1) Adoption of proposed Actuarial Guideline HHH Reserve for Immediate Payment of Claims and deletion of life project 2s Reserve for Immediate Payment of Claims, if the actuarial guideline is adopted.
- (2) Exposure of the revised draft Standard Nonforfeiture Law for Deferred Annuities.
- (3) Adoption of the proposed revision to Schedule S—Part 4.

Commissioner Lyons asked the working group to vote on these proposals one at a time. The Life Insurance (A) Committee voted to adopt the proposal on Actuarial Guideline HHH. The recommendation for the proposed revision to Schedule S—Part 4 was also adopted. On the second proposal on the Standard Nonforfeiture Law for Deferred Annuities, Commissioner Lyons asked Mr. Summers how long the task force had been working on this project. Mr. Summers replied that it had been under consideration for two years. Barbara Lautzenheiser (Lautzenheiser and Associates) expressed deep concerns about exposure of the draft at this time. She said there had been no testing on the guarantees included in the model and she thought it was appropriate that this should be done before exposure. Upon motion duly made and seconded, the committee adopted the proposal to expose the model law.

Having no further business, the Life Insurance (A) Committee adjourned at 2 p.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 Koriath, Texas; Steven T. Foster, Va.

ATTACHMENT ONE

TO: Life Insurance (A) Committee
 FROM: Carolyn Johnson (NAIC), CLU
 DATE: September 21, 1993
 RE: Low-value life insurance

At the request of the Life Insurance (A) Committee, I conducted a survey of the states, asking whether they planned to adopt the NAIC Model Life Insurance Disclosure Regulation provisions regarding the Financial Review of This Policy Form and the Guide to Buying Life Insurance After Age 60. Twenty-eight jurisdictions responded. Their responses are summarized below.

Limitations on Sales

Sales of low-value life insurance policies are prohibited in Arkansas, Illinois, Maryland, Minnesota, Nevada, New Jersey, Washington and Guam.

Georgia—plans to adopt model or a provision limiting relationship of premium to face value.

New York restricts sales of graded death benefit products to ages between 50 and 75.

Texas plans to propose rules similar to those in Washington.

Model Provisions

The state of Iowa has adopted the NAIC's model provisions requiring a Financial Review of This Policy form and the Guide To Buying Life Insurance After Age 60.

The following states indicate that they are considering adoption of the model provisions requiring the form and the guide:

Florida—already requires full disclosure by statute and is considering the regulation.

Louisiana—plans to adopt within 12 months.

Maine—plans to adopt, but no date set.

New Mexico—will be considering in 1995.

North Dakota—plans to adopt in early 1994.

Ohio—plans to adopt model provisions

Oregon—is considering for adoption in late 1993 or early 1994.

No Action

The following states responded that they do not plan to adopt the regulation provisions:

Arizona—but requests that advertising and marketing material for these products be submitted for review prior to use.

Colorado—requires legislative changes.

Connecticut, Massachusetts—no problems to date.

Idaho—may consider in the future.

Michigan—no plans to adopt.

Nebraska—no plans to adopt.

Utah—currently requires a statement of policy cost and benefit form similar to the model for low-value life insurance.

Virginia—prefers disclosure at point of sale rather than at policy delivery as is now required by the model. Will try to revisit the issue at the NAIC level.

ATTACHMENT TWO

State Insurance Department Positions
Regulation of Charitable Gift Annuities

State	Citation	Permit	Prohibit	Do Not Regulate	Provisions
AL				X	
AK			X		Consider it doing the business of insurance without a license.
AZ	<i>Did not respond</i>				
AR	§ 23-63-201	X			Special permit required. Must maintain reserves with respect to annuities they have agreed to pay charitable donees.
CA	§§ 11520 to 11524	X			Certificate of authority required. Most charities must have been in operation at least 10 years. Charity must establish reserves to meet future payment obligations, held in a separate account. Contents of contracts specified.
CO	<i>Did not respond</i>				

State	Citation	Permit	Prohibit	Do Not Regulate	Provisions
CT				X	The issuance of charitable gifts annuities constitutes the business of insurance; however the insurance department has to date not regulated this activity due to absence of complaints.
DE	tit. 18 § 2902			X	Qualified charity is exempt from insurance law.
DC	<i>Did not respond</i>				
FL	§ 627.481	X			Special permit required. Maintain reserve equal to outstanding agreements.
GA			X		Must be issued by licensed insurers.
HI				X	
ID			X		Treat product same as any other annuity.
IL	215 ILCS 5/4		X		Charity must be organized as insurer to transact annuity business.
IN	<i>Did not respond</i>				
IA				X	Laws are silent on issue.
KS				X	Kansas laws do not apply to transaction.
KY	§ 304.1-120	X			Specific exemption from insurance laws.
LA					
ME	tit. 24-A §§ 2571 to 2578	X			University of Maine may transact annuity business after getting a special permit from the insurance commissioner.
MD	art. 48A § 487	X			Special permit required. Must maintain assets equal to adequate reserves on outstanding agreements.
MA	175 § 118	X			Mass. law exempts certain charitable corps. from regulation.
MI				X	
MN					
MO				X	
MT					Code is silent regarding issue.
NE					
NV				X	
NH	<i>Did not respond</i>				
NJ	Reg. 11:4-8.1 to 11:4-8.9	X			Special permit required. Must maintain segregated account at least equal to reserves on outstanding agreements. Annual report required.
NM				X	
NY	Ins. Law § 1110	X			Special permit required. Charities required to file annual reports and are subject to examination by department.
NC	§ 58-28-5		X		Charity must be licensed as an insurer to transact annuity business.
ND	§ 26.1-34.1	X			Certificate of exemption required. Must maintain segregated account for all of gift annuity liabilities.
OH				X	
OK				X	
OR	§§ 731.704 to 731.724	X			Certificate required. Approval of contract forms required. Maintain separate fund as a reserve adequate to meet future payments under outstanding annuity agreements.
PA			X		Consider this to be transacting the business of insurance without a license. No law gives charities an exemption.
PR				X	No statute regulating charitable annuities.
RI		X			Plan to review matter.
SC	§ 38-5-20	X			Nonprofit charity in operation for at least 5 years may issue annuity without being subject to insurance laws.
SD			X		Solicitation of gift annuities is the business of insurance.

State	Citation	Permit	Prohibit	Do Not Regulate	Provisions
TN	<i>Did not respond</i>				
TX	art. 1.14-1		X		Solicitation of gift annuities is business of insurance.
UT	§ 31A-1-301 (44)	X			Specific exemption from insurance laws.
VT				X	No authority to regulate.
VA					
WA	§§ 48.38.010 to 48.38.070	X			Must obtain certificate of exemption, file any contract form for advance approval, and file its annual statement with the commissioner. Actuarial opinion of reserves required; must maintain fund adequate to meet future payments.
WV	<i>Did not respond</i>				
WI	§§ 615.03 to 615.15	X			Certificate of authority required. Must maintain segregated account for gift annuities; assets of the account not liable for any other debts of the licensee.
WY	<i>Did not respond</i>				

ATTACHMENT THREE

Unfunded Checking Accounts Working Group
of the Life Insurance (A) Committee
Boston, Massachusetts
September 20, 1993

The Unfunded Checking Accounts Working Group of the Life Insurance (A) Committee met in the Gardner Room of the Sheraton Hotel and Towers in Boston, Mass., at 4 p.m. on Sept. 20, 1993. A quorum was present and Mary Alice Bjork (Ore.) chaired the meeting. The following working group members or their representatives were present: Melodie Bankers (Wash.) and Shawn Bryan (Vt.).

1. Adopt August 10 Conference Call Minutes

Upon motion duly made and seconded, the minutes of the Aug. 10, 1993, conference call were adopted (Attachment Three-B).

2. Hear Comments on Concepts to be Included in Model Law on Unfunded Checking Accounts

Mary Alice Bjork (Ore.) invited members of the audience to comment on the proposed outline of a model on unfunded checking accounts (also referred to as a retained asset account) (Attachment Three-A). Julie Spiezio (American Council of Life Insurance-ACLI) responded that the chair of the ACLI Retained Asset Account Task Force, Steven Rahn, had sent a letter to the working group members expressing task force concerns. Ms. Spiezio said that the concept that these were unfunded was not exactly correct. She said that the funds are accounted for in one of two ways: 1) the funds may be placed in a bank, or 2) more commonly, the insurer has a separate account where the funds are not comingled with other assets, and contracts with a bank for administrative services. She said that most of the concern apparently resulted from fundamental misunderstanding of how the accounts are structured. She said that she brought along Mark Bowler (State Street Bank) to answer any questions about the services that banks provided.

Melodie Bankers (Wash.) reported that she had seen contrary evidence in her state. Washington did an examination on one of its domestics and found that the assets were in the general account. She said it took long negotiation to get them to set the funds aside. She agreed that a retained asset account is a good idea, but also pointed out another problem. When an insurer in Washington had become insolvent, no one would take responsibility for the funds in the retained asset account.

Ms. Spiezio said that the National Organization of Life and Health Guaranty Associations (NOLHGA) says that any retained asset account is covered. Except for the instance that Ms. Bankers knew about, she was unaware of any instance when coverage had not been provided. Ms. Spiezio said that she had perhaps misstated earlier or given the wrong impression and corrected herself to say that insurers really did not set up a separate account, walled off as are separate accounts for variable products. What she really meant was a segmented account where the funds for the retained asset accounts are set aside.

Ms. Bankers asked where these were accounted for on the Annual Statement and Ms. Spiezio responded that they were on Line 3. She said that in 1990 this issue had been discussed by the NAIC Accounting Practices and Procedures Task Force and the decision had been that these should be recorded on Line 3 as liabilities.

Ms. Bjork asked if any other states had similar problems to those experienced in Washington. Commissioner David Lyons (Iowa) reported that he had questioned the guaranty fund in his state and it had said it would cover the retained asset

accounts. He suggested a recommendation to the Guaranty Fund Task Force and NOLHGA that this issue be considered for clarification. As chair of the working group, Ms. Bjork said she would write a letter to both entities.

Bob Wright (Va.) suggested that the working group ask NOLHGA for documentation that it would cover these accounts. Commissioner Lyons suggested that in the alternative the working group alert them to the NAIC interpretation because he did not feel that NOLHGA would be willing to commit to a flat statement in case there was an unrelated reason why a particular account would not be covered.

Gerry Goldsholle (Advise & Counsel) offered each of the members of the working group a videotape of beneficiaries testifying as to how the retained asset program had impacted them. He said this was a four and a half minute tape distilled from over 40 hours of testimony, but he felt it was a good summary of how beneficiaries really felt. Mr. Goldsholle said retained asset account were one of the most proconsumer things an insurance company could do.

Ms. Bjork emphasized it was never the working group's position that this was not a good idea. She asked the working group members if their questions and concerns had been answered other than the guaranty fund issue. Ms. Bankers responded that her concerns had not been answered. She was still concerned about the possibility of a negative option because the claim form often did not list any other options available. Shawn Bryan (Vt.) also responded that he was not comfortable. He felt that, under his state's laws, the retained asset account was illegal and should be eliminated.

James McCormack (Metropolitan Life) described the procedure followed by his company. He says that Metropolitan does treat the contract as a supplemental contract; it is a settlement option, and a liability is set up for each account as it is opened, segmented in the general account and reset daily. He said the settlement option was part of group contracts, which represent about 75% of Metropolitan's business. In surveys by his company, consumers wanted three things: safety, access and competitive interest. Commissioner David Lyons (Iowa) asked Mr. McCormack if he was offering a suggestion for what should be contained in a recommendation of the working group.

Ms. Bjork opined that the guaranty fund question was the real issue before the working group. She suggested the working group draft a memo to NOLHGA. Commissioner Lyons agreed that guaranty fund coverage was the most significant issue.

Malcolm Campbell Jr. (Aetna Life and Casualty) asked if the working group was suggesting that the retained asset accounts be completely covered rather than limited to the amount in the guaranty fund statutes, but the working group members assured him that was not the intent. Ms. Bankers suggested the working group draft a "white paper" reiterating the concerns it had identified and suggesting to states ways to identify companies that were not following adequate procedures. Ms. Bjork suggested that this would notify all NAIC members what to look for so they could spot abuses. Mr. Bryan said that he was still concerned with full and fair disclosure. He believes the retained asset account is extra-contractual and if funds remain with the company, the beneficiary is in a different status, perhaps that of a general creditor, rather than a policy beneficiary. If a supplemental contract exists, that problem is clearly diminished.

Commissioner Lyons said it seemed to him that there were still some issues of concern before the working group. Roger Strauss (Iowa) suggested that if all companies set out the retained asset account as a settlement option the problem would be solved. Mr. Goldsholle responded that many were old policies without such an option, and the retained asset account made an improvement over what they had—a little something extra. Galen Ullstrom (Mutual of Omaha) said that his company did not consider this to be another settlement option; it treated it as a lump sum payment. The policy beneficiary has constructive receipt of the funds for tax purposes. Ms. Bjork asked Commissioner Lyons if he would be comfortable with a report from the working group and a letter to NOLHGA and to the Guaranty Fund Task Force asking for clarification of the guaranty fund issue, with work on the model deferred until response had been received. Commissioner Lyon responded that it would be appropriate to defer action until this issue was resolved as long as it was within a short period of time. Ms. Bjork agreed to defer a decision on development of a model until the December meeting.

Having no further business, the Unfunded Checking Accounts Working Group of the Life Insurance (A) Committee adjourned at 5 p.m.

ATTACHMENT THREE-A

Outline of Model Law or Regulation on Unfunded Checking Accounts

Preamble

The insurance department has become aware of the practice of some insurers to provide an unfunded draft account instead of a cash death benefit or one of the settlement options listed in the policy. These may be called "reserve asset accounts," "retained asset accounts," or "asset preservation accounts," or other phrases may be used. The beneficiary gets a "checkbook" for a draft account for which no funds are deposited until the beneficiary writes a draft against the account. The department finds there is a potential for abuse in this type of arrangement, and therefore adopts the following regulation to provide disclosure and protection to the beneficiary.

Section 1. Authority

Most states would have the authority to adopt this model under the Unfair Trade Practices Act or the entire contract provision of the general life insurance law. A model in the form of a regulation would thus be appropriate.

Section 2. Definitions

Define the unfunded account similarly to the description in the preamble.

Section 3. Settlement Options

In order to use the unfunded account, it should be included as one of the settlement options. Beneficiaries should be allowed to make an affirmative choice between the draft account and the other options and have the ability to convert to another option at a later time.

Section 4. Disclosure

The contract should disclose the fact that the funds have not actually been deposited in an account (most consumers won't know the difference between a draft account and a checking account) and the fact that FDIC protection does not cover the draft account. Any fees charged by the bank and/or insurer should be disclosed at the time the beneficiary selects the option. The possibility that the account could be frozen in the case of insurer insolvency should also be disclosed.

Section 5. Supplemental Contract

If the beneficiary chooses the unfunded account as a settlement option, a supplemental contract should be made between the insurer and the beneficiary setting out the conditions under which payment will be made.

Section 6. Reserves

Insurers should set aside the funds necessary to cover the draft accounts as a liability to be reported as "claims due—as of yet unpaid." In addition to the development of this model, the guaranty fund law may need to be revised to specifically provide coverage for funds held in such accounts. This issue should be referred to the Guaranty Fund (EX4) Task Force.

Section 7. Interest

Funds held under such a program should have interest paid at the same rate as the insurer pays for funds held on deposit.

ATTACHMENT THREE-B

Unfunded Checking Account Working Group of the Life Insurance (A) Committee Conference Call August 10, 1993

The Unfunded Checking Account Working Group of the Life Insurance (A) Committee met by conference call at 10 a.m. on Aug. 10, 1993. Participating in the call were: Mary Alice Bjork, Chair (Ore.); Ken Kattner (Texas); and Shawn Bryan (Vt.). Carolyn Johnson (NAIC/SSO) also participated in the call.

Mary Alice Bjork (Ore.) called the meeting to order and summarized the task before the working group. Referring to the memorandum prepared by Rick Barrett (Vt.), she pointed out the two alternatives: either forbid the practice and require funding, or lay out a series of requirements to prevent abuses. She also reported that Melodie Bankers (Wash.) was unable to participate in the call, but had said her main concerns were that the working group address the issues of guaranty fund coverage, setting aside reserves for the payments due, and full disclosure with a choice. Ms. Bjork said that the practice was prohibited in Oregon so she did not have personal experience with the problems. She did think that a proposal to regulate would have more support than a ban.

Shawn Bryan (Vt.) spoke in favor of developing a model with minimum standards including full disclosure. Ken Kattner (Texas) said he thought it was important to include a minimum interest rate to be paid on the account.

The working group voted to prepare an outline of a model for discussion at the fall National Meeting in Boston. The first half of the meeting should be set aside for comments on the concepts to be included in the model, with the second half of the meeting devoted to drafting by the working group. It was also decided to send the outline to the NAIC funded consumer representatives and to the American Council of Life Insurance for distribution to its membership.

Ms. Bjork expressed thanks to Mr. Barrett for his excellent analysis of the problems associated with unfunded checking accounts.

Having no further business, the Unfunded Checking Account Working Group of the Life Insurance (A) Committee conference call adjourned at 10:25 a.m.

ATTACHMENT FOUR

VIATICAL SETTLEMENTS MODEL ACT

Revised Draft: 9/27/93

Underlining and overstrikes show changes from 8/23/93 draft.

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Section 1. Short Title

This Act may be cited as the Viatical Settlements Act.

Section 2. Definitions

A. "Person" means any natural or artificial entity, including but not limited to, individuals, partnerships, associations, trusts or corporations.

A-B. "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 providers, or offers or attempts to negotiate viatical settlements between a viator and one or more viatical settlement 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 provider.

B-C. "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-D. "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;
- (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]; or
- (3) Any natural person ~~A friend or family member of the policyowner or of the insured~~ who enters into no more than one agreement ~~three or fewer agreements~~ in a calendar year for the transfer of life insurance policies for any value less than the expected death benefit.

~~D-E.~~ "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 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 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 may issue a license if the commissioner finds that the applicant:

- (1) Has provided a detailed plan of operation; and
- (2) Is competent and trustworthy and intends to act in good faith in the capacity involved by the license applied for; and
- (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
- (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 is 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 has been guilty of fraudulent or dishonest practices, is subject to a final administrative action or 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; or
- (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].

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 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. Names and individual identification data for all viators shall be considered private and confidential information and shall not be disclosed by the commissioner, unless required by law.

C. 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~~ signed by all parties:

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. 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;

E. The policyowner's right to rescind a viatical settlement contract within thirty (30) days of ~~its execution~~ the date it is executed by all parties or fifteen (15) days of the receipt of the viatical settlement proceeds by the viator, whichever is less, as provided in Section 9C; and

F. 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 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.

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; and
- 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 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.

ATTACHMENT FIVE

Viatical Settlement Working Group
of the Life Insurance (A) Committee
Boston, Massachusetts
September 20, 1993

The Viatical Settlement Working Group of the Life Insurance (A) Committee met in Independence West of the Sheraton Hotel and Towers in Boston, Mass., at 11 a.m. on Sept. 20, 1993. A quorum was present and Roger Strauss (Iowa) chaired the meeting. The following working group members were present: Mary Alice Bjork (Ore.); Rhonda Myron (Texas); and Bob Wright (Va.).

1. Discuss Comments Received Regarding Revised Draft of Model Act

Chair Roger Strauss (Iowa) pointed out three changes made in the most recent draft of the Viatical Settlement Model Act. He said that a new paragraph had been added to Section 2C(3) to exclude from the Act a friend or family member of a policyholder who wanted to enter into an agreement with a viator. He also pointed out the change to Section 4A(2) to add the phrase, "has been guilty of fraudulent or dishonest practices," to further define practices that make revocation of a license appropriate. The third change was to Section 7, adding a new Subsection B providing confidentiality for individual viators. Mr. Strauss then asked for comments from regulators, and Mary Alice Bjork (Ore.) commented first.

Ms. Bjork thought there was some confusion caused by the use of the word "person" in several places where a corporation might be acting. Melodie Bankers (Wash.) said that "person" usually includes a corporation. She suggested adding a definition of "person" to the model to clarify it. It was suggested that the definition in the Unfair Trade Practices Act would be appropriate and the working group decided to add it.

Ms. Bjork also was concerned about Section 8 where information was required as of the date a contract was "entered into." She thought that was not clear and suggested "signed by all parties" instead. The working group accepted this suggestion and also changed Section 8E similarly.

Julie Spiezio (American Council of Life Insurance—ACLI) suggested that the disclosure in Section 8 was not very helpful because it was provided at the same time as the contract was signed. Mr. Strauss pointed out there was a free look period. Wayne Morris (Kaiser) suggested that the language relating to the free look period was not clear. The earlier of the two dates in Section 8E would offer less protection. The working group agreed and changed the language to provide for the later of the two dates.

Commissioner Glenn Pomeroy (N.D.) suggested that Section 4 also would be improved by adding a provision allowing revocation if an action had been taken in another state. The working group decided to add a phrase broad enough to cover action by another state or by a federal agency.

Commissioner Pomeroy asked whether "friend" in Section 2D(3) was a defined term. Mr. Strauss said it was not, and explained the language for this paragraph had been lifted from the New York law recently adopted.

Cosette Simon (Lincoln National Life) expressed the opinion that allowing a friend to be excluded from the Act could be useful because that may be the only source of funds available. Mr. Strauss asked the working group if it wanted to strike the whole provision. Bob Wright (Va.) thought it would create a hardship to subject family and friends to the model act. Commissioner Pomeroy also thought it was good to leave the provision in, and agreed with other suggestions that the best way to handle the provision was to limit the transactions to one, instead of three per year as drafted and to exclude corporations from this exemption.

Mr. Wright made a motion to change Section 2D(3) to: "Any natural person who enters into no more than one agreement in a calendar year for the transfer of life insurance policies for any value less than the expected death benefit." The motion was adopted.

Tom Foley (Fla.) said that he would like to eliminate the market altogether. Commissioner David Lyons (Iowa) stated that some commissioners feel strongly that it is important to control the viatical settlement market, and others think a model regulation will lend credibility to the industry. He said the Life Insurance (A) Committee was committed to providing a model for two groups: (1) those states who want to ban the viatical settlement industry but cannot get it done, and want to protect consumers, and (2) the states that choose not to limit any financial activity.

Commissioner Pomeroy suggested that, in addition to the model, insurers be encouraged to offer accelerated benefits. Commissioners Lyons suggested that Commissioner Pomeroy and Mr. Foley draft a resolution to present to the Life Insurance (A) Committee to that affect. Commissioner Lyons also suggested that it would be appropriate to draft a "white paper" for regulators, discussing the model, how viatical settlement companies work, what other options are available, the issue of insurable interest and other issues related to this topic.

2. Adopt Viatical Settlement Model Act

With the amendments discussed above, the working group voted to adopt the Viatical Settlement Model Act and forward the draft to the Life Insurance (A) Committee for approval. Steve Simon (National Association of Viatical Settlement Organizations), who had testified before the group in June, was unable to attend, but sent a statement of support which he asked be made part of the record (Attachment Five-A).

3. Request Charge to Develop Model Regulation

Mr. Wright suggested that the next step was for the working group to draft a regulation. The working group voted to ask the Life Insurance (A) Committee for a charge to do so.

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

ATTACHMENT FIVE-A

National Association of Viatical Settlement Organizations
930 Washington Avenue, 4th Fl.
Miami Beach, FL 33139
(305) 534-0101

September 1, 1993

To: Carolyn J. Johnson, CLU, NAIC

As I will be unable to attend the Sept. 20 meeting of the Viatical Settlement Working Group, I respectfully request that the following statement be read aloud for the record at that meeting:

As the chairman of NAVSO (National Association of Viatical Settlement Organizations), as one of the pioneers of the viatical settlement industry, and as the brother of a 45-year-old man who is dying as a result of the AIDS virus I extend my heartfelt thanks to all of the members of the Viatical Settlement Working Group for their vision, their sensitivity and for their compassion toward the terminally ill.

Our industry has grown at a very fast pace and all of the members of NAVSO have worked very hard to uphold the highest standards and ethics.

Unfortunately there are always some people who do not respect the fragile nature of those who are stricken with a life threatening disease.

Your Viatical Settlement Model Act will empower insurance regulators from coast to coast with the tools necessary to responsibly regulate and monitor the services provided by the viatical settlement industry.

To those in our industry who have voiced opposition to your efforts we can only state that we respect their rights to their opinions.

But to all those who will be positively impacted by your efforts we say "congratulations"!

On behalf of all Americans who are infected and affected by a life threatening disease, we say thank you for the opportunity to have participated in the development of this important model act.

Sincerely,

Steven Simon, Chairman

ATTACHMENT SIX

Life Disclosure Working Group of the Life Insurance (A) Committee Boston, Massachusetts September 20, 1993

The Life Disclosure Working Group of the Life Insurance (A) Committee met in Independence West of the Sheraton Hotel and Towers in Boston, Mass., at 1 p.m. on Sept. 20, 1993. A quorum was present and Commissioner Steven Foster (Va.) chaired the meeting. The following working group members or their representatives were present: David Walsh (Alaska); John Garamendi (Calif.); David Lyons (Iowa); James Brown (La.); James Long (N.C.); Harold Duryee (Ohio) and Josephine Musser (Wis.).

The meeting was called to order by Commissioner Steven Foster (Va.).

1. Adopt Minutes of the July 22, 1993, Conference Call and the Aug. 19, 1993, Meeting

Upon motion duly made and seconded, the minutes of the July 22, 1993, conference call (Attachment Six-B) and Aug. 19, 1993, meeting (Attachment Six-A) were adopted.

2. Hear Comments From Interested Parties on White Paper to be Presented to Life Insurance (A) Committee

Commissioner Foster began by summarizing the issues before the working group. He said the life insurance illustration issue had been brought to the attention of the Life Insurance (A) Committee last year and had received more emphasis this year. He was pleased to have a draft to begin the discussion of the key issues and emphasized that it was not set in stone. He opened the floor to oral comments but said that he welcomed written submissions. Bob Wright (Va.) requested that any written comments be submitted to Carolyn Johnson (NAIC/SSO) within two weeks of this meeting. Commissioner David Lyons (Iowa) said he appreciated the work of the drafters and emphasized that this was the beginning of the process. He said he hoped to set a timeframe for the working group to report to the Life Insurance (A) Committee by the end of the meeting.

Commissioner Foster asked Mr. Wright, who had chaired the drafting session, to summarize the work to date. Mr. Wright said the working group had not attempted to come up with a lot of original thought; basically, the white paper was a summary of past comments received by the working group. Commissioner Foster emphasized that no one had attempted to put it all together into one document for regulators, so he thought the group's work served a valuable purpose.

First to comment was Sen. Howard Metzenbaum (D-Ohio), who said he was here to compliment the working group on what it had done. He considered the paper a remarkable effort to correct abuses, and he urged the working group not to back off the position it had taken. Of the four solutions mentioned in the paper, he thought number two was the best, but that any one of the four was a good solution. Then Sen. Metzenbaum asked what would be done to stop abusive practices. He asked if and when the Life Insurance (A) Committee adopts the proposal, how long will it take states to adopt the reforms? He cited a report issued by the NAIC 13 years ago that reached many of the same conclusions, but the disclosure system it found to be "seriously flawed" was still in place today. The most difficult part of the road was ahead. Sen. Metzenbaum urged the group to resist any attempts to water down or derail its project.

Commissioner Foster thanked Sen. Metzenbaum for his comments. Commissioner Foster said he realized the task would be difficult, but that regulators think the time has come to act.

George Coleman (Prudential) spoke next. He said that the NAIC had formed a resource group last November to assist and recommend changes. The resource group recommended a cover page to the illustration to include essential information about the illustrated policy. Mr. Coleman agreed that problems exist, but he felt the illustration was vital to show how the policy works and meets the needs of the policyholder. He was not in favor of standardization of the illustration because he said it

would penalize well-run companies. Commissioner Foster suggested that the performance figures imply that they are selling an investment product. He said consumers believe they have a dual benefit of insurance coverage and financial benefit. Commissioner Lyons asked whether the consumer would see the disclosure or the dollar information. Mr. Coleman responded that if the dollar figures were taken away, much of the information would be lost. Commissioner Foster commented on a time when he was a life insurance purchaser, and said the focus around his table was on the numbers and how the investment would grow.

Next to speak was William Fisher (Massachusetts Mutual). Mr. Fisher said he had completed preliminary review of the white paper and agreed with many of the conclusions. He said that many of the concepts had been presented by other groups. Mr. Fisher agreed that the life insurance illustration should not be used to compare policies. He recommended further disclosure by adding a cover sheet to inform the purchaser. He said the area of concern that was most important to him was the accountability issue. He said that accountability already exists through the advertising rules. Mr. Fisher found a practical problem in the requirement to send out another illustration if the current one was no longer correct. He said this was a time when companies were trying to cut down expenses and new illustrations every year would add expense. He also referred to the white paper section on penalties and said that penalties already existed under the Unfair Trade Practices Act. He questioned the appropriateness of taking non-guaranteed elements and making them guaranteed as suggested as a penalty in the white paper.

The next speaker was Robert Hunter (National Insurance Consumer Organization—NICO). He said that Jim Hunt (NICO) and Joseph Belth (Insurance Forum) would no doubt be offering written comments. In his opinion, the white paper documented well the problems that exist currently in life insurance illustrations, and he urged the working group to move promptly. Mr. Hunter suggested some sort of "stamp of approval" for companies following a new model before the model was adopted as a requirement by their state. Commissioner Lyons responded that the Life Insurance (A) Committee intended to act promptly. The timeframe they were envisioning was for a model act to be ready for exposure in December with adoption in March and a regulation to be exposed in March and adopted in June. After this effort is completed, he expected that the issue would still be one of importance to the Life Insurance (A) Committee, as there was a need to track the effectiveness of the efforts.

William Albus (National Association of Life Underwriters—NALU) congratulated the working group on a job well done and said that his organization would be submitting a written statement of its comments. NALU is committed to assisting in getting a model law adopted in the states when agreement had been reached. Mr. Albus opposed the concept of standard assumptions as not practical. He said it made bad companies look good and good companies look bad. Mr. Albus said his group was opposed to limiting illustrations to past performance which would, in reality, he said, limit sales to guaranteed policies. Mr. Albus said there was a need to illustrate non-guaranteed elements, but consumers must understand that they are not guaranteed. He thought it was a good idea to tighten up the parameters of assumptions. He said his group was working on the concept of a sensitivity index to allow consumers to see what would happen when assumptions changed to a small degree. He thought recommendations for clear disclosure and more precise definitions were good ideas and he expressed his association's willingness to help in formulating the definitions. Mr. Albus said he thought the bulk of the problems identified came from misunderstandings by consumers and agents. Referring to section IV-F of the report, he said his association was surveying companies currently to see what they were capable of doing. He believed that, at the very least, any time a consumer wanted another illustration, he should be able to get it.

William Miller (American Academy of Actuaries) said the Academy was one of the earlier groups interested in the life illustration issue. The Academy issued recommendations in 1991 and he urged the working group to review those recommendations carefully. Mr. Miller said that standardization would confuse and hurt consumers because, if actual experience was worse than the standard amount, a company would look better than it actually was. He offered the assistance of the Academy in helping with definitions.

John Booth (American Council of Life Insurers—ACLI) said his organization welcomed the chance to work with the NAIC to help customers to better understand the illustrations.

Brian Fetchell (Northwestern Mutual) said that while he was interested in the discussion as an agent, he was speaking as an individual to the working group. He encouraged the group to work toward a level playing field. He said one of the problems was that the difference between term and whole life is not clear; He suggested breaking the pieces down to help consumers more clearly see the components.

Commissioner Foster thanked those who presented testimony to the working group.

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

ATTACHMENT SIX-A

Life Disclosure Working Group
of the Life Insurance (A) Committee
August 19, 1993

The Life Disclosure Working Group of the Life Insurance (A) Committee met at the offices of the NAIC at 9 a.m. on Aug. 19, 1993. In attendance were Bob Wright, Chair (Va.); Roger Strauss (Iowa); Suzette Dave (Ohio); and Tony Higgins (N.C.). Joining the group for parts of the meeting via conference call were John Montgomery (Calif.); Sheldon Summers (Calif.); Harold Phillips (Calif.) and Lester Dunlap (La.). Carolyn Johnson (NAIC/SSO) also participated.

Bob Wright (Va.), Chair, called the meeting to order by clarifying the task for the day. The working group has promised to have a white paper ready for the fall National Meeting stating the position of the working group as to the best method of dealing with problems of life insurance illustrations. The report will be presented to the Life Insurance (A) Committee for its input before actual drafting begins on a model.

Mr. Wright asked the California Department attendees to provide more information on the ledger illustration bill they had developed. Harold Phillips (Calif.) reported that they had developed the draft after identifying problems and trying to fashion remedies. He said they had received more than 20 comments, mostly favorable. Mr. Wright suggested that the California proposal was a good beginning, and would provoke people to think and to discuss the issues. Roger Strauss (Iowa) asked if the legislation had passed in California, and Mr. Phillips explained that this was just a discussion document and had not been submitted to the legislature. John Montgomery (Calif.) said the decision had been made to postpone the introduction and wait to see what the NAIC would do.

Lester Dunlap (La.) provided further information on the review of the Society of Actuaries report he had studied. He emphasized the importance of differentiating between Type A usage of illustration to demonstrate how the policies work and Type B usage to project future performance and compare several policies. He said Type B usage was inappropriate and should be discouraged.

Discussion next turned to the Fungible Present Value Analysis Report by Brian Fetchell. It was the consensus of the group that this was a difficult concept to work with and needed further clarification.

Hal Phillips (Calif.) expressed disappointment that the Society of Actuaries had stepped back from its plan to develop standard definitions for terms such as "supportability" and "current interest." He said it would be difficult to develop model language without standard definitions of the terms involved. Mr. Phillips offered to develop definitions of the two terms mentioned for discussion purposes (Attachment Six-A1), and Suzette Dave (Ohio) agreed to make a list of other terms which should be defined. Mr. Wright asked for a commitment from the Life and Health Actuarial (Technical) Task Force on when it would be possible to have suggested definitions prepared and Mr. Montgomery agreed to review the task force commitments and provide a target date.

Tony Higgins (N.C.) referred the group to a resolution of the National Conference of Insurance Legislators (NCOIL) urging state insurance departments to become aware of disclosure and abuse issues in life insurance solicitation (Attachment Six-A2).

The working group decided that current practices in the area of sales illustrations are inappropriate and unacceptable. It appeared to the group that significant changes in these practices need to be made.

The rest of the meeting was spent on the development of a position paper (Attachment Six-A3) to present to the Life Insurance (A) Committee at the fall National Meeting. It was decided to send copies to interested parties prior to the meeting so that those who wanted to comment would have an opportunity to review the document prior to the meeting.

Having no further business the Life Insurance Disclosure Working Group adjourned at 2:35 p.m.

ATTACHMENT SIX-A1

TO: Bob Wright, Virginia Department of Insurance
FROM: W. Harold Phillips, Senior Life Actuary
Department of Insurance, Actuarial Division
State of California
DATE: August 19, 1993
SUBJECT: Definition of Supportability and Current Experience (first cut)

Supportability. An illustration must be supportable. An illustration is supportable where:

1. The illustration shows exactly what would be paid if current experience were to extend to the durations illustrated.
2. The actuary can demonstrate that the assumptions used in the illustration are not inconsistent with current experience.

3. Trends which improve the illustrated values may not be assumed to continue beyond two years. Thus, for example, an illustration could not assume continually improving mortality.

4. The qualified actuary approving the calculations involved in the illustrations is prepared to state that all standards of practice of the American Academy of Actuaries dealing with illustrations are met.

Current experience means:

1. The rate of return on the assets backing the product. If the product or product line has not yet been launched, it is the expected rate of return on the assets that will be purchased to support the product line.

2. The spread on the rate of return on assets the company is currently using to cover profit, expenses, mortality or other factors.

3. For percent of premium expenses, the actual percent being incurred, e.g., commissions and premium taxes.

4. For mortality, other expenses including other taxes, lapse and other decrements, the company's most recent experience studies; if these are not available or credible, the experience of comparably situated other companies or of industry studies with any appropriate modifications by the actuary to reflect the expected experience of the company illustrating.

ATTACHMENT SIX-A2

To: Governors of States
Insurance Department Leadership
From: Executive Committee of The National Conference of Insurance Legislators (NCOIL)
Date: July 24, 1992
Re: Full Disclosure/No Misleading Advertising in the Sale of Life Insurance

To encourage full disclosure and combat misleading advertising in the sale of life insurance, the Executive Committee of NCOIL urges that state insurance departments

(1) Require full disclosure of withdrawal charges and actual pure net interest when interest rates are used to advertise and sell life company products;

(2) Stay alert and keep ongoing records to review insurance companies and agents who have complaints filed against them regarding life insurance replacement; and

(3) Review their existing statutes and regulations and to the extent possible, make companies and agents aware of those existing statutes and regulations with regard to false or misleading advertising in the sale of life insurance policies.

ATTACHMENT SIX-A3

Position Paper
Life Insurance Illustrations
By the Life Insurance Disclosure Working Group
of the Life Insurance (A) Committee
August 1993
Draft: 9/7/93

I. Charge to the Working Group

The working group has been charged to evaluate policy illustrations and to consider establishing requirements for the illustrations or ledger information disclosed or made available to consumers of life insurance.

II. Activities to Date

The working group was formed in September 1992 to consider issues raised by Senator Howard M. Metzenbaum (D-Ohio) as to the adequacy of information provided to purchasers of life insurance. Of particular concern were policies sold with the aid of illustrations, some of which demonstrate the possibility that the policy would "pay for itself" at some point in the future. The working group was asked to fully review the concerns expressed in Senator Metzenbaum's letter and to recommend an appropriate regulatory response. The working group members first gathered background material to equip themselves to gauge the extent of the problem and to begin to identify the means of addressing the problems identified.

The first meeting of the working group was in Boston on Nov. 8, 1992. This meeting served as an open forum for discussion of the problems which have occurred in the use of illustrations. The group recognized that it needed more information in order to

fully understand the nature and extent of the problems that exist with respect to policy illustrations. Each member of the working group was provided a copy of Senator Metzenbaum's June 23, 1992, subcommittee meeting transcript.

The second meeting of the working group was held in Atlanta on December 6, 1992. At this time the working group reviewed a draft which California was considering to regulate ledger illustrations used in the sale of life insurance and annuities. Judy Faucett (Coopers and Lybrand) reported on the efforts being undertaken by the Society of Actuaries and James Hunt (National Insurance Consumer Organization) gave a consumer advocacy perspective. William Albus explained the activity of the National Association of Life Underwriters.

At the March 1993 NAIC meeting, the working group again met and heard testimony from Robert Nelson (National Association of Life Underwriters) on the conclusions reached by the NALU regarding supportability and illustrations. William Miller (Prudential) presented a statement on behalf of the American Academy of Actuaries and George Coleman (Prudential) gave a report on behalf of a group of companies and trade associations that had studied the matter of policy illustrations.

The working group met next on June 21, 1993, in Chicago. Commissioner David Lyons (Iowa) reported on his testimony before Senator Metzenbaum and asked the working group to prepare a written report by the September 1993 NAIC National Meeting detailing the proposals and progress of the NAIC.

After the meeting, Mr. Coleman distributed a document with resource group suggestions for a cover page to accompany an illustration, to present critical information in an understandable way.

The working group met by conference call on July 22, 1993, and assigned different members of the working group to study some of the information currently available and to be ready to provide input to the working group on that report when the working group convened in August to write a "white paper" summarizing its efforts.

The working group received and reviewed information from the following sources:

- A. American Academy of Actuaries Task Force on Life Illustrations;
- B. Testimony of witnesses before the Antitrust, Monopolies and Business Rights Subcommittee, Committee of the Judiciary, U.S. Senate, June 23, 1992;
- C. National Association of Life Underwriters Sales Illustrations Task Force;
- D. *Consumer Reports* July-September 1993 report on life insurance, especially the sections on sales illustrations, by Trudy Lieberman;
- E. "Illustrations, Ethics and You," a seminar by the Society of CLU and ChFC;
- F. "Fungible Present Value Analysis" by Brian Fetchell;
- G. California proposed legislation on ledger illustrations and the comments received on the proposal;
- H. Submission of resource group.

Judging from the amount of activity being undertaken regarding policy illustrations by other organizations, such as the Society of Actuaries and the Society of CLU and ChFC, along with the media attention that policy illustrations have received, it is clear that there are problems in this area that require regulatory response.

III. Problems Identified in Regard to Current Practices

A. Inappropriate use of illustrations to estimate future performance and to compare performance of different policies.

The theme found in several of the reports reviewed by the working group indicated the danger in attempting to use illustrations to compare different policies. Illustrations are not and cannot be predictions or estimates of future performance. If the assumptions used are altered, the results will be dramatically different, thereby making the company with the most aggressive assumptions look like it performs best if comparisons are made between policy illustrations. The format of the illustrations, with precise numbers, gives the impression that it is an accurate projection of future performance. Even if the assumptions used are exactly the same as current experience, it won't be accurate because future experience won't be identical to current performance. The only valid use of the sales illustration should be to demonstrate how the policy works.

There is often a lack of supportability of the assumptions used in the illustration. The illustration may assume a lower mortality rate than currently being experienced or a higher lapse rate, for example.

B. Lack of accountability of any of the parties to the sale: applicant, agent and company.

In the current marketplace involving life insurance sales, there is virtually no accountability for any participants in the sale. Some insurance companies indicate that they are aware that the illustrations they provide are manipulated by agents, but that they have no way to control these practices. Many agents do not appear to understand the illustrations or the assumptions underlying the illustrations provided by the insurance company. In some cases, it has been reported that portions

of illustrations have not been explained, or even presented, to the applicant. Many applicants do not understand the nature of the information in the illustration or how to make use of this information. When actual performance under the policy is less than that illustrated, they believe they have been misled.

C. Lack of a standardized format for life insurance illustrations.

Illustrations currently in use appear to be far too complex for the applicant and in many cases, the selling agent to understand. Attempts to disclose assumptions used to prepare the illustration usually lead to further complexity and misunderstanding. The consumer may not understand what is guaranteed in the policy, that the other numbers are not an indicator of future performance, and that they are at best only a projection of current performance. In some cases, the consumer doesn't even realize that a life insurance policy has been purchased and that future premium payments are required.

D. Lack of standard and consistent definitions, language, assumptions and methodology.

In some countries the assumptions are set by laws based on average experience, or projections into the future are not allowed. In our country securities such as mutual funds may only disclose past performance and may not imply this will continue into the future. Companies use different terms to describe the components of their illustration so the consumer doesn't know what is being shown. The illustration implies the applicant is purchasing an investment vehicle rather than life insurance. The lack of standard terminology tends to create confusion in the minds of consumers and agents.

E. There is an inadequate description of the policy.

Many companies show only their marketing name on the policy illustration. The consumer has no idea whether he is buying whole life, term life, or a hybrid of the two. Consumers often believe they have bought an investment and do not realize that they have purchased insurance.

F. Consumers are not notified of changes in current assumptions.

The consumer relies on the original illustration as a projection of premium assumptions. However, because the illustration was based on non-guaranteed assumptions, reality will always be different. Annual statements do not update the illustration to reflect actual performance and current assumptions.

G. Insufficient penalty provisions exist.

Without more specific definitions, it is not always possible to say that the illustration is an abuse or an unfair trade practice. There are no specific penalties for life insurance disclosure violations included in the laws.

H. Current regulatory approaches are out of date considering the designs of policies being sold today.

Most state laws contain life insurance disclosure laws which were adopted when the products were much simpler. They do not address many of the abuses possible with the types of complex products now being marketed.

IV. Alternative Solutions to be Considered to Address the Problems Identified

A. The working group recommends consideration of four alternatives to address the problem of inappropriate use of illustrations:

- (1) Use standardized assumptions, similar to the practice in Great Britain where the government sets out the standards to be used in illustrations.
- (2) Don't permit projections into the future, similar to the rules for mutual funds where you can only show past performance.
- (3) Require a uniform illustration or format design and uniform definitions. This would eliminate much of the confusion faced by the consumer, who doesn't understand the variety of products on the market.
- (4) Develop a set of rules that provide clear disclosure of the use of illustrations and the assumptions underlying the illustration.

One of these alternatives, or a combination of two or more, or other options should provide the solution to this problem.

B. Accountability

To address the problem of accountability, all the parties to a sale should be made accountable for their actions. The agent and applicant should sign the illustration used at point of sale to indicate the projected performance of the policy based on non-guaranteed factors was disclosed and explained to the consumer. The insurer should be required to examine the illustration used and to verify that the illustration correctly shows the product sold. If the illustration contains errors, the insurer should prepare a new one with corrected information as part of the policy delivery. An officer of the company should sign the illustration delivered with the policy to verify that it correctly illustrates the policy issued. If the illustration is changed from that used at the point of sale, the agent is responsible for explaining any differences and the agent and applicant must sign the

corrected illustration. The company must maintain the correct and signed illustration until the policy is out of force three years, with a copy to the policyholder.

C. Understandable Illustrations

To assist the consumer in understanding an illustration, the illustration should set forth policy value, cash surrender value, and death benefit, using both current assumptions and guaranteed assumptions. If policy values become exhausted in any duration, that must be clearly reflected and explained in bold print (as a means to better emphasize the consequences of exhaustion) in the illustration. The working group needs to develop one or more standardized formats for illustrations to follow. It may not be appropriate to include an interest rate either guaranteed or credited on the illustration because the consumer tends to equate this with the rate paid on a savings account without considering that expenses are taken out of the premium first and a much smaller net amount is left to draw interest. Because of the ability of the company to change the interplay of interest, mortality and expenses, the number may have no place on an illustration. A requirement to illustrate only the guarantees would also make illustrations easier to understand.

D. Standardized Definitions

It will be necessary to develop standard definitions with significant guidance from the Life and Health Actuarial Task Force. These definitions should be prepared and forwarded to the working group by no later than (date). This should build on the work begun by the Society of Actuaries. Some of the standard terms that will be developed are supportability, current experience, mortality assumptions, interest or crediting rates, expense charges, and persistency. Others will no doubt be identified. The working group recognizes that the development of standard definitions extends the project beyond the regulation of illustrations but intends to minimize the impact as far as possible.

E. Description of the Policy

Illustrations need to clearly identify the type of insurance being illustrated by generic name. In addition to any marketing title, the policy illustration must clearly label the policy as term, whole life, etc. (a list of generic names to be determined). The illustration must also indicate the minimum premium necessary to carry the policy to age 100 on a level premium basis using guaranteed factors if it is a universal or indeterminate premium type product, and show the effect of vanishing premiums and their resumption.

F. Assumptions

When underlying assumptions change, the policyholder should be notified. At least annually, a new illustration should be prepared showing projections using the new current assumptions, if there have been any changes. It is reasonable and appropriate to indicate to the policyholder that the assumptions on which the original illustration were based are no longer true. Interim changes in assumptions do not require a report, but one should be offered to the consumer at a minimal cost.

G. Penalty Provisions

Penalties for failure to generate supportable illustrations or to update them at least annually should be included in any solution to the current problems with illustrations. An appropriate penalty may be to require payments based on the illustration as prepared, if higher than actual experience.

V. Recommendations to Address the Problems

A new NAIC model act and regulation should be drafted or revisions to the life disclosure regulation prepared, to address specifically the problems and abuses herein identified. The alternative solutions identified in this report should be analyzed in detail and incorporated in the new or revised model as appropriate. The goal in developing the new regulatory language is to require that illustrations clearly disclose how the policy being illustrated will work and that it be understandable to all parties involved in the sale of life insurance. The members of the working group believe that an exposure draft of these acts and regulations should be completed by no later than (date). To protect the consumers of their states, insurance departments should give serious consideration to adoption of the revised standards.

ATTACHMENT SIX-B

Life Disclosure Working Group
of the Life Insurance (A) Committee
Conference Call
July 22, 1993

The Life Disclosure Working Group of the Life Insurance (A) Committee met by conference call at 11 a.m. on July 22, 1993. A quorum was present and Bob Wright (Va.) chaired the meeting. The following working group members or their representatives participated in the conference call: Don Koch (Alaska); John Montgomery (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Noel Morgan (Ohio); Tony Higgins (N.C.); and Fred Nepple (Wis.). Also participating in the call was Carolyn Johnson (NAIC/SSO).

Bob Wright (Va.), Chair, began by stating that the working group had been given a great variety of information and needed a way to assimilate it all. He suggested that different members of the committee be responsible for studying the reports and preparing a summary for the other members. He asked if there were any other ideas on how to accomplish this task. As none were presented, the following assignments were made: Lester Dunlap (La.) will review the Society of Actuaries report, with the assistance of Harold Phillips (Calif.); Roger Strauss (Iowa) will review the Fungible Present Value Analysis Report by Brian Fetchel; Carolyn Johnson (NAIC/SSO) will review the I.Q. Report of the Society of CLU and ChFC; John Montgomery (Calif.) will provide a summary of the California ledger illustration proposal and coordinate with the Life and Health Actuarial (Technical) Task Force. Tony Higgins (N.C.) will review the statement of the National Association of Life Underwriters; and Noel Morgan (Ohio) will review the testimony of James Hunt (National Insurance Consumer Organization) at Senator Howard Metzenbaum's (D-Ohio) hearing. All members were asked to review the suggestions for a cover sheet prepared by George Coleman (Prudential).

Working group members were asked to prepare a one to two page summary and send it to Ms. Johnson by August 6. Ms. Johnson would then distribute it to all of the members. Individuals responsible for summarizing reports should be ready to answer questions from the group. The working group decided to meet in Kansas City on August 19 to review the summaries and prepare a report for the fall National Meeting in Boston. The working group will identify the problems with current illustrations and specify the steps needed to respond to the problems that should be included in the report. The working group also discussed the series on life insurance disclosure appearing in *Consumer Reports*. Mr. Morgan offered to prepare a summary for the group.

Mr. Montgomery reported that California had received more than 20 letters in response to its ledger illustration draft regulation. Most were very favorable.

Having no further business, the Life Disclosure Working Group of the Life Insurance (A) Committee conference call adjourned at 11:30 a.m.