

## LIFE INSURANCE (A) COMMITTEE

### Reference:

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David J. Lyons, Chair—Iowa  
Vacant, Vice Chair

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### MINUTES

The Life Insurance (A) Committee met in Coral IV of the Hilton Hawaiian Village, Honolulu, Hawaii, at 1 p.m. on Dec. 8, 1993. A quorum was present and David J. Lyons (Iowa) chaired the meeting. The following committee members or their representatives were present: John Garamendi (Calif.); Robert M. Willis (D.C.); James H. Brown (La.); Harold T. Duryee (Ohio); Kerry Barnett (Ore.); J. Robert Hunter (Texas); and Steven T. Foster (Va.).

#### 1. Consumer Evaluation of Buyer's Guide

Commissioner David J. Lyons (Iowa) asked Mary Griffin (Consumers Union) to speak for Jim Hunt (National Insurance Consumer Organization). Ms. Griffin said that Mr. Hunt had asked her to summarize his concerns about the charge to evaluate the Life Insurance Buyer's Guide. Considering that the Buyer's Guide had not changed since 1984, Mr. Hunt did not think it was an effective or relevant tool. Ms. Griffin said that Mr. Hunt had reviewed more than 1,500 life insurance proposals over the last three years and not one of the purchasers had indicated an interest in the Buyer's Guide. He suggested a red sticker on the policy to give a warning about early surrender and the costs involved. He said the latest data he had was that 30% of the policies were dropped in two years and 40% within five years. Mr. Hunt thought that after the Life Disclosure Working Group had finished its life insurance illustrations task, it might want to consider revising the guide to include pertinent information. Commissioner Lyons said he agreed that this was an important issue and that later the Buyer's Guide could be considered for revision. Commissioner Lyons thought it was important to work on the priority issue—that of life insurance illustrations. He suggested keeping this item as a charge to work on at the appropriate time.

#### 2. Report of Unfunded Checking Accounts Working Group

Mary Alice Bjork (Ore.) reported that the Unfunded Checking Accounts Working Group had not expected to have a quorum at its meeting on Dec. 6 so held two conference calls prior to that time. One of the issues of concern to the working group had been whether or not guaranty funds would cover unfunded checking accounts, and she said this issue had been resolved. There still were several issues outstanding, so the group had decided it was appropriate to do a sample bulletin. A draft was attached to the working group minutes, and she said comments were to be received on this draft by Feb. 1. After that time she said the working group would hold a conference call with interested parties to

refine the draft, with expected adoption in March. Upon motion duly made and seconded, the minutes of the Unfunded Checking Accounts Working Group were adopted (Attachment One).

### 3. Report of Viatical Settlement Working Group

Commissioner Lyons first summarized the activity of the NAIC Executive Committee and Plenary Sessions regarding viatical settlements. He said the Plenary had adopted the Viatical Settlement Model Act. There had been significant interest and discussion in the topic, and he emphasized that the public should not see adoption of the model act as an NAIC endorsement of the concept of viatical settlements in general. Commissioner Lyons said the Life Insurance (A) Committee might receive an additional charge to investigate other alternatives such as an expanded role for accelerated benefits of life insurance policies. The group might also be expected to discuss the legal ramifications of not allowing viatical settlements at all. Commissioner Lyons next called on Roger Strauss (Iowa), chair of the working group, for a report. Mr. Strauss said the working group had begun the next task, which was development of a model regulation to implement the model act. The working group had discussed key elements to include in a regulation, and drafting would begin within the next month. He asked that the Life Insurance (A) Committee receive the report of the working group, continue the working group for the next year, and authorize the working group to proceed with the development of a regulation. Upon motion duly made and seconded, the report of the Viatical Settlement Working Group was received (Attachment Two).

### 4. Report of the Life Disclosure Working Group

Bob Wright (Va.), chair of the working group, reported that the working group met Nov. 15 and 16, Dec. 4, and Dec. 7, 1993, to develop a model act on life insurance illustrations, which the working group was now recommending for exposure. The group had also charged the technical resource advisors to come back with a recommendation for an understandable illustration. After discussion with the interested parties some changes had been made to the draft of the model act and Mr. Wright highlighted those changes for the audience.

It had been decided earlier not to cover annuities but after discussion the working group decided to incorporate annuities into the model act since it was an enabling statute only, and to go forward with the regulation for life insurance illustrations. After development of the life disclosure illustrations regulation, a corresponding regulation for annuities could be developed. Mr. Wright said Section 3 was changed to include broad enabling language, moving the list of issues to consider to a drafting note. He said there was significant discussion on the penalty section, Section 4, and the working group decided to leave it as it was. There had been a Section 5 in the prior draft that created a private cause of action. After extensive discussion, the working group decided to remove that provision. Mr. Wright said that more than likely there would be other changes before the model was adopted. He requested continuation of the working group and consideration of an expanded charge to encompass annuity products. Ted Becker (Texas) said the Texas Department of Insurance was particularly interested in annuity illustrations and asked if this approach was the fastest way to get at the issue. Commissioner Lyons said that much of what was learned from the development of the life illustration regulation would apply to annuities, so hopefully that regulation would move much more quickly. Mr. Wright said he did not think the working group had resources to do both areas at the same time, so agreed that the current approach was probably the quickest way to develop an annuity regulation.

Carolyn Cobb (American Council of Life Insurance—ACLI) assured the working group that her association looked forward to assisting the working group in development of a regulation that would serve consumers, regulators and insurers. She asked the Life Insurance (A) Committee to consider exposure of the draft without the second sentence of Section 4. She said the provision was flawed on several issues: separation of powers, due process, and a lack of understanding of the term of "supportability." She said "supportable" is not a term of art, and the industry does not yet know what that term means. Commissioner Lyons said that the concept of equity did support this remedy. Ms. Cobb responded that the remedy of specific performance has existed for a long time, but it was used in the courts rather than in the insurance code. An executive administration of this type of judicial remedy had not existed. Commissioner Lyons said that there was a procedure to request a

legal opinion from the NAIC staff, and he asked the industry to provide a brief to argue its position. Ms. Cobb again suggested that while this provision is being discussed it should be removed from the draft. Commissioner Lyons responded that if the sentence remained in the draft, the working group was likely to receive the information much more quickly. Mr. Wright asked that comments on that provision also be received by Feb. 1. Commissioner Robert Wilcox (Utah) expressed a concern about this provision. In an effort to gain a powerful tool, he did not want the model to take the illustration and translate it into a guarantee. In that case, the draft should simply say that insurers could illustrate only guarantees. Commissioner Lyons asked for a motion to remove the second sentence of Section 4 of the draft. Hearing none, he said the sentence would remain in the draft. Upon a motion duly made and seconded, the report of the Life Disclosure Working Group was received (Attachment Three).

#### 5. Report of Synthetic GIC Working Group

Reginald Berry (D.C.) reported that at the fall National Meeting in Boston a working group had been formed and given the charge to look at issues of synthetic guaranteed investment contracts (GICs). The three members of the working group had decided to approach the problem in several phases. The first phase was information gathering. Mr. Berry had a packet of information to distribute to the working group members with information about the types of synthetic GICs currently being marketed. He said the cover letter made clear that the presentation was for informational purposes only. (The cover memo and information list is Attachment Four). He asked for a charge for 1994 to have the working group continue its endeavors. Upon motion duly made and seconded, the report of the Synthetic GIC Working Group was received.

#### 6. Report of the Life and Health Actuarial Task Force

John Montgomery (Calif.) reported that the task force had seven recommendations for the Life Insurance (A) Committee. They are:

- (1) Recommend combining life Project 2j "Valuation—Revision of the Standard Valuation Law" and accident and health Project 3d "Valuation—Revision of Standard Valuation Law (Health Insurance Aspects)" in December 1993 into a single joint Project 1c "Valuation—Revision of Standard Valuation Law" which would be reported to both the Accident and Health (B) Committee and the Life Insurance (A) Committee. If this recommendation is duly adopted, it is also recommended that the resulting joint project be designated a number one priority project.
- (2) Recommend deletion of life Project 2l "Valuation—Long Range Issues" from the agenda of the actuarial task force in December 1993.
- (3) Recommend exposure of a new draft of the proposed "Second Standard Nonforfeiture Law for Life Insurance" in December 1993 for adoption in June 1994. This draft is dated Dec. 4, 1993.
- (4) Recommend exposure of a revised draft of proposed amendments to the "Standard Nonforfeiture Law for Deferred Annuities" in December 1993 for adoption in March 1994. This draft is dated Dec. 4, 1993.
- (5) Recommend deletion of life Project 4l "Special Plans—Whole Life Policies without Cash Values or Paid-Up Benefits," from the agenda of the actuarial task force in December 1993.
- (6) Recommend exposure of a revised draft of a proposed new model regulation entitled "Valuation of Life Insurance Policies—Special Rules" in December 1993 for adoption in June 1994. This draft is dated Dec. 4, 1993.
- (7) Recommend that life Project 5 "Reinsurance" be reassigned in December 1993 as a joint Project 2 "Reinsurance" to be reported to both the Accident and Health Insurance (B) Committee and the Life Insurance (A) Committee. If this recommendation is duly adopted, it is also

recommended that the resulting joint project continue to be designated a number two priority project.

Mr. Montgomery said he expected a significant amount of discussion on the draft of the Second Standard Nonforfeiture Law and the Standard Nonforfeiture Law for Deferred Annuities. He suggested that the committee might want to wait until June to adopt the annuity law.

George Coleman (Prudential) said that the drafters of the Second Standard Nonforfeiture Law had changed their approach significantly from the time the model was first proposed. He said the original idea had been to address problems with universal life insurance. Now the draft goes much beyond that and regulates rates by specifying maximum charges. He suggested the draft was fundamentally flawed and questioned whether revisions to the original Standard Nonforfeiture Law were even needed. He also said little testing had been done on the formulas contained in the draft. Commissioner Lyons said that he understood there were significant concerns about the draft but said that due to time constraints the committee could not go into these at this time. He suggested holding a public hearing on the issue of the two model drafts at the March National Meeting in Denver. Mr. Coleman said that he preferred that the drafts not be exposed at this time because the issues were not yet resolved. He said that there were major inequities to address. Upon motion duly made and seconded, the report of the Life and Health Actuarial Task Force was adopted with an amendment to propose June adoption for the annuity draft.

#### 7. Recommendations Regarding 1994 Charges

After a review of the 1993 charges, the Life Insurance (A) Committee agreed to request charges for 1994 regarding the issue of life insurance disclosure, annuity disclosure, a regulation to implement the Viatical Settlement Model Act, and a March completion for the unfunded checking accounts issue. A new charge would be requested on synthetic GICs, and the Life Insurance Buyer's Guide should remain on the list of charges with the understanding that it would be considered after completion of the illustrations regulation.

Having no further business, the Life Insurance (A) Committee adjourned at 2:10 p.m.

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

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#### ATTACHMENT ONE

##### Unfunded Checking Accounts Working Group Honolulu, Hawaii December 6, 1993

The Unfunded Checking Accounts Working Group of the Life Insurance (A) Committee met in South Pacific I of the Hilton Hawaiian Village, Honolulu, Hawaii, at 2 p.m. on Dec. 6, 1993. Mary Alice Bjork (Ore.) chaired the meeting. The following working group members were present: Shawn Bryan (Vt.).

Mary Alice Bjork (Ore.) called the meeting to order and said that two conference calls had been held by the working group since the last NAIC meeting (Attachments One-C and One-D). She said at that time they discussed the memorandum from the National Organization of Life and Health Guaranty Associations (NOLHGA) (Attachment One-A), which addressed the concerns of the working group on the issue of guaranty fund coverage.

At the Dec. 1, 1993, conference call, the working group adopted an exposure draft of a bulletin that states could use to address the other issues regarding unfunded checking accounts (Attachment One-B). She asked that comments be sent to Carolyn Johnson (NAIC/SSO) and to each of the members of the working group by Feb. 1. She said the intent was to adopt this bulletin with whatever modifications the working group felt necessary at the spring National Meeting in Denver.

Ms. Bjork asked if there were any comments on the draft at this time. Carolyn Cobb (American Council of Life Insurance—ACLI) said she had not, of course, had an opportunity to complete a review of the draft, but she did have some preliminary comments to make. She said retained asset accounts were an important benefit for policyholders and she appreciated the opportunity to work with the NAIC on this issue. Her first point was that the accounts were not unfunded; she said they were

fully funded and accounted for as liabilities on the annual statement of the company. She said drafting a regulation was inappropriate because only a few states did not have authority already to review the agreements. She agreed that it was appropriate to disclose who was in possession of the funds but she did not think there should be a requirement to say that there was no Federal Deposit Insurance Corporation (FDIC) protection and to mention the limits on guaranty fund protection. She said the ACLI would be submitting comments by the deadline and she requested a hearing and opportunity to discuss concerns after the working group had reviewed the comments of interested parties.

Ms. Bjork clarified the intent of the working group was not to develop a regulation. Ms. Cobb said she was referring to the drafting note after the first paragraph of the bulletin. Ms. Bjork said the intent was not to develop a model regulation, but if a state did not have authority to do what the bulletin says, that state might choose to do a regulation. Ms. Cobb responded that there were other methods of getting authority to review the disclosure statements.

Shawn Bryan (Vt.) said given the fact that what the working group was proposing was in the form of a bulletin, he expected the concerns of the industry had been allayed. Ms. Bjork said that the working group would provide another opportunity to interact with interested parties before the bulletin became final. She said they would probably not have a hearing but she would consider involving interested parties in a conference call. Mr. Bryan said the issues of FDIC and guaranty fund disclosure were very important and appropriate. Because of his firm conviction, he suggested that interested parties address this issue in their comments.

Having no further business, the Unfunded Checking Accounts Working Group adjourned at 2:15 p.m.

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#### ATTACHMENT ONE-A

National Organization of Life and Health Guaranty Associations  
13873 Park Center Road, Suite 329  
Herndon, VA 22071  
(703) 481-5206  
(703) 481-5209 (fax)

From: Anthony R. Buonaguro, Senior Vice President & General Counsel  
Date: November 24, 1993  
Re: Guaranty Associations Coverage of Retained Asset Accounts

#### ISSUE

An increasing number of life insurance companies are settling death claims through the use of what have become known generically as retained asset accounts. This option may be offered along with other more traditional options such as an annuity. We understand that the life insurance industry regards this form of settlements as the same as a lump sum payment since the beneficiary has immediate access to all or any part of the proceeds.

Specific arrangements vary, but it appears that the most common practice is for the insurer to retain the policy proceeds and credit interest, while arranging with a bank for the issuance to the beneficiary of bank drafts which allow the beneficiary to access all or any part of the funds at any time. The bank agrees to honor the draft subject to collection of the funds from the insurer. The insurer agrees to deposit the funds with the bank when it is notified that a draft has been presented. In effect, the bank serves merely as paying agent, and the insurer, as we understand it, continues to carry the beneficiary's account values as a liability for statutory accounting purposes, reported as proceeds in the process of settlement on line 10.3 in the Liabilities, Surplus and Other Funds statement.

The question is this: If the insurer becomes insolvent prior to the funds being fully paid out to the beneficiary, is the beneficiary protected by the state guaranty association?

#### CONCLUSION

We have concluded that funds left with the insurer under arrangements such as those described above would be protected by the guaranty association under the terms of the Life and Health Insurance Guaranty Association Model Act. We further believe that these arrangements would be subject to the same coverage limitations under the Model Act as are applicable to life policy death benefits.

#### RATIONALE

Section 3B(1) of the Model Act states that the Act provides coverage for "direct, non-group life, health, annuity and supplemental policies or contracts." Section 8C(1) of the Model Act requires the guaranty association to either guarantee, assume or reinsure, or cause to be guaranteed, assumed or reinsured, the "policies or contracts" of an insolvent insurer or assure payment of the "contractual obligations" of the insolvent insurer.

In the case of retained asset accounts, the continuing relationship between the insurer and the beneficiary can fairly be characterized either as the extended payment over time of the benefits under the original policy or the establishment of a contractual relationship between the insurer and the beneficiary which is supplemental to the original policy. Under either

analysis, it is clear from the language quoted above that coverage exists. A contract supplemental to a covered insurance policy continues to be protected, as the original policy was, subject to applicable statutory limits.

If viewed as payment over time of life insurance proceeds, it is clear under Section 3C(2)(a)(i) of the Model Act that the arrangement would be covered up to the same dollar amount as was the original life policy. If viewed as a supplemental contract, we believe the same conclusion would be reached. Obviously, the limitations for annuity and health insurance benefits would not apply. And the funds in the retained asset account cannot fairly be characterized as either "net cash surrender or net cash withdrawal values," since these concepts refer to values present under a life policy before it matures.

We believe that the correct analysis clearly is that the limitation for life insurance death benefits must apply. This analysis is supported by the lead-in to Section 3C(2)(a), which modifies the coverage limit for death benefits "with respect to any one life, regardless of the number of policies or contracts." If the retained assets arrangement is a supplemental contract, it is a covered "contract with respect to one life" which is not the policy itself but under which death benefits are nevertheless being held, a type of arrangement which the coverage limitation provision for death benefits contemplates.

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#### ATTACHMENT ONE-B

Draft: 12/1/93

#### Sample Bulletin

TO: All Life Insurers Licensed to Write Business in [State]  
FROM: [Commissioner, Director, Superintendent]  
DATE: [Insert Date]  
RE: Unfunded Checking Accounts

The purpose of this bulletin is to set forth the procedures this department expects to see in place in regard to the settlement of life insurance proceeds through the mechanism known by such terms as "unfunded checking accounts," "retained asset accounts," "reserve asset accounts" and "asset preservation accounts." These accounts are designed to be a temporary repository of funds while the beneficiary considers the available options. While the majority of insurers handle these accounts in an appropriate manner, the potential for misunderstanding or abuse is present. In market conduct examinations and handling of complaints these are the procedures the department will expect to find in place:

Drafting Note: If a state does not have sufficient authority to examine the disclosure forms and require their compliance with these provisions, the state should consider adopting a regulation instead, using this bulletin as an outline.

#### A. Disclosure

##### (1) The "Checkbook"

Literature describing the settlement options should clearly disclose that payment of the total proceeds is accomplished by delivery of a "checkbook," if that is the case. It should be clear to the beneficiary that one check can be written to access the entire proceeds, and that the other options are preserved until the entire balance is withdrawn. The literature should make clear that the proceeds are not in a true checking account insured by the FDIC unless such is the case. Any charges to maintain the account should be prominently disclosed.

##### (2) Guaranty Fund Coverage

If the proceeds exceed the statutory limit for guaranty fund coverage, the insurer should disclose the fact that only \$[insert amount] will be paid, should the insurer become insolvent. Disclosure should also include a statement that guaranty fund coverage may not include accrued interest.

##### (3) Tax Implications

The disclosure information should indicate that there may be tax implications, and the beneficiary should consult his or her tax advisor.

#### B. Interest

The funds should draw interest from the date of death at a rate comparable to that being paid for similar investments in the open market or at the statutory rate.

#### C. Accounting

The funds necessary to cover liabilities under these accounts shall be reported as liabilities (claims due and unpaid) on the annual statement. In the company books the obligations should be segmented from general assets.

#### D. Guaranty Fund Protection

As obligations of the insurer, unpaid proceeds will be subject to guaranty fund protection up to the statutory limits in the event of an insurer insolvency.

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#### ATTACHMENT ONE-C

##### Unfunded Checking Accounts Working Group Conference Call December 1, 1993

The Unfunded Checking Accounts Working Group of the Life Insurance (A) Committee met by conference call on Dec. 1, 1993, at 10 a.m. Central time. Participating were: Mary Alice Bjork (Ore.), Chair; Beth Hill (Texas); Shawn Bryan (Vt.); and Melodie Bankers (Wash.). Carolyn Johnson (NAIC/SSO) also participated.

Mary Alice Bjork (Ore.) said the purpose of the conference call was to review the draft bulletin and vote on exposure at the winter National Meeting in Honolulu, Hawaii. Shawn Bryan (Vt.) asked the members of the working group if they had received the fax which he sent. Mr. Bryan said that Vermont still favors the development of a regulation rather than a bulletin. He said his department is still uncomfortable with respect to guaranty fund coverage. Ms. Bjork said that the letter from the National Organization of Life and Health Guaranty Funds (NOLHGA) has laid her concerns to rest in this regard. She said that she believed the guaranty fund issue had been resolved and the main issue now was disclosure. Beth Hill (Texas) said she had discussed the issue with the guaranty fund in Texas and it was of the opinion the death benefit was covered, but interest would not be paid. Melodie Bankers (Wash.) asked about the situation where the guaranty fund limits were lower than the amount in the unfunded checking account. She thought that limitations on coverage should be disclosed in that situation. The working group decided that the disclosure section of the bulletin should require disclosure of the guaranty fund limits and also the possibility that interest on the account might not be paid in the event of an insolvency.

Mr. Bryan said that he did not favor allowing any transaction charges or other charges on the unfunded checking account. He said this was another argument in favor of doing a regulation rather than a bulletin, because he did not feel a bulletin could prohibit the charges. Ms. Bjork said that in Oregon interest and other charges were not permitted. Ms. Hill said that Texas did not currently have the authority to review life products to the extent of reviewing a disclosure statement. The other members of the working group suggested that, in a state like Texas, it would be appropriate to do a regulation rather than a bulletin to give the department authority to review the disclosure statements. The members of the working group decided to add a drafting note to the bulletin to make this suggestion to states.

Mr. Bryan said that he thought it was important to make clear that the unfunded checking account was to be a temporary residence for funds. Consumers ought to be encouraged to move the funds into a more permanent arrangement as soon as they had made a financial decision.

Ms. Bjork suggested that a provision be added to disclose the fact that there may be tax implications to the beneficiary's choice and he should see his tax advisor. The working group then voted to expose the draft bulletin with the changes outlined above.

Having no further business, the conference call adjourned at 10:30 a.m.

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#### ATTACHMENT ONE-D

##### Unfunded Checking Accounts Working Group Conference Call November 17, 1993

The Unfunded Checking Accounts Working Group of the Life Insurance (A) Committee met by conference call on Nov. 17, 1993, at 10 a.m. Participating were: Mary Alice Bjork (Ore.), Chair; Beth Hill (Texas); Shawn Bryan and Rick Barrett (Vt.); and Melodie Bankers (Wash.). Carolyn Johnson (NAIC/SSO) also participated.

Mary Alice Bjork (Ore.) said the purpose of the conference call was to determine the direction the working group wished to go. She asked if the members of the working group had received the letter from the National Organization of Life and Health Insurance Guaranty Associations—NOLHGA which explained the position that guaranty funds would take regarding insolvent insurers with unfunded checking account obligations. The members of the working group said that they had all received the letter and were satisfied with the response. Melodie Bankers (Wash.) said she had received a letter from the Washington Guaranty Association. She had expressed concerns earlier about Washington's guaranty fund not covering some Washington policyholders and had been informed this was an error. The Guaranty Association clarified that it did intend to cover the policies. Ms. Bjork asked if the working group considered this issue to be laid to rest, and the members of the working group responded that they were satisfied that the issue was resolved.

Ms. Bankers suggested that it would be appropriate to develop a bulletin to alert companies to the proper procedures for unfunded checking accounts. Some of the difficulties that had been expressed earlier were in regard to companies that were

not members of the American Council of Life Insurance (ACLI). The procedures which ACLI members used should be followed by these other companies and a bulletin would help alert them to that fact. Shawn Bryan (Vt.) endorsed that idea, suggesting that it would get everyone on to a level playing field.

The working group decided to produce a draft bulletin for exposure at the winter National Meeting in Hawaii with possible adoption at the spring National Meeting in Denver. The working group may not have a quorum at the December National Meeting so decided it would be appropriate to meet by conference call on Dec. 1, 1993, to review the draft and to vote on exposure.

Having no further business, the conference call adjourned at 10:15 a.m.

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## ATTACHMENT TWO

### Viatical Settlement Working Group Honolulu, Hawaii December 6, 1993

The Viatical Settlement Working Group of the Life Insurance (A) Committee met in Iolani III & IV of the Hilton Hawaiian Village, Honolulu, Hawaii, at 11 a.m. on Dec. 6, 1993. A quorum was present and Roger Strauss (Iowa) chaired the meeting. The following working group members or their representatives were present: Reginald Berry (D.C.); Mary Alice Bjork (Ore.); Rhonda Myron (Texas); and Bob Wright (Va.).

Roger Strauss (Iowa) summarized the activity of the working group to date. He said that the NAIC Plenary had adopted the model act prepared by this working group. The next step was for the working group to develop a model regulation to implement the Viatical Settlement Model Act. He said the working group would proceed with the understanding that it might get an additional charge from the Executive Committee. He asked for comments on what should be included in a regulation, and asked Carolyn Johnson (NAIC/SSO) to take a look at the statutes and regulations of states where viatical settlement companies already are regulated, to see if there are parts that can be included in the NAIC's draft. The working group would then add provisions to fulfill the other requirements.

Ted Becker (Texas) said he thought there should be a provision included in the disclosure to alert potential viators to the fact that they should consider taking out the maximum loans on their policies. That amount might be greater than the viatical settlement. Reginald Berry (D.C.) said the authority for such a provision existed under Section 8A of the model act. Mr. Berry said that the regulation also should contain a section to implement Section 9A(1) of the act, which referred to the physician without specifying whether it was a viatical settlement company's physician or the policyholder's physician. It also did not go into any detail as far as standards for determining what happens if a dispute arises between the two physicians. This would be something that should be detailed in the regulation.

Bob Wright (Va.) said he thought the most important part of the regulation was to implement Section 10B on standards for payments. Mr. Strauss said that a verbal communication had been received from the viatical settlement industry detailing its standards and he thought this was a good starting point for the working group's discussion. Don Koch (Alaska) agreed with the importance of establishing standards for approval of viatical settlement contracts. He questioned whether the language in Section 10 was broad enough authority to allow standards for record keeping and examinations. Mr. Wright said he thought the second or third sentence of Section 5 provided broad language that gave sufficient authority. John Montgomery (Calif.) said he thought the broad authority in Section 10A would cover this provision.

Chris McDonald (Ohio United Health Services) said the most important thing from the consumer's standpoint was disclosure. She said the disclosure statements in the model act were very important and should be expanded upon in the regulation. She thought the most important thing to consumers was to note the possible loss of disability income and the tax implications of a viatical settlement. Barbara Thurston (Alaska) said making the disclosure form part of the contract would allow states to review the disclosure form during contract review.

Mr. Strauss said the timetable for the working group was for Ms. Johnson to prepare a draft of the material from other states by Feb. 1, 1994, and provide this to the members of the working group. A conference call of the working group would be held after that to review the material and fill in the gaps.

Mr. Koch asked that Alaska be added to the working group.

Having no further business, the Viatical Settlement Working Group adjourned at 11:30 a.m.

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## ATTACHMENT THREE

Life Disclosure Working Group  
Honolulu, Hawaii  
December 4, 1993

The Life Disclosure Working Group of the Life Insurance (A) Committee met in Honolulu III of the Hilton Hawaiian Village, Honolulu, Hawaii, at 1 p.m. on Dec. 4, 1993. A quorum was present and Bob Wright (Va.) chaired the meeting. The following working group members or their representatives were present: Don Koch (Alaska); Roger Strauss (Iowa); Lester Dunlap (La.); Tony Higgins (N.C.); Noel Morgan (Ohio); and Fred Nepple (Wis.).

Bob Wright (Va.) said that the purpose of the meeting was to distribute the draft model law on life insurance illustrations and to hear comments on the task that had been assigned to the technical resource advisors at the Nov. 15 meeting. He said that the discussion of the draft of the model act would take place at the Dec. 7 meeting of the working group after the interested parties had time to review the draft. He reminded the attendees that there would also be continued opportunity for comment after the draft was exposed.

1. Illustration to be Understandable to the Applicant

George Coleman (Prudential) said that when the interested parties met with the working group in Kansas City on Nov. 15, 1993, to discuss what was expected of the technical resource advisors, initially there had been some confusion as to their task. The advisors understood they were being asked to make recommendations to simplify and clarify the illustration and the cover page. Because they were initially confused about their assignment, some had contacted individual members of the Life Disclosure Working Group and they now had a clear understanding of their task. Mr. Coleman said it was a very ambitious schedule to complete this project in January. Linda Lanam (Life of Virginia) said one of the difficulties with the assignment given to them was the variety of purchasers as well as the variety of products. Roger Strauss (Iowa) responded that regardless of who the consumer was, numbers are numbers. Ms. Lanham responded that, if the consumer was only interested in seeing the straight numbers, that was correct; but if the potential purchaser wanted to do things differently than pay the same annual premium every year, the illustration would be different for that person. Some things would be the same, she conceded, such as column headings and the basics that would be shown. Mr. Strauss said he did not think the working group would prohibit giving more than one illustration—one with the standard straight line premiums and one with a larger or smaller initial payment or whatever variation the potential purchaser was considering. Mr. Wright said he was most concerned about a standardized format and standardized definitions. He thought it would be permissible to make some changes for very sophisticated purchasers. Tony Higgins (N.C.) said the working group had an idea of what an illustration should look like, and the task of the technical resource advisors was to prepare something that would meet the needs of the public and industry without being limited to prior experience and showing future guarantees. He said if they could come back with something usable without going to this extreme, the working group would seriously consider that product. Lester Dunlap (La.) asked the technical resource advisors to keep in mind the working group's concerns about the potential for abuse that existed and was already being shown. Mary Griffin (Consumers Union) offered to prepare a "key features document" explaining a particular type of policy. She envisioned this document as something which would give key information about a type of policy, warn about surrender charges, and alert consumers to other important features. She also agreed to provide this document in January.

James Hunt (National Insurance Consumer Organization—NICO) said he was astonished that the working group had prepared a model to give the commissioner authority to do what he already could do under the Unfair Trade Practices Act. He said that under a similar situation in the early to mid-'70s, commissioners had used the Unfair Trade Practices Act as authority to develop and adopt a solicitation regulation. He was not finding fault with the provisions, but he questioned how many years it would be before legislatures would adopt them. Mr. Wright said that the best advice he had received was that in many states legislation was needed because the envisioned provisions go further than the legislative authority now available. He said if a commissioner felt he already had the authority, he could go forward without adoption of the model act, but from what he had been told, many did not feel they had that authority. Mr. Hunt asked that the working group consider adding a drafting note to alert commissioners to the fact that they might not need the act in order to adopt a regulation, and the working group agreed that this would be appropriate.

Mr. Hunt brought up the topic of manipulation of mortality assumptions. He said the Society of Actuaries report did not mention the "game" that is being played where the assumptions of mortality vary from what is currently being experienced. Mr. Higgins asked Mr. Hunt if he thought it was ever appropriate to vary the mortality assumptions from the current experience and Mr. Hunt responded that the commissioner should set illustration standards for mortality and he did not think they should allow improving mortality projections. Mr. Wright asked Mr. Hunt's opinion on the proposal to prepare a new illustration at any time when the assumptions changed. He asked if Mr. Hunt considered that to be a burdensome request. Mr. Hunt said it was a good idea in principle and he did not think once a year would be overly burdensome. He said almost all companies now will prepare an illustration on request so he thought the change would be modest. Scott Cipinko (National Association of Life Insurance Companies—NALIC) said that generating the paper was not the only problem; the cost was also in postage and staff time. He also said the illustration could be quite confusing to the consumer if he was not aware of its purpose. William Fisher (Massachusetts Mutual) said he thought it was appropriate to send a letter notifying consumers that a non-guaranteed element had changed and offering an opportunity to receive a new illustration if the consumer desired.

Mr. Wright asked if there were any other questions about the project of the technical resource advisors. There were no further questions, so other issues were addressed.

## 2. Actuarial Standards

Jack Turnquist (Actuarial Standards Board) said his organization had held a public hearing in March because of concern about abuses in illustrations and concerns about how non-guaranteed elements were being illustrated. The Actuarial Standards Board had considered development of standards, but he felt that it would be done in a vacuum without an understanding of what the NAIC would propose. He said there needed to be coordination of the NAIC in development of the model regulation and the Actuarial Standards Board in development of the standards. Mr. Wright asked if the Actuarial Standards Board would be willing to start drafting its standards as soon as the model regulation was developed, and Mr. Turnquist responded in the affirmative. Mr. Wright asked how long this process would take. Mr. Turnquist said he thought the Board could be finished within 12 months from the time it started drafting, allowing for a period of exposure and comment. He said the usual timeframe was 24 months but he would ask that this project be put on a fast track.

## 3. Direct Writers

Mr. Wright said he had been contacted regarding another issue. Sally Cone (American Republic Insurance Company) and others had contacted him regarding the needs of direct writers. Ms. Cone said that direct writers were not currently using illustrations but she asked the working group to keep their needs under consideration so that if direct writers started to use illustrations, they would be able to meet the requirements of the model.

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

The Life Disclosure Working Group of the Life Insurance (A) Committee reconvened in Coral II of the Hilton Hawaiian Village, Honolulu, Hawaii, at 8 a.m. on Dec. 7, 1993. A quorum was present and Bob Wright (Va.) chaired the meeting. The following working group members or their representatives were present: Don Koch (Alaska); John Montgomery (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Tony Higgins (N.C.); Noel Morgan (Ohio) and Fred Nepple (Wis.).

Upon motion duly made and seconded, the minutes of Nov. 15 and 16, 1993, meeting in Kansas City, Mo., were adopted (Attachment Three-B).

## 4. Discuss Definitions

Mr. Wright said that discussion of needed definitions would be postponed until a decision had been made on which alternative the working group's draft of a model regulation would follow. He thought it appropriate to defer discussion until that decision had been made, which would be after the technical resource advisors presented their recommendations for illustrations that would be understandable to applicants.

## 5. Discuss Life Insurance Illustrations Model Act

Mr. Wright suggested the meeting attendees go through the draft released on Dec. 4 section by section and offer comments for the working group to consider during the closed drafting session.

### Section 1

Jack Burbidge (IDS Life) said the Nov. 15 minutes reflected the decision of the group to defer discussion of annuities. Section 1 uses the term "life insurance products" which includes annuities; he suggested changing the terminology to "life insurance policies."

### Section 2

No comments were received.

### Section 3

Mr. Coleman expressed concern about the list of items contained in Section 3. He said the working group had already decided all these items would not be in the regulation, and he was concerned that if the act contained a long list of possibilities, even though the model regulation was more limited, a state might choose to go off on its own. He preferred a broad authority without the detail. Mr. Strauss said he was surprised by this comment, that he had expected the industry to want an even more precise list and was surprised they would want to start with such a broad authority. Mr. Coleman responded that he preferred to see something general until the working group had decided on an approach. Ms. Griffin also said she thought the broad list sent a mixed message. Mr. Wright responded that the purpose of the working group had been to permit any of the approaches in the position paper. Because of the timing of the draft, the working group thought it appropriate to take this approach. He expected that in the future the working group would need to go back into the model act and adjust this section.

Barbara Lautzenheiser (Lautzenheiser & Associates) suggested adding to Section 3, "for life insurance policies." John Montgomery (Calif.) asked if this meant it would be necessary to do another act and regulation for annuities. Mr. Wright responded in the affirmative.

William Regan (National Association of Life Underwriters—NALU) expressed support for the work so far accomplished by the working group. He said his organization felt the working group was on the right course, and it was committed to helping the working group achieve its goal.

## Section 4

Carolyn Cobb (American Council of Life Insurance—ACLI) said her organization felt strongly that the Section 4 provision regarding remedies was inappropriate. Remedies were currently available in the courts and she felt that was the appropriate source. Ms. Lautzenheiser said that, as written, the model act required specific performance and that illustrations would be limited to guarantees if this requirement was retained. Mr. Fisher pointed out that Section 4 did not, in his opinion, contain adequate due process provisions. He suggested a cross reference to the Unfair Trade Practices Act or additional safeguards.

## Section 5

Ms. Cobb spoke against the provision in the model providing for a private cause of action. She said ample remedies are currently available in the courts to protect policyholders and beneficiaries, and she was opposed to including a private cause of action. Mr. Cipinko agreed. He said he was concerned about the chilling affect of a private cause of action. He said if everything was required to fit the same mold such as a small tuna can, it would harm the entrepreneurial spirit evident in the small insurance companies. Reed Ashwill (National Association of Independent Life Brokerage Agencies—NAILBA) said that if someone did not understand an illustration and was unhappy with the results, he could hire a lawyer and make millions on this. He felt sorry for insurance agents who would also be sued under this provision. Ms. Griffin spoke in favor of the private cause of action. She said it provided consumers and regulators with an additional remedy.

## Section 6

No comments were received.

## Section 7

No comments were received.

Mr. Wright asked if there were any more general comments that anyone in the audience wished to make. Mr. Hunt said that he, as a funded consumer representative, wanted to extend the tuna can metaphor referred to earlier. He said consumers handle tuna shopping nicely because when the tuna comes in the same size can, they can compare price and quality. Mr. Hunt went on to say that at the earlier session of the working group he had made some remarks which may not have been perceived correctly. He expressed a concern about "cheating." He said this group is dealing with something much broader and outlined the segments of the problem as he saw it:

- 1) Cheating and tricks. He said no one at the NAIC was aware of the practices currently being used in the marketplace. He indicated that these practices should be addressed.
- 2) Optimistic assumptions. He said an example of this was mortality improvement. If a company was planning to use such assumptions, there needed to be rules setting parameters or this was open-ended.
- 3) Conservative estimates that were too optimistic. He gave the example of a company that used interest assumptions that were being currently paid but were not likely to be paid in the future.
- 4) How to make illustrations more understandable to consumers. To force everyone into the same format does require a model and he thought this was the area in which the working group was planning to work.

He said the purpose of his list was to clarify the remarks he had made earlier.

Hearing no further comments, Mr. Wright adjourned the open session and after a short break called the meeting to order in Executive Session. He said it was his plan to go over the comments to the model law section by section and the working group could decide what changes it wanted to make.

## Section 1

The working group reconsidered its earlier decision, made at the November meeting, not to include annuities under the model act. A decision was made to clarify the model act to include language so that only one act would be necessary to cover both life insurance and annuities. The regulation would be specific to life insurance, and if an additional charge was given to the working group later, an annuity regulation could be developed.

## Section 3

Next the working group discussed at length Mr. Coleman's suggestion to modify Section 3 to use broad authorizing language instead of the list of items to be addressed. Mr. Wright summarized the three approaches suggested by members of the working group:

- 1) Broad language such as suggested by Mr. Coleman;
- 2) The list contained in the November draft;

- 3) Use either the broad language or the itemized list and add a drafting note suggesting that states might feel more comfortable using the other approach.

After discussion, a decision was made to use the language suggested by Mr. Coleman in Section 3 and add as a drafting note the list of areas that might be more appropriate for use in some states and that should be addressed in the development of a regulation.

#### Section 4

Discussion of Section 4 focused on the sentence which gave the commissioner authority to require insurers illustrating benefits that were not supportable to pay benefits based on their illustrations. There was support from some members of the working group to significantly modify or delete this requirement because it would require commissioners to make a determination of which illustrations or practices would merit the payment of illustrated benefits. Mr. Wright pointed out that if commissioners were limited to the Unfair Trade Practices Act, they needed to show a pattern of behavior. Commissioner Robert Wilcox (Utah) said that if it was not a pattern, a mistake had been made, and he did not feel it appropriate to provide that type of penalty for a mistake. Mr. Higgins suggested adding the phrase "not supportable when presented." The working group agreed that the language should be retained at present with the addition of the language suggested by Mr. Higgins. It was also agreed that this question needed further study.

#### Section 5

Mr. Katz said that he was in agreement with Ms. Cobb's argument that the remedy provided under the private cause of action already existed. He said a provision creating a private cause of action was a major departure from NAIC policy. After extended discussion, the working group decided to take out the section creating a private cause of action.

Upon motion duly made and seconded, the working group voted to expose the draft with the amendments discussed (Attachment Three-A). Having no further business the Life Disclosure Working Group of the Life Insurance (A) Committee adjourned at 10 a.m.

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#### ATTACHMENT THREE-A

#### LIFE INSURANCE ILLUSTRATIONS MODEL ACT Draft: 12/07/93

##### Table of Contents

Section 1.	Applicability and Purpose
Section 2.	Prohibited Practices
Section 3.	Authority to Promulgate Regulations
Section 4.	Penalties
Section 5.	Separability
Section 6.	Effective Date

#### Section 1. Applicability and Purpose

This Act shall apply to all life insurance companies and fraternal benefit societies licensed to do business in this state and to all [producers, agents and brokers] licensed to sell life insurance or annuities. The purpose of the Act is to authorize standards which shall be followed in the illustration of life insurance products to facilitate consumer understanding of these illustrations.

Drafting Note: Insert the appropriate terminology consistent with state licensing laws.

Drafting Note: This section refers to both life insurance policies and annuity contracts. A separate regulation will be required for each.

#### Section 2. Prohibited Practices

No person engaged in the business of insurance shall misrepresent the benefits, advantages, conditions or terms of any life insurance policy or annuity contract through misleading or incomplete illustrations.

#### Section 3. Authority to Promulgate Regulations

The commissioner shall promulgate regulations that establish standards to assure that illustrations are not misleading or incomplete.

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

Drafting Note: Some states may feel it is more appropriate to have a specific list of items to use in developing standards. If so, they could add a provision such as: "These may include but are not limited to:

- A. Assumptions and methodologies;
- B. Definitions;
- C. Format;
- D. Prohibition or limitation of projections of policy values or benefits;
- E. Notification to policyowners of changes in assumptions from those provided when their policy was issued;
- F. Supportability of illustrations;
- G. Generic identification of the policy being illustrated; and
- H. Accountability of all parties to the transaction."

The drafters recognize that some of these items are mutually exclusive and will not all be included in a regulation. The purpose of their inclusion in this list is to provide a full range of options in the development of a regulation. Any regulation written pursuant to the authority contained in this act will address issues contained in A through H above at a minimum.

Drafting Note: In a state where the commissioner already has this authority, adoption of the model act may not be necessary in order to promulgate the model regulation.

#### Section 4. Penalties

A violation of this Act by any person shall be subject to the penalties found in section [insert penalty section of unfair trade practices law]. In addition to any other penalty, the commissioner may require insurers who illustrate benefits that are not supportable when presented to pay benefits based on the illustration most favorable to the policyowner or beneficiary.

#### Section 5. Separability

If any provision of this Act or the application thereof to any person or circumstance is for any reason held to be invalid, the remainder of the Act and the application of such provision to other persons or circumstances shall not be affected thereby.

#### Section 6. Effective Date

This Act shall be effective [insert date].

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ATTACHMENT THREE-B

Life Disclosure Working Group  
Kansas City, Missouri  
November 15-16, 1993

The Life Disclosure Working Group of the Life Insurance (A) Committee met at the offices of the NAIC in Kansas City, Mo., on Nov. 15 and 16, 1993. Members of the working group in attendance were Bob Wright (Va.), Chair; Don Koch (Ala.); Roger Strauss (Iowa); Lester Dunlap (La.); Noel Morgan (Ohio); and Tony Higgins (N.C.). Attending portions of the meeting by conference call were John Montgomery, Sheldon Summers and Harold Phillips (Calif.) and Fred Nepple (Wis.). Also in attendance was Carolyn Johnson (NAIC/SSO).

#### 1. Consider Model Act on Illustrations

Chair Bob Wright (Va.) said the first order of business would be to review the initial draft of a model act on illustrations, which would be designed as an enabling statute for a comprehensive regulation. This model would be exposed at the winter National Meeting in Honolulu. The draft was intended to be broad enough to allow the working group to go in any of the directions outlined in the white paper (see *NAIC Proceedings*, 1993 3rd Quarter, pp. 443-446) without closing off any of the alternatives.

Don Koch (Alaska) asked if the act would be part of the Unfair Trade Practices Act. Mr. Wright asked if there was a private cause of action in the Unfair Trade Practices Act. Carolyn Johnson (NAIC/SSO) responded that the Unfair Trade Practices Act specifically said it did not imply a private cause of action. Mr. Koch said he thought it would be appropriate to include a section in the model to provide for a private cause of action. He suggested either adding language to that effect or inserting a drafting note. The working group decided to add a section authorizing a private cause of action. This would address one of the problems noted in the white paper about insufficient penalties for violations. Mr. Koch suggested a provision such as currently being considered in the draft Title Agents Model Act being prepared by another working group. Tony Higgins (N.C.) asked if this provision would limit regulatory action in any way and the group agreed that it did not.

Mr. Wright asked the working group members if they thought the regulation should address annuity illustrations also. He had been asked this question by several regulators. It was the consensus of the working group to finish the charge it had been

given relative to life insurance illustrations and then decide whether to ask for a further charge regarding annuity illustrations.

The working group discussed the advisability of including definitions in the model act or the regulation. The working group decided it was more appropriate to include these in the regulation.

Discussion turned to development of a section defining the practices prohibited by this act. It was suggested that language could mirror the prohibition in the Unfair Trade Practices Act. The question was raised whether the illustrations violations were "practices" and the group agreed it would not be appropriate to require the regulator to establish practices. The language agreed upon was "define with specificity the acts and practices that would be defined as unfair." Lester Dunlap (La.) suggested adding language similar to the Unfair Trade Practices Act. Mr. Koch recommended the Alaska language giving the Director the authority to define the acts and practices as unfair and deceptive. It was agreed to add the language and make sure the penalty section made insurers subject to the Unfair Trade Practices Act penalties without having to find the violation a trade practice.

Next the working group considered the section giving authority to promulgate regulations. The intent of the working group was to make the section broad enough to cover any product developed later, but specific enough to allow development of necessary regulatory provisions. The working group considered whether it should eliminate some of the subsections from Section 3 that were mutually exclusive. Mr. Wright stated his opinion that it was good to have a wide range of alternatives so that if one did not work well, the regulators could choose another one. It was agreed to add a drafting note alerting regulators to the fact that some items were mutually exclusive, and they would not all be used.

## 2. Alternative Approaches in the White Paper

At this point regulators from California and Wisconsin joined the meeting by conference call and Mr. Wright requested that the group consider the four alternative approaches presented in the white paper. After lengthy discussion regarding these alternatives, the working group reached a consensus that there was strong support for Alternatives 2 and 3. These alternatives are: not permitting projections into the future; and requiring a uniform illustration or format design and uniform definition. It was agreed that Alternative 4, "develop a set of rules that provide clear disclosure" should be used in conjunction with Alternative 2 or 3. Alternative 1 from the white paper had the least support from members of the working group. Mr. Wright said that his bottom line goal was to have a proposal that consumers would understand without needing an agent to explain it.

At this point, Mr. Wright suggested that the technical resource advisors be asked to develop an illustration using Alternative 3 from the white paper. If the technical resource advisors could not develop a clear illustration using this alternative, then the working group would support Alternative 2. This was agreed to by the members of the working group.

The working group adjourned at 11:45 a.m. and reconvened at 1 p.m. for an open session. The working group was joined by interested parties.

## 3. Open Forum

Linda Lanam (Life of Virginia) asked how illustrations of new products would work if the working group chose the alternative that allowed only past performance to be illustrated. Mr. Wright said that if it was a new product there would be no illustration of past performance. Ms. Lanam suggested that would imply that there was a problem with the new product because it had no illustration. It was her experience that consumers wanted an illustration that would show how the product could perform. Past performance was not, in her opinion, a good focus for life insurance products. Judy Faucett (Cooper & Lybrand) said that there is a strong turnover of new products. She said that it would be fortunate if a company was able to illustrate a product for two or three years. If insurers could illustrate past performance of that type of product it would be better because some new products are just variations, however, some are really a different product.

Mr. Wright summarized the progress of the working group to this point. He said there would be a draft model act released for exposure at the Dec. 4 meeting of the working group and it was the goal of the working group to have a regulation for exposure in June. He said the act would be straightforward and broad. It would encompass all the alternatives in the white paper. Ed Jackson (Mitchell Law Firm) asked if there was a definition of illustration. Mr. Higgins responded that the group favored a broad definition such as "anything that purports to describe the policy and is used in the sales presentation." Mr. Jackson asked if this included every piece of information distributed and Mr. Wright responded that the working group was not considering advertising brochures etc. at this time. The working group was concentrating on ledger illustrations. He said the working group was interested in a cover sheet but wanted one somewhat different than that proposed by interested parties.

William Koenig (Northwestern Mutual) suggested that the parties all needed a common understanding of the terms used in their discussion. As an example he gave the term "past performance" and asked if this meant past performance of the company or of the product. He emphasized the need to define terms like past performance in a way commonly used by the industry.

Mr. Higgins brought up the topic of what the American Academy of Actuaries called "Type B usage" where consumers compared one policy with another based on the illustrations. Mr. Wright asked how this issue could be addressed. William Fisher (Massachusetts Mutual) said that it was his personal belief that any time there is a number, people will compare it with another one. He did not believe this should be the only use of illustrations, but he did not think it was inappropriate that there be some use in this manner. He spoke against using only guaranteed numbers. The result would be that life insurance would no longer be a competitive vehicle in the financial market place. Mr. Wright responded that he recognized this problem and

saw also the problem of illustrating extremely complex products. It was his personal view that it would require some significant changes in how products are illustrated. The working group's concern was how to bring about a change without damage to the market place.

Ms. Faucett emphasized the need for substantial education of buyers. Using standardized experience might just set consumers up for more disillusionment because they would rely to a greater extent on the illustration. She thought the focus should be on educating consumers to reduce their reliance on projections.

Tony Spano (American Council of Life Insurance—ACLI) said there were many different policies with different marketing methods, and that made it difficult to come up with a uniform way of presenting this material. If the working group recommendations tried to become too detailed or inflexible, he suggested that it would be impossible to comply. Mr. Higgins replied that companies had not always been good stewards of the flexibility they had in the past. Everyone must realize that there have to be some dramatic changes, otherwise there will be major damage to the industry as a whole. Mr. Spano replied that he was not advocating the status quo. William Albus (National Association of Life Underwriters—NALU) also agreed that a major problem is misunderstanding. Mr. Higgins agreed that there was a problem with lack of education of the agents. He said that the point-of-contact people needed to be educated, because many of them believed too extensively in computer inerrancy. Mr. Morgan added that he thought there was also misuse of computer illustrations as well as misunderstanding. Mr. Albus said that agents could not change the basic assumptions. If they did so it was fraud, but they did not always have information on the assumptions on which the illustrations were based.

The group next turned to consideration of the issue of sharing information with current policyholders when the assumptions used in the illustrations changed. Mr. Koenig said he favored this absolutely. Mr. Wright asked how this should be accomplished. Ms. Lanam said that companies probably all did it differently. In her company insureds got information saying they could ask for a new illustration. She said it would be incredibly expensive to send the illustration to everyone. Mr. Koenig said he would feel an obligation to give it to anyone who asked and Mr. Wright asked what percentage of the insureds asked. Ms. Lanam said perhaps 20% of the insureds of her company asked for a revised illustration. She said this was an increase from earlier, before they wrote on the annual statement to consumers that they had the option of requesting a revised illustration. Mr. Fisher said his company's agents have been urged to go to the client if there are significant changes, especially on vanishing premiums. Agents tell the policyholders that they can get a new illustration, but if their company sent out an unsolicited one and a half million illustrations, it would do nothing but create confusion.

Mr. Strauss asked what percentage of policies are sold without the use of an illustration at time of sale. Ms. Faucett said that upper middle and upscale policies probably were 99% sold with the use of illustrations. Mr. Strauss said that many of the complaints to his department had come from the middle class. Ms. Lanam said that the regulators should not ignore the fact that consumers take advantage of a situation. If they were now dissatisfied with the policy performance, they would look for someone to make them whole.

Mr. Wright said that he thought the issue of accountability was very important. He favored the approach of requiring all parties to the sale to agree that everything was explained. Mr. Wright said that companies say agents manipulate the figures and they cannot do anything about it. Agents say that they do not get information from the company to help them understand the assumptions.

Mr. Morgan asked if insurers could put any number in the non-guaranteed column. John States (State Farm) said that the NAIC's advertising rules prohibited this from happening. He pointed out that this was a recent addition to the model so not very many states have adopted it. Mr. Fisher said that many companies show the current interest rates being paid and something somewhat below that to demonstrate the sensitivity of the interest rate. Mr. Higgins asked those present how important they thought it was to show the interest rate being paid. He said he did not think it was a good idea because it could be misleading. Mr. Fisher said in universal life it was typical to show the interest rate but that other types of policies generally did not show that in their illustration. Mr. Strauss said that he thought it was more valuable to make a statement that the company must earn X% to pay the amount shown because consumers would know if that percentage rate was commonly available in the market place.

Mr. Morgan brought up the concept of "vanishing premium." He did not think it was appropriate to include the term unless there would be no premium due; for example, in a single pay or 20-pay policy. Otherwise he said premiums do not actually "vanish," they are just paid out of accrued money. He said many of the problems he heard came from a misunderstanding that premiums really do vanish. Mr. Spano said the premium was still due, but was paid out of dividends. Mr. Morgan clarified that the consumer could opt to pay the premiums out of the dividends and if this language was included in the illustration it would be much clearer. Diane Marchesi (Transamerica) said that instead of using the term "vanishing" her company said there would be no "out of pocket" premium. She thought this prevented a misunderstanding. Mr. Fisher endorsed that approach. He said that he agreed that it would be appropriate to show the premium all the way down with an asterisk that the consumer could choose to use paid-in amounts instead of paying that amount out-of-pocket.

Mr. Morgan asked what companies did to show surrender value. He asked if they used cash value or the net amount. Ms. Faucett said that most companies showed the net cash surrender value but she was aware that a few companies put the total surrender value and then used the footnote to explain that expenses would be subtracted. Mr. Higgins asked if the insurers had any problem with requiring the net surrender value to be shown. There was no response to his question.

Mr. Wright asked the agent and company community for assistance. He said if they felt a need for illustrations in the future, he hoped they would help the working group develop a clear understandable illustration. George Coleman (Prudential) said he thought the cover page was the key concept. He said it would provide clear illustration information in an understandable

fashion. He thought the illustration cover sheet designed by the technical resource advisors would go a long ways toward getting that job done. Mr. Wright said he did not think the flexibility that now exists would help achieve the goals of the working group. He said the working group would be open-minded to see what any of the technical resource advisors came up with to explain the complexity of the policy. Mr. Coleman asked what the regulators would like to see improved in an illustration cover sheet. Mr. Higgins said that the product presented just preserved the status quo and attached a cover sheet to it. Mr. Wright said the working group was looking for a new approach.

Mr. Coleman agreed that it would be possible to provide a revised cover sheet and suggestions for a simplified illustration format to the working group by the end of January. The working group will then schedule a meeting in February to discuss the proposal. Mr. Wright indicated that this was the opportunity for the interested parties to demonstrate that clear and understandable illustrations could be developed using future projections. He emphasized that if this could not be achieved and demonstrated to the working group by the end of January, the already strong support for only permitting the demonstration of past performance and elements that were guaranteed for future performance would be even stronger. Mr. Wright also indicated that the technical resource advisors should prepare illustrations that could be understood by the applicant, not requiring actuarial interpretation or explanation by an agent. Christine DelVaglio (Lautzenheiser & Associates) said that if regulators required simpler illustrations it might be easier to understand, but it would not really explain the policy. It would not give a clear picture of how the policy works. Mr. Koch suggested it was better to err on the side of understanding rather than overstatement. Ms. DelVaglio said that policies are used for different things, for example showing annuitization.

Ms. Faucett suggested that illustrations requirements and actuarial standards need to go together. She said the Illustrations Task Force of the Society of Actuaries was working with Harold Phillips in the California Department to develop definition standards. The Actuarial Standards Board is eager to work with the NAIC in developing standards, but did not want to go ahead without a clear understanding of what the regulators' requirements would be. Mr. Albus pointed out that the definitions needed to also include a "man on the street" definition, after the group had agreed on the definitions with the actuaries. Ms. Faucett said that Canada is addressing this problem also. Canada is not doing it through regulations but is setting standards for the illustrations, and if companies meet these standards they can put an informational mark on their page that says this is an approved illustration. Mr. Koch did not favor this approach because he said that it would imply that regulators had seen and approved the illustration.

The open session adjourned at 3:30 p.m.

#### 4. Model Law Draft

The working group reconvened in closed session on Nov. 16, 1993, at 9 a.m. The suggestions made at the meeting of Nov. 15 had been incorporated into the draft, so the working group reviewed the document. Mr. Phillips suggested adding fraternal benefits societies to the first sentence of Section 1 and the group agreed. The working group decided to revise Section 2 to refer to any "person engaged in the business of insurance" rather than referring to insurers and agents. Then discussion turned to coordinating the wording of Sections 2 and 3. The working group decided to revise the language of Section 3 to delete any reference to unfair and deceptive acts and practices.

Mr. Morgan asked who the standards would affect. The working group agreed that affect would have to be prospective, that it could not affect the policies already in effect.

The group considered whether the penalties in Section 4 should be combined with the private cause of action in Section 5. The working group decided they should remain separate. Mr. Nepple asked if intent was an element of the violation to use the remedies of Section 5, and the group agreed it was not. Mr. Nepple pointed out that consumers already could sue under a theory of intentional misrepresentation, but this alternative would not include intent. Mr. Wright agreed this was a viable approach.

The working group decided to review the draft again after the changes agreed upon today were made, and discuss it further in December in Honolulu. The next steps would be to review any product of the technical resource advisors, develop an outline for a regulation and consider the definitions. Mr. Morgan offered to develop an evaluation tool to use to review the suggestions by the interested parties for a revised cover sheet and illustration page.

Having no further business, the working group adjourned at 11:30 a.m.

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## ATTACHMENT FOUR

Government of the District of Columbia  
Department of Consumer and Regulatory Affairs  
Insurance Administration  
Post Office Box Number 37200  
Washington, DC 20013-7200

The Honorable David Lyons  
Commissioner of Insurance  
State of Iowa  
Lucas State Office Building  
Des Moines, Iowa 40319

Re: Synthetic Guaranteed Interest Contracts

Dear Commissioner Lyons:

This letter is with reference to the Life Insurance (A) Committee charge establishing a working group to determine and evaluate the regulatory issues presented by Synthetic Guaranteed Interest Contracts (SGIC). The charge was provided during the Sept. 21, 1993, committee meeting.

In responding to this charge, the working group expanded the primary effort to include the question of whether these contracts call for the insurer to provide a financial guarantee. We took this action in response to a letter submitted by the Life and Health Actuarial Task Force and a legal memorandum submitted by the Prudential Insurance Company. At this juncture, the working group has not obtained adequate information to resolve this important issue.

To properly address these issues, the working group has agreed to first accumulate sufficient background information concerning SGICs. We believe it is critically important to first achieve a base line understanding of these innovative products before we can properly evaluate these designs within the context of existing insurance laws. It is important to note that there are several different SGIC designs.

Toward this end, the working group has accumulated background information and descriptive documents which we encourage the committee members to read. As questions arise, members should bring them to our attention so they can be incorporated into our overall efforts.

After the working group has digested this information, we will outline a specific course of action to satisfy the charge placed by the A Committee. Our next primary step is to survey states to determine whether a SGIC would be considered an insurance contract and whether it is a financial guarantee. We will also ask states to determine their regulatory position on several SGIC designs. This process will provide sufficient information to determine if specific policy language requirements are appropriate.

As you will note from the Prudential legal memorandum, the author concludes that the sale of SGICs is not engaging in the business of insurance nor is it providing of a financial guaranty under New York insurance laws. However, this evaluation is limited to Prudential's product design and an analysis based on New York laws. The New York Insurance Department, however, has not reached any determination in support of this position. Absent such a determination, we do not have a balanced response to the questions raised or the conclusions reached in the Prudential memorandum.

The working group encourages the A Committee to request a charge from the Executive Committee to continue with its work during 1994.

The working group is available to respond to your questions.

Sincerely,  
Robert M. Willis, Commissioner of Insurance

*(Editor's Note: The background information, descriptive documents and Prudential legal memorandum are not published in the NAIC Proceedings.)*

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Synthetic Guaranteed Interest Contract  
Summary of Attachments

1. "A Flood of New GICs"

An article written by Laurie Goodman, Kelli Hustad Hueler and Kal P. Tourville and published in the April 1993 edition of *Best's Review*

2. "Continued GIC Sales Predicted in '90s"

An article extracted from the July 19, 1993, edition of the *National Underwriter* written by Larry H. Mylnechuk, Executive Director of the GIC Association

3. Product News Marketing

4. A Glossary of Terms

5. A survey of GIC products

Jointly conducted by the GIC Association and the Life Insurance Marketing and Research Association (LIMRA)

6. Five (5) monograph publications written by the GIC Association. They are as follows:

"Coping with the New Investment Options for Book Value Funds"

"Separate Account GIC Alternatives"

"Evaluating GIC Product Alternatives"

"Canadian Life Insurance Companies in the United States"

"Guaranteed Interest Contracts"

7. Miscellaneous documents

8. The Prudential Insurance Companies of America legal memorandum prepared by the law firm of Debevoise and Plimpton which concludes that Synthetic GICs are not insurance products.