

## LIFE INSURANCE (A) COMMITTEE

### Reference:

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Robert M. Willis, Chair—D.C.  
Dwight K. Bartlett III, Vice Chair—Md.

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### MINUTES

The Life Insurance (A) Committee met in the Bissonet Room of the New Orleans Marriott in New Orleans, La., at 2 p.m. on Dec. 6, 1994. A quorum was present and Robert M. Willis (D.C.) chaired the meeting. The following committee members or their representatives were present: Dwight K. Bartlett III, Vice Chair (Md.); James H. Dill (Ala.); Terri Vaughan (Iowa); Harold T. Duryee (Ohio); Kerry Barnett (Ore.); J. Robert Hunter (Texas); Steven T. Foster (Va.); and Deborah Senn (Wash.).

#### 1. Hear Report of Synthetic GIC Working Group

Reginald Berry (D.C.) gave the report of the Synthetic GIC Working Group (Attachment One). He said the first page of his report included a recommendation that the Life Insurance (A) Committee ask for a charge to draft a model law and regulation that grant life insurance companies the authority to utilize what are currently described as "synthetic guaranteed interest contract (GIC) products." He said his report contained several recommendations about what should be included in a model law. Commissioner Robert M. Willis (D.C.) asked about the estimated target date for completion of the model. Mr. Berry responded that the working group thought it could complete work by December 1995. Martin Carus (N.Y.) said that the New York position was aired at the June NAIC meeting and through the circular letter issued by the New York Insurance Department. He said the use of synthetic GIC products was objectionable from New York's prospective because it was in actuality financial guaranty insurance. He saw the possibility of conflict with the Financial Guaranty Insurance Model Act.

Ted Becker (Texas) said the Life and Health Actuarial Task Force already had a project related to synthetic GICs and asked if the recommendation in the working group's report is intended to be folded into that project and to move it to a number one priority. Mr. Berry said the original charge to the Life and Health Actuarial Task Force had not come from the A Committee, and this request was meant to clarify that.

Upon motion duly made and seconded, the report of the Synthetic GIC Working Group was adopted.

## 2. Hear Report of Genetic Testing Working Group

Kip May (Ohio) summarized the work of the group and explained progress on the charge given to it. He said it was a consensus among the working group members that the report they developed should show the impact on life insurance and on health insurance. Commissioner Robert Wilcox (Utah) said the Life Practice Council of the American Academy of Actuaries (AAA) had offered its assistance and suggested the working group make a formal request to them. Director Harold T. Duryee (Ohio) moved that the working group make a formal request to the AAA for assistance and this motion was adopted.

Commissioner Willis asked if the Academy had enough resources to handle all of the projects for which the NAIC is asking its assistance. Donna Claire (Claire Thinking) said the academy has more than 10,000 members and could bring in volunteers to assist on projects as needed.

Upon motion duly made and seconded, the working group report was received (Attachment Two).

## 3. Hear Report of Life Disclosure Working Group

Commissioner Wilcox reported that attached to the minutes of the working group is a preliminary draft of the Illustrations Used in Connection with the Sale of Life Insurance Model Regulation. In terms of future charges for the working group, he asked that, in addition to a charge for completing the life illustration model currently under development, the working group receive a broader charge to include variable life so that all types of life products would get similar attention. He said the working group also would like to have the authority, immediately after completion of that project, to start developing a regulation on annuity illustrations. Commissioner Willis asked if the working group would be seeking the assistance of the Actuarial Standards Board (ASB) on the annuity project also. Commissioner Wilcox responded that it was expected that the same group of individuals who are assisting in development of the actuarial practice standard for life insurance also would assist in expanding that standard to cover annuities. He reported that the ASB had been making excellent progress and is ready to provide a second draft of the standard to the working group.

Scott Cipinko (National Association of Life Companies—NALC) asked if there would be an opportunity for further discussion on variable life insurance. Commissioner Wilcox responded that the working group would meet in early January to further discuss the model regulation, and he expected additional discussions on the issue of variable life insurance. Commissioner Wilcox emphasized that one of the working group's goals is that the illustration rules should not drive the market. He said companies should not be encouraged to sell one product over another simply because it has less onerous illustration requirements. For this reason he said it was important to have consistent regulation of all the types of policies.

Upon motion duly made and seconded, the Life Disclosure Working Group report was received (Attachment Three).

## 4. Hear Report of Life and Health Actuarial (Technical) Task Force

John Montgomery (Calif.) said the report to the A Committee contained three recommendations and he asked the Life Insurance (A) Committee to act on each of them separately. Recommendation number one was to consider a revised draft of the Standard Nonforfeiture Law for Deferred Annuities with a recommendation to adopt it at the March 1995 National Meeting. Mr. Montgomery provided to the members of the Life Insurance (A) Committee a chart comparing the current Standard Nonforfeiture Law for Defined Annuities to the revised model (Attachment Four). Upon motion duly made and seconded, this recommendation was adopted by the A Committee.

Mr. Montgomery said the second recommendation of the task force was to adopt a proposed actuarial guideline GGG "Determining Minimum CARVM Reserves for Individual Annuity Contracts." Upon motion duly made and seconded, this recommendation was adopted by the Life Insurance (A) Committee.

The third recommendation from the Life and Health Actuarial (Technical) Task Force was to adopt a proposed new model entitled Valuation of Life Insurance Policies Model Regulation. Mr. Montgomery described the purpose of the model regulation. He said it included new tables for the valuation of reserves and it is important to adopt this to give relief to companies on premium deficiency reserves. Mr. Montgomery also explained that the regulation had begun with the title of Guideline XXX. He said he had received some comments from individuals who felt that there had not been sufficient time to review this model. Bill Schreiner (American Council of Life Insurance—ACLI) said this model is the culmination of a six-year process, and the ACLI supported its adoption. Commissioner Dwight Bartlett (Md.) added that this model had been discussed extensively at the actuarial task force meeting earlier that was well attended. Upon motion duly made and seconded, the Valuation of Life Insurance Policies Model Regulation was adopted by the Life Insurance (A) Committee with Washington dissenting.

Mr. Montgomery pointed out that the report of the actuarial task force report does not contain a recommendation regarding the Second Standard Nonforfeiture Law for Life Insurance because the task force had adopted a motion to reappoint a working group to further determine the direction that should be taken on this draft. He said the working group would decide by March how it should proceed. Commissioner Bartlett said that those newer to the task force felt that it had lost track of the purpose and the problems it had planned to address. The task force had decided to step back and redefine what it is trying to accomplish. He said after articulation of the principles, further drafting would take place. Commissioner Bartlett moved that the entire report of the Life and Health Actuarial Task Force to the Life Insurance (A) Committee be received and that motion was adopted.

Mr. Montgomery said there was an additional report from the Life and Health Actuarial (Technical) Task Force that was designed to go to the Life Insurance (A) Committee and to the Accident and Health Insurance (B) Committee. He said it contained two recommendations. The first recommendation is to dissolve the Life and Health Actuarial (Technical) Task Force and to create two new actuarial task forces. One of these would be devoted solely to life insurance issues and the other would be devoted solely to health insurance issues. He explained that some actuaries are more interested in one area or the other and this would allow them to more fully participate. Commissioner Bartlett added that the task force recently has been so busy with life issues that health issues had gotten short shrift. He said that in the past many departments did not have sufficient actuarial staff to support two groups but now there are enough regulatory actuaries to have two meaningful task forces. Director Duryee emphasized that what the Life Insurance (A) Committee would do would be making a recommendation to the officers for their consideration.

Mr. Montgomery said that, in addition, the Life and Health Actuarial (Technical) Task Force had attached a draft of proposed changes to the Actuarial Opinion and Memorandum Regulation for comments. Upon motion duly made and seconded, the joint report of the Life and Health Actuarial (Technical) Task Force was adopted.

Having no further business, the Life Insurance (A) Committee adjourned at 3 p.m.

Robert M. Willis, Chair, D.C.; Dwight K. Bartlett III, Vice Chair, Md.; James H. Dill, Ala.; Terri Vaughan, Iowa; Harold T. Duryee, Ohio; Kerry Barnett, Ore.; J. Robert Hunter, Texas; Steven T. Foster, Va.; Deborah Senn, Wash.

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#### ATTACHMENT ONE

##### Report of the Synthetic GIC Working Group of the Life Insurance (A) Committee

##### Introduction

The working group has completed what it believes is the necessary information gathering phase associated with exploring the legal and regulatory issues arising from the sale of synthetic guaranteed interest contracts (GICs). We now believe that it is appropriate for the NAIC to promulgate and adopt a model law and regulations which regulates synthetic GIC products.

### Recommendation

The working group makes the following recommendation to the Life Insurance (A) Committee:

The working group recommends that a model law and regulations be developed which grant life insurance companies the authority to sell what are currently described as synthetic GIC products.

The working group further recommends that the Life and Health Actuarial Task Force be given the charge to examine the risks associated with the sale of synthetic GIC products and to provide suggestions to this working group of how best to incorporate the regulation of those risks into the proposed model law.

### Discussion

#### History:

In December 1993, the NAIC Life Insurance (A) Committee established a working group to study synthetic GIC products. The working group's charge was to explore the legal and regulatory issues arising from the sale of synthetic GICs. The members of the working group are Illinois, New York and the District of Columbia.

In February 1993, the working group held an all-day meeting at the NAIC office in Washington, D.C. The District of Columbia and New York attended this meeting. In addition, life insurance industry representatives attended as well as a pension plan manager. The meeting's purpose was as follows:

1. To understand the synthetic GIC product designs;
2. To understand the need for this product in the pension market;
3. To discuss the strategic direction the life insurance industry was intending to pursue and why; and,
4. To have an open dialogue concerning the extent these products should be regulated and why.

During the February meeting, the working group determined that many state insurance commissioners and staffs were not familiar with synthetic GIC products. It was decided that it would be worthwhile to conduct a public seminar on the subject at the upcoming June NAIC meeting in Baltimore. Our short-term goal was to provide an opportunity to:

1. Obtain general understanding of these products;
2. The pension market targeted; and
3. Surface some of the foreseeable regulatory issued and exposures.

Based on feedback received from regulators, the June 1994 seminar met these important objectives. With several industry representatives and regulators serving as panelists, the seminar sensitized regulators to the issues surrounding synthetic GICs. In the working group's June 1994 report to the Life Insurance (A) Committee, we noted that more work was necessary, in an educational context, before the working group would be ready to recommend a model law to regulate synthetic GIC products.

Nonetheless, an interesting dynamic developed at the June 1994 meeting. Two of the three members of the working group (the District of Columbia and Illinois) clearly stated a belief that synthetic GIC products could be sold by life insurance companies within the structure of a model law addressing regulatory concerns for consumer protection and solvency, measurable criteria to determine foreseeable general account exposure and appropriate financial information reporting mechanisms.

Although the District of Columbia and Illinois supported this approach to regulation, as you know, the New York Insurance Department has opined that under its laws, synthetic GICs are "Financial Guarantees" which cannot be sold by life insurance companies within the state of New York. The working group fully respects the unique features of New York laws and understands how this position was reached. However, the working group's charge is to explore the legal and regulatory issues for the NAIC membership, and then advise the Life Insurance (A) Committee of our findings and recommendations. This effort is and remains our primary goal.

At the NAIC's September 1994 meeting in Minneapolis, the working group reported to the Life (A) Committee that it will present to the committee a white paper at the December 1994 meeting discussing the suggested regulatory approach for synthetic GIC products. Given developments that have arisen after the Baltimore meeting, the working group has elected to postpone the drafting of its paper.

Our goal is to work with industry representatives to develop the overall structure for what should be included in a Synthetic GIC Model Law. The goal, if so charged, would be to develop a model law for NAIC adoption in 1995.

#### Current NAIC Activity:

For insurance regulators, the reality is that synthetic GIC products are being sold by life insurance companies. In anticipation of some yet to be determined regulatory structure, the NAIC has already started several regulatory initiatives. It is our understanding that these initiatives did not start as a result of a charge made by the Life Insurance (A) Committee.

The Life and Health Actuarial Task Force and the Blanks Task Force have established specific synthetic GIC working groups.

The Life and Health Actuarial Task Force is looking into the potential reserve requirements for these products, with a view toward the attendant risk-based capital implications. The Blanks Synthetic GIC Working Group has started the design of new informational lines in the life annual statement where synthetic GIC products will be reported. Clearly, the work of these two groups will play an important role in developing a model law and will require careful coordination with the Synthetic GIC Working Group's model law recommendations to the Life Insurance (A) Committee.

#### Effective Regulation of Synthetic GIC Products:

During the information gathering phase, several ideas surfaced concurring the effective regulation of synthetic GIC products. While other ideas may surface, the working group has cautiously focused on four primary areas of concern that must be addressed by any model law to adequately protect consumers and maintain insurer financial solvency. They are as follows:

1. The model law should address and allow for the differences in synthetic GIC product structures;
2. The model law should quantify definitive risk based measurement criteria to ensure conservative reserve levels are established and maintained to adequately reflect the risk assumed by the differing stable value product structures;
3. The model law should take into account the asset holding and/or asset management characteristics of stable value product structures; and
4. The model law should establish parameters for the disclosure of the potential financial risks to plan beneficiaries.

Before briefly discussing each of these model law recommendations, the working group herein shares its views on the role of state insurance regulation, as applied to synthetic GIC products. The views that are shared are a majority view. The state of New York holds a minority view which is clearly contrary to the majority view. Regulators must accept the fact that as demand in the retirement funding market increases, new product designs like synthetic GIC products are inevitable and will require an appropriate regulatory framework as opposed to blanket prohibition.

Given this expectation, very different and creative retirement plan funding vehicles are going to be sold by insurance companies as well as banks and other financial institutions. We believe insurance regulators must at least be sensitive to the impact this emerging market could have on the profit status of life insurers and recognize the importance of allowing insurers the opportunity to compete for a reasonable share of this market. Provided, however, that the four issues we have raised are adequately addressed.

The working group believes that insurance regulation for the singular purpose of protecting against insolvency should not be the exclusive goal for the model law that regulates synthetic GIC products. Effective regulation should encourage and allow for healthy competition while at the same time protect against any foreseeable financial insolvency.

Let's now look at some ways these objectives can be accomplished in relation to a proposed model law.

The first suggestion is that the model law should address and allow for the differences in synthetic GIC product structure.

We believe that a model law should recognize that the concept of synthetic GICs is generic. Within this concept are different product types ranging from annuity contracts to contracts that provide management services while selling insurance products ancillary to providing investment advice. The model law should be designed so that it is flexible enough to accommodate new and emerging nontraditional stable value products.

Clearly because of investment features, some of these new products also will be regulated by the Securities and Exchange Commission and other governmental entities. However, we also must remember that insurance companies now sell variable contracts which contain an insurance and investment component which also are regulated by different governmental entities. We believe that it is fair to say that regulation in this manner has been effective in meeting a wide range of consumer and regulatory concerns.

The second suggestion is that the model law should quantify definitive risk based measurement criteria to ensure that conservative reserve levels are established and maintained to adequately reflect the risk assumed by the differing stable value product.

The working group has a divergence of view. The issue raised is whether this issue should be addressed in this or a separate model law. Given this divergence, the working group fully believes that this issue will be resolved during the drafting phase.

As you know, the NAIC has adopted the Risk-Based Capital Standards for life insurers to protect consumers from potential insurance company insolvencies. Within this overall approach, "risk" has been divided into four areas. They are the C-1 Asset Risk; C-2 Liability Risk; C-3 Disintermediation Risk; and C-4 General Business Risk. In the application of these RBC Standards, companies that sell synthetic GICs should be required to comply with these risk-based capital requirements in the same manner as insurance companies that do not sell these types of products.

Let's briefly look at how the model law should look at these different risks. Credit quality duration and prepayment options affect a company's C-1 (Asset Risk). The participant's rights to withdraw funds at book value effects the C-2 (Liability Risk). Product pricing based on an experience rating and the requirement for the liquidity of investments, both have a direct impact on a company's C-3 (Disintermediation Risk). Consideration of the C-4 (General Business Risk) might be impractical to even attempt for inclusion in the model law.

The third suggestion is that the model law should take into account the asset holding and/or asset management characteristics of synthetic GIC product structures. The working group believes that this issue is going to require careful analysis.

The model law should recognize that since synthetic GICs are not owned by the insurance company, the different configurations are allowed to hold plan assets under a custody arrangement or to be specifically identified. The regulatory issues arising from either structure should be addressed and resolved separately.

The fourth suggestion is that the model law should establish parameters for the disclosure of the potential financial risk to plan beneficiaries.

Regulators should seek to strike a balance in this area by recognizing that a significant amount of synthetic GIC products will be sold to sophisticated corporate purchasers. Clearly, these products will not be the type sold door to door, but to pension plan managers who have a greater degree of expertise than the general public. However, recognizing that expertise does vary across pension plan managers, the foreseeable financial risk should be a required disclosure to plan participants. This requirement would serve to force a quantification of the risk by the insurer and the plan manager and provide the plan participant information to more clearly assess the risk on an annual basis. This would be a fair system since the synthetic GIC product structure recognizes that some level of financial losses may be absorbed by the fund (and, therefore, the plan participant) before an insurance company's general account exposure is triggered.

The fifth suggestion is that the model law should address how an insolvency would affect synthetic GICs in terms of the priority of claims.

If this event arises specifically, should purchasers be covered by state life and health or property/casualty guaranty associations? If synthetic GICs are sold as separate account products, should the purchasers be treated as any other annuity contract owner or should they be treated as general creditors? In the context of a defined contribution plan supported by a synthetic GIC arrangement, is the "purchaser" the plan or the plan participant?

#### Conclusion

As you can see, the NAIC and the Synthetic GIC Working Group have a substantial amount of work to do in structuring a Synthetic GIC Model Law. At this point, it is still questionable whether and under what regulatory format state insurance regulators will accept the idea that synthetic GIC products may be sold by life insurance companies. While the District of Columbia and the state of Illinois support the concept, there still remains a lot of convincing. However, the working group is confident that all regulatory issues will be adequately addressed through a well-conceived model law covering the points outlined today. Even though there exists a divergence of views amongst regulators, the working group strongly believes that it is essential for the NAIC to develop a model law which regulates synthetic GIC products.

If the Life Insurance (A) Committee charges this working group, as recommended, we will continue our effort to educate regulators in addition to commencing with the drafting of a model law. Given the uniqueness of the product, when compared to other products sold by life insurance companies, the working group believes that is extremely important for regulators to be kept abreast of the changes that are taking place. The issues of whether synthetic GICs are financial guarantees and whether states are pre-exempted by ERISA from regulation are issues which we expect to be resolved within the upcoming year.

A majority of the working group believes that the NAIC must continue with its efforts to draft a model law. Therefore, the working group strongly urges the Life Insurance Committee to provide the necessary charge so that it can continue its work.

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#### ATTACHMENT TWO

Genetic Testing Working Group of the  
Life Insurance (A) Committee  
New Orleans, Louisiana  
December 5, 1994

The Genetic Testing Working Group of the Life Insurance (A) Committee met in Balcony I of the New Orleans Marriott in New Orleans, La., at 4 p.m. on Dec. 5, 1994. Kip May (Ohio) chaired the meeting. The following working group members or their representatives were present: Don Koch (Alaska); and Mary Alice Bjork (Ore.).

Kip May (Ohio) said it had been necessary to cancel the interim conference call but the working group hoped to have a document to review at the March 1995 meeting. He went over the original charge from the Life Insurance (A) Committee and reviewed the progress of the working group. He said Carolyn Johnson (NAIC/SSO) had conducted a survey of state laws on genetic testing in life and health insurance on behalf of the working group. A public hearing had been conducted at the fall 1994 National Meeting in Minneapolis to receive comments from interested parties. The remaining portion of the charge is to make a recommendation to the Life Insurance (A) Committee regarding the future direction of the group. He suggested a time table for the working group. He asked those who had submitted information to the working group to summarize the information more briefly and send a copy to Ms. Johnson to distribute to the members of the working group by Jan. 6, 1995. He asked Ms. Johnson to schedule a conference call for the working group approximately two weeks after that. At that point the working group would prepare a report which would be discussed point by point at the spring National Meeting in Miami.

After the spring meeting Mr. May said it might be necessary to have an interim meeting or a conference call to make amendments to the report so that it could be presented to the A Committee at the summer National Meeting.

Roberta Meyer (American Council of Life Insurance—ACLI) asked if the draft would be available for review before the meeting in Miami in March. Mr. May said the working group would do its best to make the material available in time for review before the spring National Meeting. Ms. Johnson asked those who were interested in receiving a copy of the report draft to provide their names and addresses to her. Philip Bereano (Washington Biotechnology Action Council) suggested it might be helpful to the members of the working group if the information provided to them began with a general discussion, and then discussed issues specific to life or to health. Members of the working group agreed that would be helpful.

Having no further business, the Genetic Testing Working Group adjourned at 4:30 p.m.

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### ATTACHMENT THREE

#### Life Disclosure Working Group of the Life Insurance (A) Committee New Orleans, Louisiana December 3, 1994

The Life Disclosure Working Group of the Life Insurance (A) Committee met in Balcony J of the New Orleans Marriott in New Orleans, La., at 3 p.m. on Dec. 3, 1994. Robert E. Wilcox (Utah) chaired the meeting. The following working group members or their representatives were present: Tom Foley, Vice Chair (Fla.); Don Koch (Alaska); John Montgomery (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Tony Higgins (N.C.); Noel Morgan (Ohio); Ted Becker (Texas); Van Tompkins (Va.); and Fred Nepple (Wis.).

#### 1. Adopt Minutes of Oct. 26, 1994, Meeting and Nov. 22, 1994, Conference Call

Upon motion duly made and seconded, the minutes of the Oct. 26, 1994 meeting (Attachment Three-E) and the Nov. 22, 1994 conference call (Attachment Three-D) were adopted.

#### 2. Review Draft of Model Illustrations Regulation Allowing Projection of Non-Guaranteed Elements

Commissioner Robert E. Wilcox (Utah) asked the group to turn its attention first to the applicability and scope section of the Model Illustration Regulation (Attachment Three-A). He said he believed the draft did not say exactly what the group intended and suggested several changes (Attachment Three-B). He said the intent of the working group was that an insurer should designate whether a particular policy form would be sold with an illustration. If the company designated a form as not using an illustration, then the company would be prohibited from the use of any illustration for that form. Roger Strauss (Iowa) asked if the insurer would make this designation at the time it filed the policy form. Tom Foley (Fla.) said that this would be clearer than having the regulators decide which policies did not get illustrations. Tony Higgins (N.C.) clarified that this also meant no supplemental illustrations would be allowed. Scott Cipinko (National Alliance of Life Companies—NALC) said it was his understanding that there would not be a requirement to use an illustration. He asked if companies that had designated a policy form would be required to use illustrations at every sale. Commissioner Wilcox said this would be true, although the illustration could be presented at the time of delivery. Mr. Cipinko asked if the illustration would be part of the policy. Mr. Foley responded that it would not be part of the policy but copies of the illustration would be maintained as part of the file. Ted Becker (Texas) asked if someone requested an illustration, and the company had designated that policy form as not being illustrated, would it be appropriate to say that the company does not provide illustrations? The answer was in the affirmative. George Coleman (Prudential) said that after the company has designated a form as not using an illustration, the insurers still needed a clearer idea of what they could use that did not meet the definition of an illustration. Commissioner Wilcox responded that any information provided that showed something other than guarantees would be considered an illustration.

Mr. Higgins asked about the exclusion in Subsection B for life insurance policies sold in connection with plans subject to the Employee Retirement Income Security Act of 1974 (ERISA). He asked if this exclusion meant that there were no restrictions on products sold in the ERISA market. Mr. Foley said it meant they were not covered by this regulation and Mr. Higgins responded that this concerned him. Commissioner Wilcox asked if it would create a problem if this exclusion was not in the model. Mr. Coleman responded that the technical resource advisors would bring an answer to that question, and he asked that this section not be struck at the present time.

Discussion next turned to Section 11, Notice to Policyholders. Commissioner Wilcox pointed out that Subsection A required an updated report each year without describing how this report should look. He said it was not clear from the language in the draft whether this report would be required to show whether the assumptions had changed. He asked the working group members for their thoughts. Mr. Strauss said that he preferred that the insured should always get a summary similar to that at the beginning of the illustration which had been provided by Michelle VanLeer (John Hancock) at the fall National Meeting. He described this summary as numbers projected into the future from several years using the then current assumptions. He said this might trigger a request for more information. John Montgomery (Calif.) pointed out that it was important for the insured to at least know when the funds would run out and the policy would lapse for an indeterminate premium fund-based plan. Mr. Higgins added that it was also important to provide a specific statement to that effect if assumptions had changed. Commissioner J. Robert Hunter (Texas) said that, from a consumer perspective, it was important to know if the assumptions into the future were less than had been originally illustrated. He suggested sending a smaller version of the original

illustration every year. He said that would be less alarming to the consumer than if one was only received at a down turn. Gary Corbett (Actuarial Standards Board—ASB) suggested that if changes had been initiated by the policyholder instead of initiated by the company, then it should not be the company's responsibility to provide a new illustration. Commissioner Wilcox pointed out that according to the current draft it is the company's responsibility to give a new illustration each year, but it is not the company's obligation to compare that illustration with the prior one. Commissioner Wilcox said this brought up another problem: if the company had originally provided a supplemental illustration, such as a vanishing premium illustration, is there an obligation to provide a new vanishing premium illustration or simply a new basic illustration? Mr. Corbett pointed out that the policyholder could request the supplemental illustration. Commissioner Wilcox also noted that it might require agent intervention to know the original goals of the insured and how they might have been affected.

Commissioner Wilcox summarized the three possible levels that could be required in the draft: (1) A status report of the current results; (2) a brief form of the basic illustration; or (3) a special illustration corresponding to any supplemental illustrations used. Upon motion duly made and seconded the working group voted to include a requirement that on an annual basis the insured get an updated status report and a brief illustration based on the current scale. Included with this illustration should be specific notice of any change which had occurred in the assumptions used since the last illustration. Mary Griffin (Consumers Union) asked that the regulators also make very clear to the insureds that they would be able to get more information. Commissioner Wilcox agreed this was a good point and asked Ms. Griffin if she would put together specific language that could be used to alert insureds.

Ms. Griffin asked also that the regulators research the industry's ability to provide the information required by the last motion. Mr. Cipinko said that many smaller companies were not able to provide this kind of information. Judy Faucett (Coopers and Lybrand) said that based on the Society of Actuaries' limited research, indications were that some good-sized companies are not fully automated and would have difficulty in providing this type of information. Commissioner Wilcox pointed out that the current life cycle of a computer system is about five years so at any given point a company is, on average, about two and one-half years from its next system. He said before any state would have implemented the requirement of the draft now being prepared, it would be 1996. After implementation of the model, the first anniversary would actually be two and one-half years from the current time, so companies would have ample opportunity to reprogram their systems, and it would not be a large burden for very many companies. Richard Ostuw (Metropolitan Life) said that to the extent that the regulation raised companies' costs, these would be passed on to the consumers and he asked the regulators to balance the costs with the benefits to the public. Linda Lanam (Life of Virginia) said that a great many companies already provide some form of disclosure to consumers, and asked the working group to recognize that it was not helpful for consumers to get too much paper. Mr. Montgomery asked if the working group had ever taken a survey of the type of materials companies now provide, and Mr. Foley asked the companies to provide that type of information. Jim Van Elsen (Allied Life) said he believed that most companies could comply with reasonable requirements if given enough lead time.

### 3. Hear Report from the Actuarial Standards Board

Mr. Irish said the second draft of the actuarial standard had been completed and he said he would provide a copy to Carolyn Johnson (NAIC/SSO) for distribution to the working group. Commissioner Wilcox asked if there were any areas in which the board was having difficulty. Mr. Irish said the standard defined that every illustration must be self supporting and this was defined by policy form, not age. He said this was a relatively liberal standard that might need to be tightened up. He said another area of difficulty had been lapse supported pricing and he said this was being tested under alternate lapse assumptions. He said the group was defining disciplined current scale and he said they were having difficulty in deciding between portfolio rates and generation rates. He said the actuaries were not happy with allowing that choice, but he saw no reasonable alternatives. He said another area of difficulty was in trends and pointed out that some companies will be basing their illustrations on experience from several years ago so they are looking at trending to the date of issue. Another area he said was difficult was expense assumptions; for example, when a company can show savings from a reduction in their employee force. Mr. Foley asked when the ASB would be exposing its draft to all actuaries for comment, and Mr. Irish responded that the board hoped to do this in April.

### 4. Any Other Matters Brought Before the Working Group

Jim Hunt (actuarial consultant) said he had come prepared to consider the list of topics to be addressed by the Life Disclosure Working Group in a memo that Ms. Johnson had prepared (Attachment Three-C). Commissioner Wilcox said that in a two-hour meeting there had not been time to address very many of those points and said that there would be an interim meeting of the working group in Kansas City after the first of the year to consider those points. He asked that written responses from interested parties be sent to Ms. Johnson before the end of the year.

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

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## ATTACHMENT THREE-A

**ILLUSTRATIONS USED IN CONNECTION WITH THE  
SALE OF LIFE INSURANCE MODEL REGULATION**  
Draft: 12/3/94

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**Section 1. Purpose**

The purpose of this regulation is to provide rules for life insurance policy illustrations which will protect consumers and foster consumer education. The rules provide illustration formats, prescribe standards to be followed when illustrations are used, and require disclosures to be used in connection with illustrations. The goal is that illustrations accurately describe policies and, to the extent possible, be understandable by purchasers of life insurance without assistance from an insurance agent.

**Section 2. Authority**

This regulation is issued based upon the authority granted the commissioner under [cite enabling legislation].

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

**Section 3. Applicability and Scope**

A. This regulation applies to all group and individual life insurance policies and certificates, including variable life insurance insofar as these provisions are not inconsistent with securities laws and regulations, including rules, regulations or guidelines promulgated by the National Association of Securities Dealers (NASD). With respect to variable policies, investment performance shall be illustrated in accordance with NASD rules relating to the rate of return on underlying investment portfolios, but mortality and expense elements on a guaranteed or disciplined current scale basis shall be illustrated in accordance with the provisions of this regulation.

Drafting Note: The above applicability and scope section seeks to harmonize this regulation with existing NASD regulation of variable policy illustrations. Variable life policies are different from fixed policies because generally they provide no guaranteed cash values. Under a variable policy, cash values vary based on the investment performance of the underlying investment portfolio of a separate account, whereas under a fixed policy, the investment performance is dependent on crediting or dividend rates established by the insurer subject to a guaranteed minimum. Because of this inherent difference between variable and fixed policies, certain provisions of this regulation do not apply to variable policies, especially those provisions relating to guaranteed cash values (when the policy provides no guarantees), and those elements of disciplined current scale relating to investment performance.

B. This regulation shall not apply to the illustration of individual and group annuity contracts, [life insurance policies issued in connection with pension and welfare plans as defined by and which are subject to the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. Section 1001 *et seq.* as amended], or credit life insurance.

Note: The bracketed material is being considered for deletion.

C. This regulation shall not be construed to impose limitations upon the ability of insurers or agents to make available supplemental or concept illustrations and information in addition to a basic illustration provided in accordance with this regulation. Any additional information provided shall be consistent with the requirements of this regulation.

**Section 4. Definitions**

For the purposes of this regulation:

A. "Actuarial Standards Board" means the board established by the American Academy of Actuaries to develop and promulgate standards of actuarial practice.

B. "Contract premium" means the amount of premium that is required to be paid under a fixed premium policy in order for guaranteed benefits to be paid as illustrated.

C. "Disciplined current scale" means a scale of non-guaranteed elements currently being illustrated by an insurer that is logically and reasonably based on actual recent historical experience as defined in standards established by the Actuarial Standards Board and certified by an illustration actuary designated by the insurer. Standards shall include, but not be limited to, a requirement that illustrations of policies be self-supporting and that non-guaranteed elements illustrated not be more favorable than the more conservative of the elements reflected in the insurer's currently paid or credited scale or that are reflected in the most recently available experience on the policy block. A disciplined current scale may reflect actions that have already been taken or events that have already occurred but shall not include any projected trends of improvements in experience or any assumed improvements in experience based on events that have not yet occurred or actions that have not yet been taken.

D. "Generic name" means a short title descriptive of the premium and benefit patterns of a policy.

E. "Guaranteed" and "Non-guaranteed Elements"

(1) "Guaranteed elements" means the premiums, benefits, credits or charges under a policy of life insurance that are guaranteed and determined at issue.

(2) "Non-guaranteed elements" means the premiums, benefits, credits or charges under a policy of life insurance that are not guaranteed at issue, including, but not limited to, dividends, credited interest rates, cost of insurance charges and expense charges.

Drafting Note: The definition of illustration is rather broad and, therefore, may inadvertently bring within its purview items that are not intended to be affected. For instance, a solicitation letter, which is clearly only an invitation to a prospective client to inquire further, should only be regulated under applicable advertising regulations and laws. This regulation is not intended to require the inclusion of a ledger-type illustration with solicitation letters or to impose its format and minimum standards on information provided in addition to an illustration.

F. "Illustration"

(1) "Basic illustration" means a ledger or proposal used in the sale of life insurance, the primary purpose of which is to show in tabular form both guaranteed and non-guaranteed policy elements, including premiums, death benefits and values available upon surrender which meets the requirements of this rule applicable to basic illustrations.

(2) "Supplemental illustration" or "concept illustration" means an illustration furnished in addition to a basic illustration that meets the requirements of this rule, that may be presented in a format differing from the basic illustration, but may not depict any scale of non-guaranteed elements that is not permitted in a basic illustration.

G. "Illustration actuary" means a member in good standing of the American Academy of Actuaries or any other individual acceptable to the commissioner who certifies an understanding of and agrees to be bound by the standards of practice relating to illustrations based on disciplined current scale promulgated by the Actuarial Standards Board.

H. "Lapse-supported pricing" means....

Drafting Note: The current working group position is to require the policy to be profitable at zero lapses. This concept will be discussed in more depth by the Actuarial Standards Board. This definition and the definitions of "persistency bonuses" and "self-supporting illustrations" depend on the results of those discussions.

I. "Persistency bonuses" means....

J. "Premium outlay" means the amount of premium assumed to be paid by the premium payer in order for the benefits, guaranteed or not guaranteed, to be paid as illustrated. In the case of a policy which does not require a fixed premium to be paid, the illustrated benefits, guaranteed and not guaranteed, are based on the indicated premium outlay.

K. "Self-supporting illustration" means....

## Section 5. Policies to Be Illustrated

Each insurer marketing policies to which this regulation is applicable shall identify for each policy form whether or not that policy form is to be marketed with an illustration.

A. Policy forms marketed without an illustration.

If the insurer identifies a policy form as one to be marketed without an illustration, any use of an illustration is prohibited.

**B. Policy forms marketed with an illustration.**

If the insurer identifies a policy form as one to be marketed with an illustration, a basic illustration prepared in accordance with Section 6 and Section 7 of this regulation must be provided.

**Section 6. Basic Illustration Format**

Each basic illustration shall begin with at least the following information:

**A. Basic Information**

- (1) Name of insurer;
- (2) Name and business address of producer or insurer's authorized representative, if any;
- (3) Name, age and sex of proposed insured;
- (4) Underwriting or rating classification upon which the illustration is based;
- (5) Generic name of policy, company product name, if different, and form number;
- (6) The guaranteed death benefits;
- (7) Dividend option election or application of non-guaranteed elements, if applicable;
- (8) A brief description of the policy being illustrated, including a statement that it is a life insurance policy;
- (9) A brief description of the premium outlay or contract premium, if applicable, required by the policy. For a policy which does not require a specific premium payment, a statement as to what premium outlay must be paid to guarantee coverage for the term of the contract, subject to maximum premiums allowable to qualify as life insurance under the applicable provisions of the Internal Revenue Code;
- (10) A brief description of any policy features or options, guaranteed or not guaranteed, shown in the basic illustration and the impact they may have on the benefits and values of the policy.

**B. Numeric Summary**

If the basic illustration shows any non-guaranteed benefits and values based on the insurer's disciplined current scale, the illustration shall also show the death benefits, values and the premium outlay and contract premium, if applicable, on which they are based for policy years five (5), ten (10) and twenty (20) and at age 65 on the following three bases:

- (1) Policy guarantees;
- (2) Insurer's disciplined current scale;
- (3) Insurer's disciplined current scale but with the non-guaranteed elements reduced as follows:
  - (a) Dividends must be shown at fifty percent (50%) of the dividends contained in the disciplined current scale;
  - (b) Non-guaranteed interest crediting rates must be shown at rates that are the average of the guaranteed rates and the rates contained in the disciplined current scale; and
  - (c) All non-guaranteed charges, including but not limited to cost of insurance charges, term insurance rates, and mortality and expense charges, must be shown at rates that are the average of the guaranteed rates and the rates contained in the disciplined current scale.
- (4) In addition, if coverage would cease prior to policy maturity or age 100, the year in which coverage ceases shall be identified for each of the three (3) bases.

**Drafting Note:** The susceptibility of non-guaranteed benefits and values to changes in the underlying assumptions can be demonstrated in various ways. The approach suggested here involves reducing the non-guaranteed elements to a midpoint. Alternative approaches the working group may consider are (i) reducing the interest factor by a specific amount, e.g., two percentage points, (ii) reducing it by an amount that varies depending on the level of the current interest rate, i.e., by a larger amount if interest rates are high and by a smaller amount if interest rates are low, or (iii) using an interest rate that is the average between the guaranteed rate and the disciplined current scale rate.

**C. Statements**

- (1) A statement shall be signed and dated by the applicant not later than the time of policy delivery reading as follows: "I have received a copy of this illustration and understand that any non-guaranteed elements illustrated are

subject to change. No representations have been made to me to the contrary." If the illustration is produced by the insurer and mailed to the applicant no signature shall be required.

**Drafting Note:** In certain group situations, as well as individual policy sales made to employers, signatures should not be required from the insureds. The signature of the owner (the employer or corporation) is sufficient. This may need further clarification in this subsection.

(2) A statement shall be signed and dated by the insurance producer or other authorized representative of the insurer at the time of policy application as follows: "I certify that this illustration has been presented to the applicant and that I have explained that any non-guaranteed elements illustrated are subject to change. I have made no representations that are inconsistent with the illustration." If the illustration is produced by the insurer and mailed to the applicant no signature shall be required.

**Drafting Note:** The information required to be shown may necessitate that the cover page actually consist of more than one page. In that event, pages should be numbered accordingly. In addition it may be preferable to permit companies the flexibility to incorporate certain of the information into the body of the illustration rather than requiring it on the cover page. This option should be considered.

#### Section 7. Standards for Basic Illustrations

A. All basic illustrations used in connection with the sale of life insurance policies shall be incorporated in a written document conforming with the following minimum standards:

- (1) The basic illustration shall be clearly labeled "Life Insurance Illustration," and shall include the information in this section and in Section 6.
- (2) Each page of a basic illustration, including any explanatory notes or pages, shall be numbered and show its relationship to the total number of pages in the illustration (*e.g.*, the fourth page of a seven-page illustration shall be labeled "page 4 of 7 pages").
- (3) The assumed dates of payment receipt and benefit pay-out within a policy year shall be clearly identified.
- (4) If the age of the proposed insured is shown as a component of the illustration, it shall be issue age plus the number of years the policy is assumed to have been in force.
- (5) The payments assumed to be paid by the premium payer, on which illustrated benefits and values, guaranteed or not guaranteed, are based shall be identified as premium outlay. If a different amount must be paid in order for guaranteed benefits and values to be paid as illustrated, it shall be identified as contract premium. For policies which do not require a specific premium payment amount, the illustrated payments shall be identified as premium outlay. Premiums displayed in the basic illustration shall be based on the underwriting, if any, performed at issue.
- (6) Guaranteed death benefits and values available upon surrender for the illustrated premium outlay or contract premium shall be shown and clearly labeled guaranteed. The guaranteed benefits and values must be shown before corresponding non-guaranteed benefits and values and must be specifically referred to on any page of the illustration which shows or describes only the non-guaranteed benefits and values (*e.g.*, "See page one for guaranteed benefits and values.")
- (7) Illustrations may show non-guaranteed benefits and values based upon the company's disciplined current scale and on any other additional scale not more favorable than disciplined current scale at any duration. These benefits and values must be clearly labeled not guaranteed.
- (8) The account or accumulation value of a policy, if shown, shall be identified by the name this value is given in the policy being illustrated and shown in close proximity to the corresponding value available upon surrender.
- (9) The value available upon surrender shall be identified by the name this value is given in the policy being illustrated and shall be the amount available to the policyowner in a lump sum after deduction of any applicable surrender charges, policy loans and policy loan interest.

B. Each illustration shall include, for each policy year for policy years one (1) to twenty (20) and for every fifth policy year thereafter ending at age 100 or policy maturity, the following in tabular format:

- (1) The premium outlay or contract premium;
- (2) The guaranteed death benefit, as provided in the policy, corresponding to the amount in Paragraph (1);
- (3) The guaranteed value available upon surrender, as provided in the policy, corresponding to the amount in Paragraph (1).
- (4) Illustrations may be in graphic or chart form in addition to the tabular format, and must show the corresponding guaranteed elements if non-guaranteed elements are shown.

- C. If non-guaranteed values and benefits are shown, they must be shown at the same durations as guaranteed values.
- D. Any illustration of non-guaranteed benefits and values must be accompanied by a statement indicating that:
  - (1) They are not guaranteed;
  - (2) The assumptions on which they are based are subject to change by the insurer; and
  - (3) Actual results may be more or less favorable.
- E. Non-guaranteed benefits and values shall not be displayed with any greater prominence than corresponding guaranteed benefits and values.

#### Section 8. Supplemental and Concept Illustrations

- A. A supplemental or concept illustration may be provided so long as:
  - (1) It is incorporated into or accompanied by a basic illustration which complies with this regulation;
  - (2) Any non-guaranteed elements shown are not more favorable to the policyholder than the corresponding elements based on the insurer's disciplined current scale; and
  - (3) It contains the statement in Section 7D if non-guaranteed benefits and values are illustrated.
- B. If a supplemental or concept illustration shows that, at an insurer's disciplined current scale, the premium payer may have the option to suspend premium outlays and allow policy charges to be paid by using non-guaranteed values, the illustration must disclose that a charge continues to be required and that, depending on actual results, the premium payer may need to continue or resume premium outlays. Similar disclosure must be made for fixed premium outlay of lesser amounts or shorter durations than the contract premium. The premium outlay display shall not be left blank or show zero unless accompanied by an asterisk or similar mark to draw attention to the fact that the policy is not paid-up.

#### Section 9. Record Retention

A copy of a signed basic illustration shall be submitted to the insurer no later than the time of policy delivery unless no illustration was utilized in the sale of the policy, as certified by the selling agent. A copy should also be provided to the applicant. The insurer shall maintain a copy of the signed illustration or certification that no illustration was used until three (3) years after the policy is no longer in force. A copy need not be maintained if no policy is issued.

#### Section 10. Prohibitions

The following actions by insurers or their producers or other authorized representatives are prohibited:

- A. Representing the policy as anything other than life insurance;
- B. Utilizing or describing non-guaranteed elements in a manner that is misleading or has the capacity or tendency to mislead;
- C. Stating or implying that the payment or amount of non-guaranteed elements is guaranteed;
- D. Using a policy illustration which does not comply with the requirements of Sections 6 or 7 of this regulation;
- E. Using an illustration that at any policy duration depicts policy performance more favorable than that produced by the disciplined current scale of the insurer whose policy is being illustrated;
- F. Providing an applicant with an incomplete illustration;
- G. Representing in any way that premium payments will not be required for each year of the policy in order to maintain the illustrated death benefit, unless that is the fact;
- H. Using the term "vanish" or "vanishing premium" to describe a plan for using non-guaranteed elements or dividend credits to pay a portion of future premiums;
- I. Using an illustration that depicts "lapse-supported pricing" as defined in this rule;
- J. Using an illustration that depicts a "persistency bonus" as defined in this rule;
- K. Using an illustration that is not "self supporting" as defined in this rule.

#### Section 11. Notice to Policyholders; Updated Illustrations

A. In the case of policyholders who received illustrations that depicted non-guaranteed values and benefits in connection with the purchase of their policies, the insurer shall provide an annual report on the status of their policies and instructions for obtaining more information about the policy.

B. Upon request of the policyholder, the insurer shall furnish an updated illustration based on amounts actually paid, credited, withdrawn or charged under the policy since issue; and the insurer's present disciplined current scale applicable to the policy. No signature or other acknowledgment of receipt of this illustration shall be required.

#### Section 12. Annual Certification

The use of disciplined current scale in illustrations shall be in conformity with the standards of practice for the determination of disciplined current scale promulgated by the Actuarial Standards Board. An insurer shall appoint an illustration actuary to annually certify that the scales used in company-authorized illustrations are in conformance with the standards of practice. In addition, a responsible company officer shall annually certify that the illustration formats and scales used in illustrations provided by it to its agents meet the requirements of this rule. The annual certification shall be provided to the commissioner each year by [insert date].

#### Section 13. Separability

If any provision of this regulation or its application to any person or circumstance is for any reason held to be invalid by any court of law, the remainder of the regulation and its application to other persons or circumstances shall not be affected.

#### Section 14. Effective Date

This regulation shall become effective one year after the date of adoption and shall apply to policies sold on or after the effective date.

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#### ATTACHMENT THREE-B

#### ILLUSTRATIONS USED IN CONNECTION WITH THE SALE OF LIFE INSURANCE MODEL REGULATION

Make the following changes to Section 3:

#### Section 3. Applicability and Scope

A. This regulation applies to all group and individual life insurance policies and certificates ~~marketed with the aid of an illustration~~, including variable life insurance insofar as these provisions are not inconsistent with securities laws and regulations, including rules, regulations or guidelines promulgated by the National Association of Securities Dealers (NASD). With respect to variable policies, investment performance shall be illustrated in accordance with NASD rules relating to the rate of return on underlying investment portfolios, but mortality and expense elements on a guaranteed or disciplined current scale basis shall be illustrated in accordance with the provisions of this regulation.

Drafting Note: The above applicability and scope section seeks to harmonize this regulation with existing NASD regulation of variable policy illustrations. Variable life policies are different from fixed policies because generally they provide no guaranteed cash values. Under a variable policy, cash values vary based on the investment performance of the underlying investment portfolio of a separate account, whereas under a fixed policy, the investment performance is dependent on crediting or dividend rates established by the insurer subject to a guaranteed minimum. Because of this inherent difference between variable and fixed policies, certain provisions of this regulation do not apply to variable policies, especially those provisions relating to guaranteed cash values (when the policy provides no guarantees), and those elements of disciplined current scale relating to investment performance.

B. This regulation shall not apply to the illustration of individual and group annuity contracts, life insurance policies issued in connection with pension and welfare plans as defined by and which are subject to the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. Section 1001 *et seq.* as amended, or credit life insurance ~~and life insurance policies and certificates sold without an illustration~~.

C. This regulation shall not be construed to impose limitations upon the ability of insurers or agents to make available supplemental or concept illustrations and information in addition to a basic illustration provided in accordance with this regulation. Any additional information provided shall be consistent with the requirements of this regulation.

Add a new Section 5:

Section 5. Policies to Be Illustrated

Each insurer marketing policies to which this regulation is applicable shall identify for each policy form whether or not that policy form is to be marketed with an illustration.

A. Policy forms marketed without an illustration.

If the insurer identifies a policy form as one to be marketed without an illustration, any use of an illustration is prohibited.

B. Policy forms marketed with an illustration.

If the insurer identifies a policy form as one to be marketed with an illustration, a basic illustration prepared in accordance with Section 6 and Section 7 of this regulation must be provided.

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ATTACHMENT THREE-C

To: Life Disclosure Working Group  
Interested Parties  
From: Carolyn J. Johnson, NAIC, CLU  
Date: November 23, 1994  
Subject: Draft of Life Insurance Illustrations Model Regulation Issues to Discuss

The Life Disclosure Working Group met by conference call Nov. 22, 1994, to discuss the model draft. At the end of the conference call a number of issues remained that will be discussed during the scheduled working group meeting Dec. 3, 1994, from 3 to 5 p.m. in New Orleans.

These are the issues that the working group will discuss:

1. How do we coordinate this model with the disclosure provisions of the Second Standard Nonforfeiture Law for Life Insurance being drafted by the Life and Health Actuarial Task Force?
2. Is it advisable to attempt to include variable life insurance in this draft, or are there enough differences that discussion of variable life should be postponed?
3. Should the draft use the term "disciplined current scale" or is there a better adjective that would meet the needs of the working group and consumers?
4. How can the definition of "generic name" be improved?
5. Should a sensitivity index be included, and, if so, what type?
6. Is "premium outlay" the appropriate term to use to indicate expected premiums to be paid?
7. Consider appropriate wording for the statement to be signed by the applicant. Does the current draft adequately protect his interests?
8. Consider the premise of the last drafting note on page 6 of the draft. Do regulators want to provide the flexibility to place this information in the body of the illustration rather than "up front"?
9. Consider several issues related to "vanishing premium." Should the basic illustration standards specifically prohibit the use of illustrations without dollar figures where a premium is due? Should the supplemental illustration be allowed to show asterisks? What terms should be prohibited in § 9H; just "vanishing," or also "similar terms" so that insurers don't use terms like "disappearing" or "invisible."
10. Should illustrations described in § 6B be required to show the first 20 years or the first 10 years?
11. Will there be an actual sample format in an appendix or where will insurers find these points from the standards:
  - a) Use consumer-friendly terminology
  - b) Avoid extensive footnotes
  - c) Standard glossary of terms
12. Does the annual report required in § 10 need further explanation? There is no standard about what must be included or mention of the explanation of the changes in the assumptions required in the standards.

13. The annual certification in § 11 limits the insurer's responsibility to the illustrations it has provided to its agents. The standards say the company will be responsible for *all* illustrations. Does this need to be changed?

14. The penalties included in Section IX of the standards are not mentioned in the model.

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#### ATTACHMENT THREE-D

#### Life Disclosure Working Group of the Life Insurance (A) Committee November 22, 1994

The Life Disclosure Working Group of the Life Insurance (A) Committee met by conference call on Nov. 22, 1994, at 11 a.m. Robert E. Wilcox (Utah) chaired the meeting. The following working group members participated: Tom Foley, Vice Chair (Fla.); Don Koch (Alaska); John Montgomery (Calif.); Roger Strauss (Iowa); Noel Morgan (Ohio); Ted Becker (Texas); and Bob Wright (Va.).

Commissioner Robert Wilcox (Utah) began the meeting with a housekeeping item. He said that since the NAIC had changed its policy on advisory groups, clarification had not been given to the technical resource advisors, and he intended to send them all a letter to explain the help that was being requested by the working group. After reading a copy of the draft to the members of the working group, Commissioner Wilcox asked if there were additional people the working group members would suggest be added to the list of technical resource advisors, to provide input from different viewpoints. He said he wanted to add the name Scott Cipinko (National Alliance of Life Companies—NALC) to represent the small companies. Other suggestions made by working group members were to add Mary Griffin (Consumers Union) and James Hunt to represent the consumer viewpoint. John Cutler (American Association of Retired Persons—AARP), David Beard (National Travelers), Chris Kite (FIPSCO), and Reed Ashwill (National Association of Independent Life Brokerage Agencies) were also added to the list.

Commissioner Wilcox then turned the meeting over to Tom Foley (Fla.) who had chaired the drafting group. Mr. Foley said that the purpose of this conference call was to review the draft of the Illustrations Used in Connection with the Sale of Life Insurance Model Regulation and make any changes the working group thought were appropriate. Mr. Foley suggested that the notes prepared by Carolyn Johnson (NAIC/SSO) contained many of the issues that the working group should consider.

Commissioner Wilcox said that it would be important for the working group to consider how this model would coordinate with the disclosure provisions of the second standard nonforfeiture law being developed by the Life and Health Actuarial (Technical) Task Force. Don Koch (Alaska) said the working group would also need to address possible conflicting provisions in other NAIC model regulations.

Mr. Foley said that one of the first issues on Ms. Johnson's memorandum was whether to apply this model to variable life. George Coleman (Prudential) said his impression from the last working group meeting was that the working group intended to do traditional life first, then variable life, and then annuities. He said the provisions included in the draft should be reviewed section by section to be sure that there was nothing inconsistent with the existing requirements for variable life insurance policies. Commissioner Wilcox said that it would be good to prepare the model once, but he did not want to hold up the process to discuss variable life. The working group agreed to discuss this issue further at the winter National Meeting. Commissioner Wilcox asked Ms. Johnson to keep a list and prepare a memorandum that itemized the items that the working group wanted to discuss further at the winter National Meeting in New Orleans.

Mr. Foley asked the working group to concentrate on three definitions contained in the draft. The first definition was for "disciplined current scale." He asked if there was another term the working group would prefer to use instead. John Montgomery (Calif.) said that the words "current scale" already had a meaning so he thought it was necessary to add something else. Roger Strauss (Iowa) said the term "disciplined" does not mean anything and so he was in favor of changing it. Mr. Foley asked the working group members to think of possible alternatives and be prepared to discuss this issue further at the winter National Meeting.

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

Discussion next turned to Sections 5 and 6 of the basic illustration. Commissioner Wilcox said he was confused by the format of these two sections. He asked why the cover page which was described first seemed to go beyond the cover page. Mr. Foley explained that Section 5 is the format, and Section 6 lists what is required in the basic illustration. The working group suggested several ways to clarify this and agreed that they would review the draft after Ms. Johnson put in their suggestions and see if further clarification might be needed.

Noel Morgan (Ohio) said he was uncomfortable with the disclosure statement required to be signed by the consumer. He said it took away too much from the consumer. Bob Wright (Va.) agreed that this went much further than the working group had intended. Mr. Coleman responded that insurers need to get something out of this compromise also. He suggested this would allow companies a little protection. Mr. Phillips suggested that the second sentence of the disclosure statement had too much legalese.



The working group discussed the drafting note to Section 6 that allowed companies to place the items in the illustrations rather than at the beginning. Mr. Strauss said he did not think this was a good idea because it would allow companies to bury information that they did not want an applicant to see. Mr. Coleman explained that companies had asked the working group to consider this because they had spent a great deal of money developing programs that did not have these items on a cover page. Judy Faucett (Coopers & Lybrand) suggested that if some of those companies could bring samples to the working group's attention, it would help the regulators see if these type of illustrations would meet their standards.

Mr. Morgan asked if the basic illustration required that each premium that was to be paid should be shown and that there should be no vanishing premiums. Mr. Foley said he recognized this was the working group's intent, but he did not know either where this was in the draft. Mr. Coleman asked if this could be an item kept open for discussion. Mr. Strauss said that if the vanishing premium was allowed to be illustrated in the basic policy, then he would want to be sure that the dollar amount was shown with the asterisk. In a supplemental illustration, he thought it might be permissible just to show the asterisk.

Mr. Foley asked Ms. Johnson to place the last four items from her memorandum to the working group on the list of topics to be discussed at the New Orleans meeting in December and the Life Disclosure Working Group of the Life Insurance (A) Committee adjourned at 1 p.m.

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### ATTACHMENT THREE-E

#### Life Disclosure Working Group of the Life Insurance (A) Committee Kansas City, Missouri October 26, 1994

The Life Disclosure Working Group of the Life Insurance (A) Committee met at the Kansas City Airport Marriott Hotel on Oct. 26, 1994. Commissioner Robert E. Wilcox (Utah) chaired the meeting. The following members of the working group participated: Tom Foley, Vice Chair (Fla.); Roger Strauss (Iowa); Lester Dunlap (La.); Tony Higgins (N.C.); Noel Morgan (Ohio); Ted Becker (Texas); Bob Wright (Va.); and Fred Nepple (Wis.). John Montgomery (Calif.) participated part of the day by conference call.

#### 1. Adopt Minutes of Oct. 5 and Oct. 12, 1994 Conference Calls

Upon motion duly made and seconded, the minutes of the conference calls of Oct. 5 and Oct. 12, 1994, were adopted (Attachment Three-E3).

#### 2. Consider Statement of Standards

Commissioner Robert Wilcox (Utah) explained that the purpose of the statement of standards being developed by the working group was to outline the provisions that would be included in a model regulation. He emphasized that the specific language that would be included in the regulation was not yet developed.

##### a. Requirement to Use an Illustration

Commissioner Wilcox said the concept currently in the standards draft was that an illustration would be required for all life and annuity products except those specifically exempted. He said some of the working group members had expressed concern that these exemptions would be difficult to identify. He called on Roger Strauss (Iowa) who had volunteered to work on the list of exclusions. Mr. Strauss said that it was Iowa's opinion that the illustration should not be mandated. Judy Faucett (Coopers & Lybrand), an NAIC consultant on the illustrations project, asked if it would suffice to deliver the illustration with the policy. Commissioner Wilcox responded that in his opinion presenting the illustration at the time of delivery was acceptable, but he emphasized this was still an open question. Scott Cipinko (National Alliance of Life Companies—NALC) agreed that a requirement to provide the illustration with policy delivery was appropriate. He said at some times the agent would not have brought along an appropriate illustration and if the requirement was for the illustration to be presented at the time of sale he would not be able to proceed with the sales call.

Commissioner Wilcox asked Mr. Strauss to explain the list that he and Tony Higgins (N.C.) had prepared. Mr. Strauss explained to the working group the tentative list that had been prepared (Attachment Three-E1). Mr. Higgins said he was afraid the regulators sent the wrong message by requiring a sales illustration. He said it would elevate the illustration to an unwarranted level. Commissioner Wilcox reminded the working group that one of the goals of a sales illustration is to serve as an education tool. He also saw a problem when a market conduct examiner looked in a file and saw no illustration. He wondered if the examiner should assume there was no illustration just because none was in the file. Bob Wright (Va.) suggested a sign-off sheet that no illustration had been used which could be placed in the file. Commissioner Wilcox asked the members of the insurance industry in attendance if they had any more comments on the concept. He said he had not heard much opposition to this idea. Linda Lanam (Life of Virginia) said that as long as there are carve-outs for plans that do not typically use illustrations and that it could be presented at the time of delivery, she did not expect much industry opposition. Upon motion duly made and seconded, the working group voted not to make the illustration mandatory, but if an illustration is used it must meet the requirements of the model. If no illustration is used, a form must be signed saying that no illustration was used, except for sales in the lines of insurance listed on Attachment Three-E1.

b. How to Provide for States That Want to Use Guarantees Only

Commissioner Wilcox said that Texas had asked that the model provide a method for states that want to use guarantees only. Commissioner Wilcox said he had talked with Commissioner Robert Hunter (Texas) and he had agreed that the inclusion of drafting notes to identify changes for states that wanted to use only guarantees would be acceptable. Tom Foley (Fla.) asked if this was in any way an endorsement of guarantees only. He said that in his estimation guarantees only was misleading and he did not want to endorse it in any way. George Coleman (Prudential) said he thought the NAIC sent a confusing message if it adopted provisions that were meant to serve the needs of a small minority of states. Mr. Cipinko pointed out that what the NAIC was drafting was a model, and states were always free to change it. He said if the drafters went through a model and added drafting notes for every issue that any state disagreed on, it would be a mess. Ms. Van Leer said it seemed to her that there had been a long process to reach consensus and the model should stand for that consensus. Mr. Coleman differentiated this from occasions when the NAIC had drafted several alternatives such as in small group health insurance, where the drafters said there were several equally valid alternatives, but that was not the case with the issue of life insurance illustrations. The majority of the working group felt that guarantees only was not a good idea. Mr. Strauss suggested that Texas or any other state that so desired use the guarantees only draft that the working group had prepared earlier, even though it had not been formally adopted. Mr. Wright said he thought it was too early to decide this issue, because the working group did not know what the draft allowing nonguaranteed elements would look like. Upon motion duly made and seconded, the working group voted to table the issue.

c. Amount of Standardization of Illustrations

Commissioner Wilcox said that one of the issues that had been raised in the comments to the draft was the amount of standardization that would be provided for illustrations. Mr. Strauss said some of the comments received had expressed concern about the serialization of the pages when there was a basic illustration and supplemental illustrations prepared by software vendors. Mr. Foley pointed out that the paging required in the standards document was applicable to the basic illustration rather than the supplemental illustrations prepared for specific purposes. Commissioner Wilcox reminded the group that the requirement was that any supplemental illustration could not conflict with the basic illustration. Mr. Cipinko said a problem would arise if the model regulation said that each item had to be on a certain place on a certain page. Commissioner Wilcox clarified that the model regulation would require a certain order but not a certain page so that each illustration had to be the same length. Commissioner Wilcox said some of the comments had expressed concern that the working group's draft would be harmful to the software vendors. He said it was his guess that vendors would thrive under a new NAIC model because everyone would have to modify software and that would create new business for the vendors. Lester Dunlap (La.) asked who was accountable for the software produced by outside vendors. Ms. Lanam said that the company was not responsible for the software vendor, but the company was responsible for materials prepared by the agent. If the agent used unapproved software, the company would handle that problem through the agent. Mr. Foley reminded the attendees that a company signature would be required so, if the vendors' software did not meet the company standards, the company could decline to sign.

d. Assumptions

Commissioner Wilcox said several comments had been received suggesting that Paragraph A(3) under Section V be eliminated. This provision says "the rate that can reasonably be expected on the policy block." He said this had been included because it would be useful for a new policy where there was no experience. It could be used also if the company knew that it soon would be changing its rate. Frank Irish (Actuarial Standards Board—ASB) spoke in favor of dropping Number 3. In his opinion it was too broad. Fred Nepple (Wis.) agreed with the concern that the language is too broad, but said the working group needs to come back to this as a concept of rate of return. Upon motion duly made and seconded, the working group agreed to drop Number 3 under Paragraph A of the Assumptions section. Commissioner Wilcox pointed out that Paragraph E under the Assumptions section had been deleted during the working group's conference call. Mr. Coleman asked if it would still be considered in the ASB charge and the answer was in the affirmative.

The working group next considered Paragraph E under Section V on lapse-supported pricing. Mr. Irish said the ASB Committee had several ideas on what this meant and he asked the working group to consider the line between the provisions of a model law and the ASB standards. Commissioner Wilcox asked if it would be a good idea to delete the second sentence that described lapse-supported pricing. Ms. Faucett said she would hate to see a regulation that did not allow any support from lapses. She said the chance that there would be no lapses was near zero. She thought the ASB should identify exactly how to measure the appropriate amount. Mr. Koenig said he thought it would be a mistake to take out the sentence because it let the ASB know what was in the mind of the working group. Mr. Irish said the ASB Life Illustrations Group had agreed that lapse-supported pricing is a special problem and had agreed to make some recommendations. He said the sentence as it was written was confusing and suggested it would be better if it said *reduced* rather than *zero* lapse assumptions. Mr. Nepple suggested that the ASB provide suggestions for what specific language to include in the draft. Commissioner Wilcox pointed out that the working group product would actually end up as three separate documents: this statement of objectives, the model regulation, and the actuarial practices standard. He said these all needed to be in complete harmony but he saw this statement as a goal not a requirement. The working group decided to ask Ms. Faucett to work with the ASB to arrive at a good definition, and to leave the language in Paragraph E as it now exists. Mr. Higgins said it had been an early decision of the working group that lapse-supported illustrations should not be permitted, and he asked if the working group's opinion had now changed. Members of the working group agreed that it was still their opinion. Commissioner Wilcox said that the people producing illustrations need some bright-line tests to know when they have used a lapse-supported illustration.

Tony Spano (American Council of Life Insurance—ACLI) asked the working group to elaborate on the intent of Paragraph G on minimum profit objectives. He said it was his concern that the working group not restrain product pricing. Commissioner Wilcox responded that it was the intent of the working group to regulate illustrations rather than rates. He said the working group intended to preclude illustrations that contained a presumption that the company would make no profit. The working group considered combining the last three paragraphs of Section V into one because they are very closely related. Barbara Lautzenheiser (Lautzenheiser & Associates) suggested that the last three paragraphs all be part of the ASB charge rather than provisions of this document. Mr. Strauss said these three paragraphs helped focus on the issues and he thought it was appropriate to leave them in. The working group agreed to leave the three paragraphs as they were.

Mark Peavy (NAIC/SSO) reminded the working group that the concept of a standardized interest assumption remained unresolved from the last conference call. Mr. Foley reported that he and Ms. Faucett had put together examples to try and find a standard that could be used by both portfolio and new money companies where neither would have to grade up to the standardized assumption, but he did not see a way to do that. Mr. Foley said that, as now conceived, the model would not allow companies to project improvements or to use lapse-supported pricing, so he said most of the abuses would be fixed. He wondered if it was necessary to build in this provision also. Mr. Higgins asked if it was a bad result for companies to grade up. He said the assumption was that interest rates were unpredictable 10 years into the future. Mr. Coleman suggested that the addition of standardized assumptions would tend to confuse people. Commissioner Wilcox said that this argument swayed him because he also thought it would be a difficult concept for consumers to understand. Mr. Nepple said that in his opinion a sensitivity analysis added confusion, but he did not see that it was essential for consumers to understand standardized assumptions. Mr. Irish said the ASB had not come to a conclusion on this issue; but reflected the same division as seen in the members of the working group. Mr. Koenig said it would be a big mistake to imply that an illustration is a predictor of future interest rates. The other activities of the working group are trying to clarify that an illustration does *not* predict the future. Ms. Faucett said she thought at the minimum companies would need to disclose that after 10 years they were using standardized assumptions and a company should disclose whether it was currently earning that much. Mr. Cipinko said that since the company has to sign off on the illustrations, there might be liability because the illustration was unlike the actual experience of the company. Jim Ellis (General American Life) said it was his understanding that the working group wanted to show there was a possibility that the interest rate would change. He said the sensitivity analysis did this. Upon motion duly made and seconded the working group agreed to show guarantees and the current scale without a standardized assumption.

Mr. Nepple asked the group to consider further the issue of a sensitivity analysis. He said he thought it added one more column of numbers that could cause confusion. Ms. Lautzenheiser said she noted from the conference call minutes that the working group was considering focus groups and suggested adding a sensitivity analysis and letting the focus group clarify whether this was understandable. Chris Kite (FIPSCO) suggested that it was not necessary to have a whole column of numbers. A simple statement of when the premium would vanish or when the policy would expire would be sufficient. Brad Barks (Life USA) said the benefit of the column of numbers at a lower interest rate was to make it clear not to rely on the column of nonguaranteed numbers. Mr. Fisher said he hoped the working group would allow companies to use the sensitivity analysis even if it was not mandated.

Mr. Foley said the working group had talked at one point about not allowing vanishing premiums to be illustrated. He said he did not see this in the standards. Upon motion duly made and seconded, the working group decided to include an explicit statement in the standards on vanishing premiums. At a minimum, the model should say that every year there is a cost of insurance that cost should be shown, and the model should also ban the use of terms like "vanishing."

e. Appointed Actuary; Illustrations Actuary

John Montgomery (Calif.) suggested that there should be a valuation actuary and an illustration actuary, although in a small company the valuation actuary and illustration actuary might be the same person. Upon motion duly made and seconded, the working group decided to change the standards so that references to the appointed actuary would be to the illustration actuary.

f. Signatures of Company and Actuary on Illustration

Commissioner Wilcox said he was particularly interested in receiving comments on practical problems caused by this requirement. Ms. Van Leer said that there were equipment limitations because older equipment might not have the capacity to add a signature. Commissioner Wilcox asked if the same result would be accomplished by printing the names of the company officer and actuary. Noel Morgan (Ohio) said he had been puzzled about why the working group had ever thought it needed signatures. If the regulation says the company is responsible, a signature does not add anything. Mr. Wright said the Society of Actuaries report referred to the fact that companies said they had no control over what agents did. Mr. Morgan responded that the regulation could deal with that explicitly by saying the company is responsible. He did not think a signature added anything. Mr. Coleman agreed that by law a company is responsible for its agents. If an agent fails to act as its company requires, the company must deal with the agent. Mr. Nepple agreed that the law is clear that a company is responsible for its agents, but he saw some value in having the redundancy.

Paul Cartwright (Equitable of Iowa) said there was a difference as to whether the actuary said something was appropriate or whether the marketing department said it was. Commissioner Wilcox said one of the goals of the working group was to empower the actuary, because in some cases an actuary does not have much to say about how the illustration looks. Mr. Koenig said that if the marketing director's name was on the illustration, he could say that it had been filed in accordance with the actuary's calculations. Ms. Faucett pointed out that substantial changes have been made in many companies

over the past six months or year to place more focus on compliance. She suggested that a note be added to the illustration that said if you have any questions the agent cannot answer, call the compliance officer of the company. David Beard (National Travelers Life) asked the working group to take a look at the interrogatories for the annual statement that the actuaries now sign. He suggested this could be a vehicle to address the issue instead of having a signature on each illustration. Upon motion duly made and seconded, the working group voted to have the company officer and actuary provide certification to the insurance department that the actuarial standards had been met in preparing the illustrations, rather than requiring signatures of the officer and actuary on each illustration.

Mr. Morgan said that, although it may be redundant, he would like to see in the regulation that the company is responsible for the illustration. He said it is a big problem in consumer complaints, because a company says it is not responsible for its agent. Mr. Morgan made a motion that the model regulation specifically state that the company is responsible for the illustration. Mr. Higgins made a substitute motion that added a further condition that the working group reconsider its earlier position and require an illustration be produced for each policy except those specifically exempted. His reason was that the policyholder would no longer have a signed certification from a company that an illustration had been prepared in accordance with the law. The substitute motion failed. The original motion carried.

g. Consider Rewording Section VII

Mr. Becker suggested to the working group some amended language for Paragraph A that said an insurer was responsible for any representation or material omission in the sale of a life insurance policy. John Dinius (Aetna) asked how the company could be responsible for what the agent produced on non-company software. He was concerned that the company would not even see the material that had been prepared. Commissioner Wilcox said that was more appropriately handled in the insurer's contract with its agent rather than in a model law. Upon motion duly made and seconded, the amendment to Paragraph A was adopted. Mr. Coleman suggested that the word "propriety" be removed from Paragraph A because it implied that the company had determined the suitability of the coverage. The working group members agreed that was not their intent. S. Reed Ashwill (National Association of Independent Life Brokerage Agencies—NAILBA) suggested that the word "appropriate" in Paragraph C also implied suitability. Commissioner Wilcox reminded him that this was a statement of objectives and not the language that would be included in the regulation.

h. Annual Reports Required Every Year or Only if Assumptions Change

Commissioner Wilcox said it seemed to him that an automatic report on the policy anniversary would actually turn out to be less expensive. Mr. Van Leer said this was not true because of postage costs. If rates stayed level there would not be a change and under the scheme the working group had considered earlier an updated illustration would not be necessary. Mr. Strauss suggested an abbreviated illustration using part of the form that Ms. Van Leer had prepared for the working group as a sample illustration (attached to September working group minutes). Mr. Becker suggested changing Paragraph B(1) of Section VIII to require an established format that would be included in model draft. Mr. Ashwill asked if the regulation could include this requirement only for policies issued after the date of adoption of the regulation. Commissioner Wilcox agreed that this was the intent of the working group. Mr. Beard asked if it was the intent of the working group to require a reproduction of the original illustration with all the variables. Commissioner Wilcox said it was not the working group's intent to reproduce all of them—just the original standard illustration. Upon motion duly made and seconded, Paragraph (1) was changed to state that the report would be in a prescribed format.

Commissioner Wilcox said he would hate to have this "report card" turn into a deficiency notice. He thought it was in the company's interest also to report when the policy was doing well. Mr. Higgins disagreed, saying that it would dilute the impact of the report if one was received every year rather than just when interest rates went down. Commissioner Wilcox responded that he did not think the working group intended to tell insurers that they could not send a report. Ms. Van Leer emphasized that it is important to prepare this document carefully so that it does not give an impression to the policyholder that his policy had been an incorrect purchase because this would increase lapses. Mr. Higgins responded that he thought it would increase persistency if the policyholder had a report that he could use to compare to any proposals for new policies. Several representatives from insurance companies described the type of annual update that their companies provide to policyholders. They said they seldom got requests for a full illustration. Commissioner Wilcox asked how difficult it would be to add a few projections such as described by Mr. Strauss. Phyllis Dilbeck (Transamerican Occidental Life) said it would be very difficult because the original illustration had been prepared on PC-based software, and the data for preparing an updated illustration generally would be found on mainframe applications. Several companies' representatives agreed that they would go back to their home offices and request information about what type of data could be easily reproduced if there were no cost constraints.

i. Penalties

Mr. Becker suggested removing the requirement that "the insurer knew or should have known" the illustrations were not prepared according to the requirements from Section IX, Paragraph B. The working group agreed to delete that phrase and also the term "supportable" in the paragraph. The working group agreed to hold a conference call Nov. 22 to discuss the draft prepared by Mr. Foley and to attempt to mail a draft to the interested parties before the New Orleans meeting in December.

3. Focus Groups to Review Illustrations for Understandability

John Booth (ACLI) said his company had run focus groups in the past and offered to assist the NAIC with this project. Mr. Strauss suggested that the focus groups would be more valuable if they were independent rather than provided by the

insurance industry. Mr. Booth clarified that he was offering the ACLI's assistance in helping to arrange a focus group, not to implement it.

#### 4. Drafting of Revised Model Regulation

Commissioner Wilcox asked if the members of the working group would be able to attend another interim meeting before the winter National Meeting to prepare a revised draft that reflected the standards (Attachment Three-E2). Mr. Foley suggested that a small subgroup meet to redraft and then have the working group meet by conference call. Commissioner Wilcox appointed Mr. Foley and Ms. Faucett to work on that project and asked Mr. Coleman and Mr. Koenig to provide assistance with what the technical resource advisors had put together in the past.

Having no further business, the Life Disclosure Working Group adjourned at 4 p.m.

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#### ATTACHMENT THREE-E1

##### Products to be Exempted from Illustration Requirements

##### Scope

A. Products marketed without the use of individual illustrations shall be exempted from these requirements.

(It is anticipated that this would include:

1. Credit Life
2. ERISA qualified plans sold without an illustration
3. Group Life sold without individual illustrations
4. Reinsurance policies
5. Policies that use only guaranteed assumptions
6. Pre-need funeral contracts)

Annuities - Exclude from regulation, include in model act

Consider excluding - Policies with face amounts of \$10,000 or less

B. Variable life and other products shall comply with these requirements to the extent they are not in conflict with the disclosure requirements imposed by regulatory agencies other than Departments of Insurance.

DO NOT EXCLUDE TERM—REQUIRE THAT ILLUSTRATION OF INSURANCE PRODUCT STAND ALONE.

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#### ATTACHMENT THREE-E2

##### LIFE DISCLOSURE STANDARDS Prepared by the NAIC Life Disclosure Working Group Draft 10/26/94

#### I. Background Statement.

In recent years the "illustration" has become a standard part of the life insurance agent's sales presentation. The ostensible purpose of the illustration has been to demonstrate to the potential buyer how the policy "works." In its simplest form, the illustration summarizes the insurance contract, with a year-by-year projection of the premiums, cash value, and death benefits. As policies have become more complex, so have the illustrations, portraying not only the contract ("guarantees") but also financial benefits that are outside the contract guarantees ("non-guarantees"), illustrating not only what will happen but what could happen. Unfortunately, since "could" was invariably much more attractive than "will," such illustrations have been used to support deceptive-sales presentations, encouraging consumers to base their purchase decisions only on optimistic projections.

The problems associated with life illustrations were summarized in the working group's white paper of August 1993. They have been aired before congressional committees, in the media, and the courts. They have also been the subject of thousands of consumer complaints to state insurance departments.

Unlike many sales abuses, these have not been limited to a handful of players, but, rather, have involved some of the nation's largest companies.

As a step in the process of preparing a model act and a model regulation that will restore integrity to the life insurance sales presentation process, the NAIC Life Disclosure Working Group, based on many months of review, is summarizing here the standards and objectives that are expected to form the basis for the development of these new models.

## II. Scope.

A. Illustrations for life insurance and annuity products are not required, but if they are used they must meet the requirements of the model regulation. Except for specified products, if no illustration is used, the company file for the policy must contain a statement signed by the agent and the applicant that no illustration was used.

B. Standard nonforfeiture laws require certain disclosures. The requirements described in this document are intended to harmonize with and avoid conflict with nonforfeiture requirements.

C. Products such as variable life that are subject to other disclosure requirements should correspond as closely as possible to these requirements.

Note: The working group intends to focus first on a regulation for non-variable life insurance products, so much of the balance of this document is more specific to non-variable life.

## III. Understandability.

A. The goal is that illustrations should be understandable without assistance from an insurance agent.

B. The focus of the illustration must shift from use as a sales tool to consumer education.

## IV. Standardization of Presentation.

A standard format and content will be used for illustrations. The standard illustration will:

A. Contain specified information in a specified sequence and format;

B. Eliminate as far as possible the use of footnotes and caveats as well as excessive detail;

C. Use a standard glossary of terms;

D. Use "consumer friendly" language that eliminates arcane insurance terminology;

E. Emphasize guaranteed values over non-guaranteed values by showing them first and at least as prominently;

F. Show premium payments for every period for which there is a cost for insurance;

G. If graphic illustrations are used they must reflect only information otherwise illustrated;

H. Use serialized page numbering (e.g., the fourth page of a seven-page illustration should be labeled "page 4 of 7 pages");

I. Be clearly labeled as a "Life Insurance Illustration";

J. Identify the insurer, the generic type of life insurance, and the policy form number;

K. Contain appropriate personal information including:

1. name
2. age
3. amount
4. rating classification
5. additional benefits
6. dividend option (if applicable)
7. generic policy name

L. Contain a statement to be signed and dated by the applicant; and

M. Contain a statement to be signed and dated by the producer.

## V. Assumptions.

A. Non-guaranteed elements will be based on *separate* assumptions for interest, mortality, lapse and expenses that are each not more favorable to the applicant than the most conservative of:

1. The rate reflected in the current credited scale;
2. The most recent experience on the policy block.

B. Mortality and lapse rates will not reflect future improvement.

C. Expense rates in each renewal year will be at least equal to incurred expenses.

- D. Anticipated, but not yet realized, reductions in aggregate or unit expenses may not be reflected.
- E. Lapse-supported pricing may not be illustrated. Lapse supported pricing means that minimum profit objectives cannot be met with zero lapse assumptions.
- F. Persistency bonuses may not be illustrated.
- G. Minimum profit objectives must be established by the regulation or the actuarial practice standard.

#### VI. Actuarial Standards.

- A. It is preferable to have the Actuarial Standards Board develop the necessary standards.
- B. The Actuarial Standards Board must work in close cooperation with the NAIC to assure that the standards drafted in response to the model meet the expectations of the NAIC with regard to specific requirements and minimal actuarial creativity.
- C. In the event that the Actuarial Standards Board fails to meet the expectations of the NAIC, a regulatory standard prepared by the NAIC will be utilized.

#### VII. Responsibility.

- A. The company shall be responsible for the accuracy and propriety of the illustration as evidenced by the signed and dated certification by a company officer provided to the insurance department. The insurer is responsible for any representation or material omission of a representation in the sale of a life insurance policy.
- B. The company's illustration actuary shall be responsible for the accuracy of both guaranteed and non-guaranteed portions of the illustration and shall certify that the illustration is accurate and prepared in accordance with the appropriate actuarial standards as evidenced by the signed and dated certification by the illustration actuary.
- C. The producer shall be responsible to provide the appropriate illustration and to assure that no inappropriate illustration is provided to the applicant.

#### VIII. Annual Reports.

- A. The insurer shall annually on the policy anniversary provide a report to each policyowner.
- B. The report that is provided shall:
  1. Be in a prescribed format;
  2. Illustrate actual values as of the date of the report;
  3. Illustrate future non-guaranteed values using then current assumptions; and
  4. Explain changes in assumptions since the last report.

#### IX. Penalties.

- A. A violation of the act or regulation would be subject to civil penalties.
- B. If the agent or insurer provided illustrations that were not prepared in accordance with these requirements or illustrated benefits that were not based on the prescribed standards, the insurer may be subject to administrative penalties including a requirement to pay benefits based on the illustration.

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#### ATTACHMENT THREE-E3

##### Life Disclosure Working Group of the Life Insurance (A) Committee October 5 and October 12, 1994

The Life Disclosure Working Group of the Life Insurance (A) Committee met by conference call at 1 p.m. on Oct. 5, 1994, and 10 a.m. on Oct. 12, 1994. Commissioner Robert E. Wilcox (Utah) chaired the calls. The following persons participated in the conference calls: Tom Foley, Vice Chair (Fla.); John Montgomery and Hal Phillips (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Tony Higgins (N.C.); Noel Morgan (Ohio); Ted Becker and Andy Salmon (Texas); Bob Wright (Va.); and Fred Nepple (Wis.).

Commissioner Robert Wilcox (Utah) said the purpose of the conference calls was to discuss comments that had been received relative to the statement of standards distributed at the Sept. 17, 1994, Life Disclosure Working Group meeting. He suggested going through the statement paragraph by paragraph to determine where modifications might be necessary.

## Section II. Scope

The working group spent considerable time discussing the comments received in regard to requiring an illustration. Roger Strauss (Iowa) said it had been his understanding that the working group did not intend to require an illustration. Commissioner Wilcox explained his position: In a market conduct examination there is no way to verify if a company has used an illustration just because one is not in the file. If only specified types of coverage are excluded and everyone else must do an illustration, there will always be an illustration in the policy file for the market conduct examiner to review. There will also be a basis for the annual illustration update. Mr. Strauss pointed out that the problem with making a list of policies to exempt is that it would be very difficult to make this list inclusive enough. One of the comments received included a suggestion of the types of policies that could be excluded and Tony Higgins (N.C.) and Mr. Strauss agreed to use that as a starting point for the list of suggested exclusions to discuss at the interim meeting. Commissioner Wilcox asked them to also report on the difficulties of preparing the list.

The working group considered changing Subsection A to "Any representation of future performance of the policy provided for life contracts must satisfy the standards. No representative may be made unless these standards are complied with." Commissioner Wilcox pointed out that if one of the goals was to use an illustration for education, and no illustration was required, education would not take place. Other commenters discussed the provision of Subsection A that required applicants for life and *annuity* contracts to comply with this model. These commenters pointed out that other parts of the statement of standards referred only to life insurance. Commissioner Wilcox clarified that the working group had already decided to prepare a separate model for annuities after the life draft was complete. The overall objectives would be the same or similar in both circumstances. John Montgomery (Calif.) suggested adding a note that specifically stated the plan of the working group was to develop rules for life insurance first, variable life second, and then annuities.

The working group next discussed the illustration of variable life policies. Commissioner Wilcox suggested handling this issue as identically as possible to that of the other life products. The working group considered the advantages of combining variable life illustration rules with those for other life policies, or making a separate regulation. Mr. Higgins suggested looking at the rules for variable life so that the same standards could be used as much as possible. Commissioner Wilcox pointed out that the cover sheet would look the same, the treatment on interest rates would be different, but much of the other rules would remain the same. He suggested developing the standards at the same time.

The working group considered several other comments on this section about wording and Commissioner Wilcox noted that many of the people who had made comments on the draft misunderstood the purpose of this document. He said it was never intended to rise to the level of a model and was not intended to include all of the language that would be required in the model.

## Section III. Understandability

Noel Morgan (Ohio) asked about the phrase "typical applicant" that was included in Subsection A. He said this was not legal phrasing and had caused some confusion at the Sept. 17 meeting. Mr. Higgins suggested removing the four words from the draft. The working group also considered comments that earlier drafts had used the phrase: "the goal of the working group" was that illustrations should be understandable, and the working group decided to add that phrase at the beginning of Subsection A. In regard to Subsection B, Commissioner Wilcox said he had appreciated the comments from Dick Weber (Merrill Lynch Life) on vanishing premiums and how to educate consumers about this marketing tool. He suggested a review of the suggestions when the working group began drafting the actual model language.

## Section IV. Standardization of Presentation

The working group next discussed comments received regarding the level of standardization in the draft model regulation. Ted Becker (Texas) said he was not persuaded by the arguments. Mr. Strauss opined that the illustrations ought to at least start out the same, with opportunity for variation at later points. Commissioner Wilcox suggested that the model ought to give the sequence of the information that should be included. He said he did not have in mind a "fill in the blank" rule. Mr. Becker said that the placement of the numbers should be standardized so that the applicant would know where to look for certain information. Tom Foley (Fla.) said he envisioned an illustration that began by showing the mechanics of the policy which might be followed by further illustrations of how the policy would be used. Mr. Becker agreed that anything supplemental to the basic illustration should follow the standardized part.

The working group next discussed the comments on Subsection E and whether it was appropriate to add a sensitivity analysis or to use standardized assumptions. Some of the members of the working group thought it was a good idea to add the sensitivity analysis and others felt that it added confusion. Those who were in favor of the sensitivity analysis thought that a number halfway between the guarantee and the current assumptions was appropriate. The working group did not come to a conclusion on whether to include the sensitivity analysis and decided that discussion at the next meeting would be helpful. Commissioner Wilcox said he was impressed by the comments of those on the working group who were not actuaries that sensitivity adds more confusion than enlightenment. He said as an actuary, if he were buying a policy, he would want to see what 1% less interest produced. He said variations other than interest would be more difficult. Mr. Foley offered to do some testing of sensitivity and standardized assumptions. At the second conference call Mr. Foley reported on his work. He said it was very difficult to make an adjustment in elements other than an interest assumption. In the examples he prepared the results were very different in the situations where the company used the portfolio method of crediting or the new money method. He said in some instances his analysis required a standardized assumption to be higher than current scale. He recommended not using standardized assumptions. Fred Nepple (Wis.) suggested using current or the standardized assumption, whichever was less. Mr. Foley said that would change what was now a relatively level playing field between portfolio and new money methods of crediting. Judy Faucett (Coopers & Lybrand), who is an NAIC consultant on this project,



agreed that the type of portfolio a company had would also make a difference in the results. She said if a company had a lot of nonperforming real estate the contents of the portfolio would change the results. Frank Irish (Actuarial Standards Board—ASB) said the ASB Committee had discussed this issue but had not come to a conclusion. He said that group was split on the issue of standardized assumptions and on the issue of a sensitivity analysis. It was his opinion that standardization did not work unless companies were allowed to grade up as well as down. Mr. Irish said one danger in using this type of analysis was that companies could continually start new blocks of forms to use the new money method or the portfolio method, whichever was advantageous at that moment. Commissioner Wilcox added that he was reluctant to force companies to use one method or the other. Mr. Foley also pointed out that if the working group did not allow standardized illustrations higher than the current scale the rule would actually eliminate the new money method because it could cause an unlevel playing field. Commissioner Wilcox asked the working group to consider this issue more thoroughly and to bring specific examples to an interim meeting to be held in Kansas City on Oct. 26. A decision would be made at that time. The working group also agreed to consider further the issue of a sensitivity analysis at the Kansas City meeting. Mr. Montgomery cautioned the working group to not use the term “basis points” if a sensitivity analysis was decided upon. He said this term was meaningless to most consumers.

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

The working group considered several comments that had been received on Subsection K and discussed whether an appointed actuary should be required. Mr. Irish said an important factor was that the illustrations was representative of recent experience rather than the overall health of the company. He said it was a different kind of information than the appointed valuation actuary would ordinarily consider. Mr. Foley suggested having an “illustrations actuary” who must be appointed by the company. Commissioner Wilcox said this had the advantage of requiring the person who had the best information, but avoided giving a company the opportunity to shop for someone to sign the illustration. Commissioner Wilcox also suggested not using the term “appointed.” He said there was already a body of literature of what an appointed actuary is and it all refers to a valuation actuary.

#### Section V. Assumptions

Several members of the working group commented on Subsection A(3), and the fact that many of the comments received said this was a bad idea. Hal Phillips (Calif.) asked why each of the elements must be based on *separate* assumptions. Mr. Foley responded that this was an attempt to get at game playing. Mr. Irish said that if the working group wanted to get at the issue of interest rating, the concept could be incorporated in another place. The working group agreed to leave Subsection A(3) in now and to consider later moving it to the section on actuarial standards.

Discussion next turned to the issue of lapse-supported price. Mr. Foley said the working group could either define this concept or let the ASB develop a definition in its standards.

#### Section VII. Responsibility

The working group considered whether Subsection C limited the company's responsibility. The working group agreed that was not the intent and decided that rewording might be necessary.

#### Section VIII. Annual Reports

Initially the working group had suggested that a report would be given only if there was a change in the assumptions. The working group discussed Subsection A that now required an annual report whether there had been a change in the assumptions. Mr. Becker suggested that it would be necessary to change Subsection B(1) so that it would be in a format *proposed by the NAIC*.

The working group discussed a letter that Mr. Becker had sent to each working group member with a suggestion that Section V.E be deleted. Mr. Irish said the ASB would consider this issue in formulating its standards, and the working group voted to delete Subsection E from the draft. Mr. Becker asked if each individual set of numbers would be certified or whether the actuary would certify the software. Bob Wright (Va.) responded that if the program has been properly prepared, the actuary can certify that the program will produce accurate numbers. Mr. Phillips asked what the point of the signature requirement was. He did not think that it was meaningful to require the signature on the illustration. Mr. Foley asked the members of the working group to consider ways to make this workable and discuss it further at the interim meeting in Kansas City.

Mr. Wright said that earlier the working group had discussed having focus groups to determine whether the proposed illustrations were understandable by the typical consumer. Mr. Wright asked that this item be put on the agenda in Kansas City so that the working group could determine whether the industry would be willing to fund a study of this nature.

Having no further business, the Life Disclosure Working Group adjourned the conference calls at 3 p.m. and at 11:15 a.m. respectively.

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## ATTACHMENT FOUR

## Comparison of Current Model Annuity Nonforfeiture Law vs. Revised Model

	Current Law	Revised Model
1. Certification by Qualified Actuary	Initially only, with form filing, but only in certain states.	On file at company during the 5 years subsequent to issue or change. The certification shall be updated any time additional benefits are guaranteed.
2. Permissible Product Designs	(a) Continuous Access Annuity (CAA) (b) No Cash Value Annuity (NCVA)	(a) Continuous Access Annuity (CAA) (b) No Cash Value Annuity (NCVA) (c) Restricted Surrender Provision Annuity (RSPA)
3. Applicability	Individual fixed deferred annuities.	Individual and specified group deferred annuities, both fixed and variable.
4. Limitation on Expense Loads	35% on first-year premiums and 12.5% of subsequent for flexible premium deferred annuities; 10% on single premium deferred annuities.	(a) 20% of first \$10,000 (limited to \$3,000 per year), plus 10% of excess, plus (b) \$40 annual fee, plus (c) \$1.25 for consideration credited to the contract, plus (d) \$10 for transfer between subaccounts with annuity contract. Items (b), (c) and (d) are indexed to changes in the Consumer Price Index.
5. Limitation on Charges at Surrender	Based on grade-in to maturity-cash-value	The amounts specified in #4 less any expense loads previously charged.
6. Exception to Limitation on Expense Loads	Not Applicable	For CAA, the 10% in #4(a) may be replaced by 20% if (1) by age 65, the cash value converges to the amounts specified in #4, (2) specified additional guarantees are provided upon annuitization.
7. Market Value Adjustments	Separate Account Only	Yes, in General Account (when permitted by state) or Separate Account, subject to a maximum downward adjustment of 25% of the account values.
8. Minimum Interest Rate (Not applicable to Variable Annuities)	3%, on a cumulative basis, during deferral only.	Lesser of 2.25% and a rate of interest specified by commissioner. Can be changed on 60 days notice regarding future premiums.
9. Mortality Table	None specified	1983 Table A with projection scale G or other table adopted by NAIC and approved by commissioner. At the company's option and if approved by commissioner, non gender-distinct versions of approved tables may be used.

The description of the current law came from a table dated 7/27/94 (page 128 of the November Actuarial Mailing) from Garth Bernard.