

LIFE INSURANCE (A) COMMITTEE

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Dwight K. Bartlett III, Chair—Md.
Kerry Barnett, Vice Chair—Ore.

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MINUTES

The Life Insurance (A) Committee met in Club Atlantic D of the Fontainebleau Hilton in Miami, Fla., at 10 a.m. on March 14, 1995. A quorum was present and Dwight K. Bartlett III (Md.) chaired the meeting. The following committee members or their representatives were present: Kerry Barnett, Vice Chair (Ore.); Terri Vaughan (Iowa); James H. Brown (La.); Fabian Chavez (N.M.); Elton Bomer (Texas); and Robert E. Wilcox (Utah).

1. Hear Report of Life and Health Actuarial Task Force

Jerry Fickes (N.M.) reported that the Life and Health Actuarial Task Force had eliminated some projects from its agenda that were not being addressed. The Life Working Group prepared a statement of basic principles for the life nonforfeiture law and plans to redraft the model from that list of principles. He said that the working group wants to explore the concept of considering the current formula-based method as well as the possibility of determining a more accurate dynamic approach. He said the American Academy of Actuaries had been requested to investigate this approach and bring recommendations to the working group at its next meeting. Upon motion duly made and seconded, the Life and Health Actuarial Task Force report was received.

2. Consider Standard Nonforfeiture Law for Deferred Annuities

Mr. Fickes said the Actuarial Task Force report contained a recommendation to the Life Insurance (A) Committee to consider amendments it had prepared and attached to its report. He said the task force had reviewed all of the comments that had been submitted to the Life Insurance (A) Committee and recommended a number of changes to the draft Standard Nonforfeiture Law for Deferred Annuities. Mr. Fickes said the task force's recommendation was that the Life Insurance (A) Committee further expose the draft to hear comments resulting from the changes made. Upon motion duly made and seconded, the Life Insurance (A) Committee adopted the recommendation of the Life and Health Actuarial Task Force to continue to receive comments on the annuity nonforfeiture law draft.

3. Hear Report of Genetic Testing Working Group

Commissioner Dwight Bartlett (Md.) said that Ohio had been chairing the Genetic Testing Working Group but had asked to be relieved of this duty. Ohio intends to remain a part of the Genetic Testing Working Group, but because of budget constraints is no longer able to chair the working group. Dixon Larkin (Utah) agreed to chair the working group. Ted Becker (Texas) asked if Texas could be added to the working group, and Commissioner Bartlett agreed.

David Randall (Ohio) reported that the Genetic Testing Working Group held a hearing and heard comments on the outline of a white paper that it had prepared. He said the comments had been very helpful and the working group intends to proceed with writing, based on information it has gathered.

Upon motion duly made and seconded, the report of the Genetic Testing Working Group was received (Attachment One).

4. Hear Report of Life Disclosure Working Group

Commissioner Robert E. Wilcox (Utah) reported that the Life Disclosure Working Group had an aggressive schedule to complete the drafting of the Life Insurance Sales Illustrations Model Regulation. He said most of its meeting time had been spent reviewing the draft put together by a subgroup of the working group and discussing possible changes to that draft. He said there are a number of outstanding issues that the working group intends to review at an interim meeting in April. He said the working group had also received a draft from the Actuarial Standards Board (ASB) of an actuarial standard of practice. Commissioner Wilcox said the ASB would meet in Washington, D.C., in April and intends to expose its standard of practice at that time. The Life Disclosure Working Group intends to meet in conjunction with the ASB meeting to resolve final issues related to the model law draft. After that meeting, Commissioner Wilcox promised that copies of the draft would be sent to all interested parties and it was the working group's intent to submit the draft regulation to the Life Insurance (A) Committee in June for adoption. He said that would complete the portion of the working group's charge related to non-variable life insurance.

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

5. Appoint Synthetic GIC Working Group

Commissioner Bartlett said that Reginald Berry (D.C.) has chaired a working group the previous year and had recommended that this working group be reappointed. He said the charge from the NAIC leadership included a regulatory response to the issue of synthetic guaranteed interest contracts (GICs). Commissioner Bartlett said he would reappoint the working group from the prior year, which consisted of the District of Columbia, New York and Illinois.

6. Appoint Working Group on Viatical Settlements

One of the charges to the Life Insurance (A) Committee is to consider viatical settlements as they relate to the secondary market. Commissioner Bartlett said that a working group would be appointed to consider this issue and report to the Life Insurance (A) Committee. Commissioner Glenn Pomeroy (N.D.) offered to chair the working group and Commissioner Bartlett asked for other states interested in being a member of the working group. Florida, Oregon and Utah expressed interest in being on the working group. Commissioner Bartlett said he thought it would be appropriate to have several more members on the group and asked for those who are interested to speak to Commissioner Pomeroy.

7. Any Other Matters Brought Before the Committee

Mr. Fickes asked the committee to consider asking for a charge related to annuities. He said there was a great change in the annuity market since the recent U.S. Supreme Court decision in *NationsBank of North Carolina v. Variable Annuity Life Insurance Company*. Mr. Fickes said that the insurance department could no longer regulate the writing of annuities in New Mexico and suggested that this is an important issue for the NAIC to review. Commissioner Bartlett asked Mr. Fickes to draw up a charge that might be considered. Commissioner Bartlett said that the Market Conduct and Consumer Affairs (EX3) Subcommittee also had a charge on the issue and asked Mr. Fickes to review that charge also. Commissioner Wilcox said it seemed to him that the annuity issue is much broader than a market conduct issue. He said it was troublesome that products might be offered in an unregulated way. He said banks have no experience in this product and cautioned that dual regulation could lead to unfairness. John Booth (American Council of Life Insurance—ACLI) said he is pleased to see the

NAIC's interest in addressing this situation. He emphasized that it is important to work out a solution on this issue.

Having no further business, the Life Insurance (A) Committee adjourned at 10:30 a.m.

Dwight K. Bartlett, Chair, Md.; Kerry Barnett, Vice Chair, Ore.; Terri Vaughan, Iowa; James H. Brown, La.; Drew Karpinski, N.J.; Fabian Chavez, N.M.; Jim Long, N.C.; Elton Bomer, Texas; Robert E. Wilcox, Utah

ATTACHMENT ONE

Genetic Testing Working Group of the
Life Insurance (A) Committee
Miami, Florida
March 12, 1995

The Genetic Testing Working Group of the Life Insurance (A) Committee met in the LeMans/Bordeaux Rooms of the Fontainebleau Hilton in Miami, Fla., at 9:30 a.m. on March 12, 1995. David Randall (Ohio) chaired the meeting. The following working group members or their representatives were present: Don Koch (Alaska); Tom Foley (Fla.); Richard Rogers (Ill.); Mary Alice Bjork (Ore.); Dixon Larkin (Utah); and Roy Olson (Wash.).

David Randall (Ohio) announced that the purpose of the meeting was to hold a hearing on genetic testing to gather information for the white paper the working group was charged to prepare. He began by reading the charge to the group from the outline for the genetic testing paper (Attachment One-A).

Roberta Meyer (American Council of Life Insurance—ACLI) testified that she believed the outline the working group had prepared is a good tool for gathering information. Ms. Meyer said the ACLI had not had time to prepare a comprehensive response, but would address the three basic issues included in the outline and respond more completely at a later time. She introduced Michael Moore (Nationwide) who provided the working group with additional background information on the science of genetic information and genetic tests as it relates to risk classification. He said that as he learned more and more about the genetic mechanisms of disease, he found it more and more difficult to make distinctions between which diseases do and do not have a genetic component. Dr. Moore said there are genetic disorders that are inherited from our parents, and genetic disorders that are acquired over a lifetime as a result of alterations of genes. He said that, to his knowledge, insurers are not currently requiring genetic DNA-based tests as a prerequisite for life insurance coverage, but he emphasized that his organization felt it is essential that insurers have the right to underwrite on the basis of genetic testing.

Birny Birnbaum (Texas) asked what criteria insurers generally used for their tests, and Dr. Moore responded that tests should have Food and Drug Administration (FDA) approval and give accurate information. Mr. Birnbaum asked if there was a published list of criteria that companies used and Dr. Moore responded that each company made its own decision on the tests to use. Dixon Larkin (Utah) asked if the kinds of questions asked now on an insurance application were not a form of genetic testing. Dr. Moore responded that even questions on how tall are you and how much do you weigh are a kind of genetic question. He said the line between genetic and non-genetic questions and testing is getting fuzzier as time goes on. Dr. Larkin asked if the genetic testing was not really being used as a way of setting rates individually, as opposed to a kind of community rating for life insurance.

Landon Clayman (a consumer) shared an anecdote of his own experience. He said he had a genetic disease which, if not treated, would become very dangerous, but he was in good health because his genetic disease was being treated. His doctor told him that there would be no effect on his life expectancy as long as he continued to treat the disease, but he was unable to get life insurance. He expressed concern about insurers drawing a line about who is insurable and who is not, even when life expectancy may not be affected.

John Booth (ACLI) testified on the reasons why the risk classification process is important. He emphasized the differences between life and disability income insurance and health insurance. Mr. Booth said medical advances had served to make it possible for increased numbers of people to obtain coverage at better rates, and he saw no reason that advances from DNA-based genetic tests would operate differently.

Wendy McGoodwin (Counsel for Responsible Genetics) focused her comments on the definition of genetic testing. She expressed the opinion that under a narrow definition limiting the genetic testing to a laboratory test of genes or chromosomes, large segments of the population would be unprotected from discriminatory underwriting. She said in reality there are many other signs that will point to a genetic abnormality, such as blood tests. She encouraged the working group to adopt a broad definition to include a variety of ways to identify genetic disorders. Ms. McGoodwin emphasized that a genetic test result would not give information about the onset of the disease. As an example she noted that Huntington's disease may manifest itself in a person as a teenager or not until the individual is in his 60s.

Phillip Bereano (Washington Biotechnology Council) disagreed with Dr. Moore's definition of acquired genetic disease. He found this definition amazing because he said there was no such thing, instead it was an environmental problem. Mr. Bereano

said the issue was discrimination and the result should not be different depending on how one got the information. He pointed to the broad public policy issues. For example, it is not permissible to offer higher rates to African Americans or lower rates to Mormons because of the public policy decision that it is not appropriate to discriminate on the basis of race or religion. Mr. Bereano said that mortality tables being used already have an adjustment for genetic disease and that allowing insurers to exclude individuals who have a genetic disease gives them two bites of the apple.

Robert Gleeson (Northwestern Mutual) said that 85% of applicants are issued at the better classes and genetic testing would not change that. He said the issue of guaranteed issue was different and it was not appropriate to get there through the mechanism of a genetic testing discussion.

Terry Sorate (Health Insurance Association of America—HIAA) endorsed the comments of the ACLI. She said she had come to the meeting thinking that it would be a discussion about DNA testing and since insurers were generally not doing so or planning to do so, she had planned to phrase her comments with that in mind. But, she said it seemed that the comments are really focusing on risk classification, and she urged the working group not to increase insurers' risk of adverse selection. She said that health insurance is less of a problem because so many policies are issued to groups and, because of employer contributions, a large pool was created.

Mr. Randall said he thought a key element is how the definition should be constructed—whether broad or narrow. Mr. Birnbaum asked if the working group could schedule a meeting in the near future to get into much greater detail on the issues presented. He expressed frustration at the amount of information that was available through the individuals in attendance, but the format of the meeting did not allow time for fuller discussion. Mr. Randall responded that, because of travel restrictions, many states are unable to attend interim meetings so the working group would have a conference call to discuss drafting the white paper based on the information received. Kathleen Connor (Wash.) said it would be helpful to receive the responses based on section by section of the outline, so that the working group could lay comments side by side and compare.

Having no further business, the Genetic Testing Working Group adjourned at 11 a.m.

ATTACHMENT ONE-A

Outline for White Paper on Genetic Testing in Insurance Draft: 2/23/95

The Genetic Testing Working Group has been charged with developing a white paper on genetic testing in insurance. The working group believes that a white paper following the outline below will provide relevant and useful information for regulators who are considering public policy dealing with genetic testing and insurance.

The working group solicits information and comments from regulators, industry, consumers and other interested parties on the various topics in the outline. It is hoped that interested parties can help the working group gather the information necessary to fill in the outline and develop the white paper.

I. Definition of Genetic Testing

- A. Narrow definition: direct test of DNA or chromosomes or gene products to detect genetically controlled disease.
- B. Broader definition: laboratory analysis of DNA, chromosomes or gene products to detect propensity to disease if exposed to certain environmental factors.
- C. Broadest definition: any diagnostic assessment suggesting evidence of a genetic condition, including laboratory analysis, physical examination, ultrasound and family history survey.

II. The Current State of Genetic Testing

- A. Description of the U.S. Human Genome Project
- B. How, when, at what cost, for what and by whom is genetic testing currently used?
- C. How reliable a predictor of health problems is genetic testing? Does the reliability vary by type of test, type of health problem? What is the current state of the technology?
- D. How reliable a predictor of insured losses is genetic testing? Does this reliability vary by type of test, type of insured loss?
- E. What will the technology and reliability of genetic testing look like in two, five and 10 years?

III. Genetic Testing in Life, Health and Disability Income Insurance

- A. Overview of life, health and disability income insurance: how sold (group vs. individual), what covered, how underwritten, classified and priced.

B. What is the current state of genetic testing in life, health and disability income insurance?

- (1) Are insurers currently requiring applicants to submit to genetic testing?
- (2) Are insurers currently using genetic test results from any source in underwriting?

IV. Concerns about Genetic Testing in Life, Health and Disability Income Insurance

A. Insurance Industry Concerns

- (1) Consumers gaming insurers (do concerns vary for life vs. health and disability?)
- (2) Prohibitions against risk classification—cost and market impact
- (3) Other

B. Consumer concerns

- (1) Uninsurability
- (2) Confidentiality
- (3) Burden of knowledge
- (4) Discrimination and its consequences on personal medical decisions
- (5) Impact on existing policyholders
- (6) Other

C. Public policy concerns

- (1) Public health problems
- (2) Fair discrimination in insurance
- (3) Excessive classification
- (4) Americans with Disabilities Act
- (5) Other

V. Regulatory Options

A. Policy options: discuss how the policy addresses the concerns identified in IV above, how the definition of genetic testing affects the results of the policy, and how the policy may affect life and health insurance differently.

- (1) Prohibit the use of genetic test results in underwriting, prohibit insurers from requiring applicants to undergo genetic testing.
- (2) Allow insurers to use results of genetic tests if consumer knows results of genetic tests obtained for other reasons.
- (3) Allow insurers to require genetic testing for only limited types of characteristics and allow insurers to use only that limited information in underwriting.
- (4) Allow insurers to require genetic testing and use results of genetic tests if consumer seeks coverage above a threshold amount or in other specific circumstances.
- (5) No restrictions on insurers' ability to require genetic testing and underwriting on the basis of genetic test results.
- (6) Other policy options

B. Survey of State Legislative and Regulatory Activities and Initiatives

VII. Genetic Testing Working Group Recommendations

VIII. Bibliography

ATTACHMENT TWO

Life Disclosure Working Group
of the Life Insurance (A) Committee
Miami, Florida
March 13, 1995

The Life Disclosure Working Group of the Life Insurance (A) Committee met in Fontainebleau C of the Fontainebleau Hilton in Miami, Fla., at 10 a.m. on March 13, 1995. 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); Daphne Bartlett (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Tony Higgins (N.C.); Ted Becker (Texas); and Fred Nepple (Wis.).

1. Adopt Minutes of Jan. 5-6, 1995, Meeting and Feb. 9-10, 1995, Meeting

Upon motion duly made and seconded, the minutes of the Jan. 5-6, 1995, meeting (Attachment Two-C) and Feb. 9-10, 1995, meeting (Attachment Two-B) were adopted.

2. Consider Draft Life Insurance Sales Illustration Model Regulation

Commissioner Robert Wilcox (Utah) said the working group intends to spend the majority of the meeting reviewing the draft Life Insurance Sales Illustration Model Regulation (Attachment Two-A), with the understanding that an interim meeting in approximately 30 days would be held to address the rest of the issues. Commissioner Wilcox asked the group to turn its attention first to Section 4C, the definition of "disciplined current scale," and the two alternatives that were suggested in the draft before the members. In the first alternative, the second sentence of the definition was deleted. The second suggestion deleted the same sentence and also began with a sentence that said, "Disciplined current scale" means the maximum values for non-guaranteed items which may be illustrated at any duration as defined in standards established by the Actuarial Standards Board. Judy Faucet (Coopers and Lybrand), an NAIC consultant, asked if the sentence was moved to another place within the model regulation. Daphne Bartlett (Calif.) said she thought the sentence was redundant. Tom Foley (Fla.) recommended the working group go back to the original language of Subsection C and the group agreed this was the most appropriate definition.

Commissioner Wilcox asked the group to turn its attention to the definition of illustration actuary in Subsection G. He said it must be clear that the illustration actuary is appointed by and answers to the board of directors of the company. The working group decided that it was not necessary to put some of the requirements for the illustration actuary in the definition, and instead referred to Section 15 of the model where the requirements for the illustration actuary are fully set out.

Commissioner Wilcox said it was important that the definitions of "lapse supported pricing," "persistency bonus" and "self-supporting illustration" be in the draft regulation, and asked that the definition of lapse supported pricing and self-supporting illustration that are currently in the draft of the Actuarial Standards Board (ASB) Standard of Practice be included. He suggested that the definition of persistency bonus that had been prepared by Mark Peavy (NAIC/SSO) at the working group's last meeting be used. He said the definitions could be discussed more fully at the working group's next meeting.

Commissioner Wilcox asked the group to turn its attention to Section 5 to discuss which policies should be illustrated. He said the intent of the working group all along had been that if a policy was selected to be sold with an illustration, it would not be sold without an illustration. If the insurer chose to use no illustration, the policy could not be sold with an illustration. He said the only time an illustration would be provided at delivery was if the insurer sold by mail. If a producer was involved, an illustration must be used at the time of sale. Commissioner Linda Ruthardt (Mass.) said that at some point people will be able to buy life insurance over the Internet and will create their own illustrations. She urged the group not to draft so narrowly that this type of illustration was not covered. Commissioner Wilcox asked the technical resource advisors to respond to this issue at the next working group meeting. He said it was a valid point that needed to be addressed in the draft.

George Coleman (Prudential) said it had been his understanding that illustrations would not be required at the point of sale. He said some agents did not use illustrations and he thought it more appropriate to get a signature on an illustration at the end of the process so that the one illustration signed matched the policy applied for. Commissioner Wilcox asked Don Koch (Alaska) what he, as a market conduct examiner, wants to see during a market conduct examination. Mr. Koch responded that he thought that it was important to have in the file any illustration that had been used, so that the market conduct examiner was able to track the whole process. He said he thought companies would want to see the type of illustration their agents were using. Commissioner Wilcox agreed that the only way to know what was being said was to require the use of an illustration and to require that it be documented in the file by asking the applicant to sign the illustration. Tony Higgins (N.C.) reminded the group that an alternate had been considered previously that allowed applicants to sign a statement saying that they had purchased the policy without an illustration. Mr. Foley suggested that the members of the working group and the others in attendance give this issue a great deal of thought before the next working group meeting so a final decision could be made.

Commissioner Wilcox asked the working group to turn its attention to Section 12 on the standards for supplemental and concept illustrations. He said the issue of vanishing premiums was one of the most contentious issues in the draft. It was his opinion that, if insurers had never illustrated vanishing premiums, there probably would not have been a working group created. He said it seemed to him that to keep the integrity of the illustration, vanishing premiums needed to be shown in a supplemental illustration. He said it actually gave the industry more flexibility to include vanishing premiums in the supplemental illustration, because then the only limit was that it not be inconsistent with the basic illustration. Linda Lanam (Life of Virginia) said the problem that arose was the premium payment pattern. She said that if the applicant selected a premium that bore no relationship to what was shown on the basic illustration, it would not contribute to the applicant's understanding. She said if the person planned to pay a larger premium in earlier years so that it would vanish, the company would not be able to illustrate this appropriately. Mr. Foley suggested a compromise: he said if the planned premium did not violate Internal Revenue Code Section 7702 rules, it could be shown for all years. Roger Strauss (Iowa) said a fundamental issue was that the consumer realize that the premium is being paid from someplace. He said that was the most important issue to him and if it were to be included in the basic illustration then he would want to show the numbers with an asterisk beside them saying that they were being paid from other than the consumer's pocket. Ted Becker (Texas) said he would favor a basic illustration with very rigid requirements to allow the applicant to compare products. He suggested an illustration with a set dollar amount such as \$720 per year. Commissioner Wilcox suggested that this discussion be continued at the working group's next meeting, and Ms. Faucet suggested that technical resource advisors bring sample illustrations that showed the vanishing premium concept in a basic illustration and a supplemental illustration.

Michelle VanLeer (John Hancock) said she was concerned about the alternative provision in the draft that required supplemental illustrations to also show guarantees. She said it would make the illustration extremely complex for a split dollar product, for example. However, Ms. VanLeer pointed out that if the supplemental illustration was not required to show the guaranteed figures or something in between disciplined current scale and the guarantees, it would not give information to consumers that a vanishing premium would vanish at different times with different assumptions. Commissioner Wilcox agreed this was a danger. The working group agreed to consider this issue further at the interim meeting.

Commissioner Wilcox next asked the group to turn to Section 14 on the annual report to the policy owners. He said the draft currently required an annual report that would be received each year, but did not specify the information that needed to be included in the report. He said the draft also provided for an updated illustration upon request, but did not have any requirements for what that would look like. He identified the need to explore both of these requirements more fully at the interim meeting. Mr. Higgins said he also thought it was important to add an alert that there was something different, if in fact that was the case, so that the insured would understand the importance of requesting an in-force illustration. Commissioner Ruthardt emphasized that it was very important to get information to the policyholders on how their policy was doing. Mary Griffin (Consumers Union) noted that there was a change in the language in the most recent draft and encouraged the working group to return to language that more forcefully talked about replacing an insurance policy. Commissioner Wilcox asked for the reason that the draft had changed and Carolyn Johnson (NAIC/SSO) responded that the ad hoc drafting group had felt the former language might actually encourage replacement of a policy. Ms. Griffin said her intent was to warn people not to replace their policy, especially within the first 10 years. Mr. Koch and Mr. Higgins suggested replacement language for the policyholder notice that they thought would address Ms. Griffin's concerns and their own. Commissioner Ruthardt pointed out that one of the ways to stop churning of policies was to let the policyholder know also when good things had happened to his policy.

Discussion next turned to Section 15 on the annual certifications of the actuary and company officer. Commissioner Wilcox said it was his understanding that certification would be required to the commissioner and the insurer's board when the disciplined current scale changed, if the actuary discovered a previous certification had been in error, for new policies, and yearly for all other policies. The working group agreed this was their understanding and Commissioner Wilcox asked Ms. Johnson to change the language to reflect that understanding. Bill Koenig (Northwestern Mutual) said the ASB Life Committee doing the drafting of the actuarial standard did not think it was necessary to provide a certification upon a change in scale. He said if the company lowered its scale and had to recertify, it would encourage the company not to change its scale because of the extra administrative burden. Mr. Peavy asked what the result would be if the actuary felt he could not certify to the scale that the insurer wished to use. Commissioner Wilcox asked how the insurer could even sell such a product. Mr. Peavy responded that the current draft of the ASB standard only required certification to the board, but not notification to the commissioner. Commissioner Wilcox said that if the actuary could not certify to the proposed scale, the company had two alternatives: it could not sell the policy with that illustration, or it could change its scale. He asked why it was necessary to even consider what would happen if the actuary could not certify. Mr. Koenig responded that the ASB was attempting to give the actuary who was in a bad spot a way to get out of trouble. If the actuary said he could not certify to the insurer's board, it would open negotiations within the company. Commissioner Wilcox said if the illustration actuary advised the regulator that he could not certify to a policy, the regulator would be aware of the need to watch for any instances when that type of policy would be sold. Commissioner Ruthardt pointed out that if there was a sudden change in a company's illustration actuary, that would be a red flag to the regulators in the same way as it is when a company suddenly changes accounting firms. The working group agreed to add a requirement to notify the commissioner if the illustration actuary changed.

3. Consider Revised Draft of Actuarial Standards of Practice

Commissioner Wilcox asked Mr. Koenig to describe the tests used to implement the actuarial standards of practice. Mr. Koenig described the testing results and explained the differing results when conservative or aggressive assumptions were used.

Commissioner Wilcox next asked for more information about persistency bonuses. Mr. Koenig said the goal of the ASB was to write a standard that would prohibit illustrations that could not be supported. He said if a persistency bonus relied on funds accumulated from other policyholders, it would fail, but an individual policy that held back some of its value to give a bonus would pass the test. In Mr. Koenig's opinion this was not an illustration abuse but rather a mediocre product. Commissioner Wilcox said that the working group had always been concerned that any type of persistency bonus should not be illustrated and asked the group if they felt comfortable allowing that type of persistency bonus. Mr. Becker said he did not think this type of illustration was appropriate.

Mr. Koenig said the ASB Life Committee would meet on April 19 and 20 to work on the draft standard of practice again and intended to expose the standard at that time. Commissioner Wilcox said it might be useful for the working group to schedule its interim meeting in connection with the ASB meeting in Washington, D.C.

Having no further business, the Life Disclosure Working Group adjourned at noon.

LIFE INSURANCE SALES ILLUSTRATIONS MODEL REGULATION
Draft: 3/13/95

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Section 1. Purpose

The purpose of this regulation is to provide rules for life insurance policy illustrations that will protect consumers and foster consumer education. The rules provide illustration formats, establish maximums for non-guaranteed items to be illustrated, prescribe standards to be followed when illustrations are used, and specify the disclosures that are required in connection with illustrations. The goal is that illustrations accurately describe policies and do not mislead potential or actual purchasers of life insurance. It is also the goal of the regulation to make illustrations more understandable by encouraging insurers to eliminate as far as possible the use of footnotes and caveats and to define terms used in the illustration in language understood by the average consumer.

Section 2. Authority

This regulation is issued based upon the authority granted the commissioner under Section [cite any enabling legislation and state law corresponding to Section 4 of the NAIC Unfair Trade Practices Act].

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 except variable life insurance.
- B. This regulation shall not apply to the illustration of individual and group annuity contracts or credit life insurance.
- 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.

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.

Comment: Do we need to define applicant if we define policy owner?

- B. "Contract premium" means the gross premium that is required to be paid under a fixed premium policy including the premium for any rider for which benefits are shown in the illustration.

Comment: Consider deleting reference to contract premium and just showing what the applicant intends to pay.

C. "Disciplined current scale" means a scale of non-guaranteed items 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.

D. "Generic name" means a short title descriptive of the policy being illustrated such as "whole life," "term life" or flexible premium adjustable life."

E. "Guaranteed" and "non-guaranteed items"

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

(2) "Non-guaranteed items" 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.

F. "Illustration" means a presentation or depiction of the premiums, values and benefits of a policy of life insurance of one of the two types defined below:

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

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

G. "Illustration actuary" means an actuary meeting the requirements of Section 15 who certifies to 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 a product or product illustration based on the assumption that surrender gains are passed on with tontine effect to those policy owners who persist into later years.

I. "Persistency bonus" means an illustrated cash surrender value whose ratio to the accumulated cash flows exceeds by more than two percent (2%) the ratio of the illustrated cash surrender value to the accumulated cash flows for the prior year. The value of the accumulated cash flows shall be those calculated for testing compliance with the requirements of the "self-supporting" definition, including the accumulated cash flows calculated for the first ten (10) policy years.

J. "Policy owner" means the owner named in the policy.

K. "Premium outlay" means the amount of premium assumed to be paid 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 non-guaranteed, are based on the indicated premium outlay.

L. "Self-supporting illustration" means an illustration for a policy form is self-supporting if it can be demonstrated that, when using experience assumptions underlying the disciplined current scale, for all points in time on or after the fifteenth policy anniversary (or upon expiration if shorter), the accumulated value of all policy cash flows equals or exceeds the total policy owner value available. For this purpose, policy owner value will include cash surrender values and any other illustrated benefit amounts available at the policy owner's election.

Section 5. Policies to Be Illustrated

Each insurer marketing policies to which this regulation is applicable shall notify the commissioner whether a policy form is to be marketed with or without an illustration. For all policy forms being actively marketed on the effective date of this regulation, the insurer may, by letter, identify those forms and whether or not an illustration will be used with them. For policy forms filed after the effective date of this regulation, the identification shall be made at the time of filing and may thereafter be changed by notice to the commissioner.

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 to sell that form 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 Sections 6 through 13 of this regulation shall be provided as required by this regulation.

Section 6. General Rules and Prohibitions

A. An illustration used in the sale of a life insurance policy must:

- (1) Satisfy the requirements of this regulation; and
- (2) Contain at least the following components:
 - (a) Basic information contained in Section 7;
 - (b) Numeric summary and statements contained in Section 8; and
 - (c) Tabular details contained in Section 9.

B. An illustration used in the sale of a life insurance policy shall meet the following requirements:

- (1) An illustration shall clearly be labeled "life insurance policy illustration."
- (2) Each page of an illustration, including any explanatory notes or pages shall contain an identifying number that is unique to that illustration.
- (3) The assumed dates of payment receipt and benefit payout within a policy year shall be clearly identified.
- (4) If the age of the applicant is shown as a component of the tabular display, it shall be issue age plus the numbers of years the policy is assumed to have been in force.
- (5) Whenever non-guaranteed items are illustrated:
 - (a) They must be based on a scale or scales no more favorable than the disciplined current scale at any duration;

Alternative 4A. Add this statement to each page. Alternative is to add it to the statement signed by the applicant.

- (b) Each page of the illustration shall contain in substance the following statement:

Note: Illustrated values are not guarantees except where clearly indicated as guaranteed. An illustration is not an estimate or a prediction of future results.

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

- (1) Representing the policy as anything other than a life insurance policy;
- (2) Using or describing non-guaranteed items in a manner that is misleading or has the capacity or tendency to mislead;
- (3) Stating or implying that the payment or amount of non-guaranteed items is guaranteed;
- (4) Displaying non-guaranteed benefits and values with any greater prominence than corresponding guaranteed benefits and values.
- (5) Using a policy illustration which does not comply with the requirements of Sections 6, 7 and 8 of this regulation;
- (6) 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;
- (7) Providing an applicant with an incomplete illustration;
- (8) 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;
- (9) Using the term "vanish" or "vanishing premium" or any similar term to describe a plan for using non-guaranteed items or dividend credits to pay a portion of future premiums;

- (10) Using an illustration that depicts "lapse-supported pricing";
- (11) Using an illustration that depicts a "persistency bonus";
- (12) Using an illustration that is not "self-supporting."

Section 7. Basic Illustration Format

A. All basic illustrations used in connection with the sale of life insurance policies shall conform with the following minimum standards:

- (1) Each page, 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").
- (2) The assumed payments on which the illustrated benefits and values are based shall be identified as premium outlay or contract premium, as applicable. For policies that do not require a specific premium payment amount, the payments shall be identified as premium outlay.

B. A basic illustration shall begin with at least the following 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 illustrated policy is based;
- (5) Generic name of policy, the insurer's product name, if different, and form number;
- (6) Dividend option election or application of non-guaranteed items, if applicable;
- (7) A brief description of the policy being illustrated;
- (8) A brief description of the premium outlay or contract premium, if applicable, required by the policy. For a policy that 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 a life insurance policy under the applicable provisions of the Internal Revenue Code;
- (9) A brief description of any policy features, riders 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.
- (10) Identification and a brief definition of column headings and key terms used in the illustration.

Comment: Will these come from a standard glossary of terms or will each company define its own terms? Should the glossary be included in the model? How will regulators deal with situations where company terms differ from glossary terms?

Section 8. Numeric Summary

The numeric summary shall come after the basic information required in Section 7. If the basic illustration shows any non-guaranteed benefits and values based on the insurer's disciplined current scale or any lower scale greater than guaranteed, 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 70 on the following three bases. For joint life policies the numeric summary shall be for years 10, 20 and 30.

- A. Policy guarantees;
- B. Insurer's disciplined current scale or some lower scale;
- C. Insurer's disciplined current scale or lower scale used but with the non-guaranteed items reduced as follows:
 - (1) Dividends must be shown at fifty percent (50%) of the dividends contained in the disciplined current scale or lower scale used;

Note: Review carefully for consistency between participating and nonparticipating policies.

- (2) 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 or lower scale used; and

(3) 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 or lower scale used.

D. 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 items to a midpoint.

Alternative 3B would eliminate this section and incorporate the information in Section 13.

Section 9. Statements

Statements similar to the following shall be included on the same page as the numeric summary required in Section 8, and signed by the applicant and the producer or other authorized representative of the insurer.

A. 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 numbers in the non-guaranteed column are subject to change, either higher or lower. The agent has not told me they are guaranteed." If the illustration is produced by the insurer and mailed to the applicant, no statement or signature shall be required.

Comment: The working group needs to consider whether the exemption for the signature requirement applies only if no agent is involved. If the agent uses an illustration, but does not get it signed, and then mails another one to the applicant, it would appear no signature is required. This could be a revised illustration, or the agent could have chosen to present a second copy, under the provisions of this section. If the working group intends to have the original statement signed at time of application if one was used, changes will be needed in several places in the draft.

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

Alternative 4B: Include in substance the following sentence in the statement:

Note: Illustrated values are not guaranteed except where clearly indicated as guaranteed. An illustration is not an estimate or a prediction of future results.

C. If the policy issued is not the same as the one originally illustrated, a new policy illustration shall be prepared that corresponds to the policy issued. The revised illustration shall conform to the requirements of Subsections A and B above, shall be labeled "Revised Illustration" and shall be signed and dated by the applicant and producer or other authorized representative of the insurer.

Comment: The exemption from the signature requirement contained in Subsections A and B may mean the revised illustration does not need to be signed because it may be mailed by the insurer rather than delivered by the producer. How can the working group make sure the applicant is aware that he or she has received a second illustration if no signature is required? After further discussion, Subsection C will need clarification.

Section 10. Tabular Detail

A. 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;
 - (a) (i) For a fixed premium policy, the contract and the premium outlay if applicable;
 - (ii) For a flexible premium policy, the premium outlay;
 - (b) (i) For a fixed premium policy, the guaranteed death benefit and the guaranteed value available on surrender, as provided in the policy corresponding to the contract premium amount in Subparagraph (a)(i);
 - (ii) For a flexible premium policy, the guaranteed death benefit and the guaranteed value available upon surrender, as provided in the policy corresponding to the premium outlay amount in Subparagraph (a)(ii).
- (2) The guaranteed death benefit, as provided in the policy, corresponding to the premium in Paragraph (1);

(3) The guaranteed value available upon surrender, as provided in the policy, corresponding to the premium in Paragraph (1);

B. Illustrations may be in graphic or chart form in addition to the tabular format, and must show the corresponding guaranteed items in the same format if non-guaranteed items are shown.

C. 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.

D. 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 policy owner in a lump sum after deduction of any applicable surrender charges, policy loans and policy loan interest.

Comment: If a standard glossary of terms is added, the values in Subsection C and D will also be identified by those terms.

E. If non-guaranteed values and benefits are shown, they must be shown at least at the same durations as guaranteed values.

F. 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.

G. Whenever non-guaranteed items are illustrated on a page of an illustration that does not also show guaranteed items, a statement must appear on that page referring to where information on the guaranteed items may be found (e.g., see page one for guaranteed benefits and values.)

H. If amounts based on a combination of both guaranteed and non-guaranteed items are shown, they shall be indicated as being non-guaranteed.

Section 11. Standards for Basic Illustrations

A. Guaranteed death benefits and values available upon surrender for the illustrated premium outlay or contract premium shall be shown and clearly labeled guaranteed.

B. Illustrations of non-guaranteed benefits and values must be based upon the insurer's disciplined current scale or on any other additional scale or scales not more favorable than disciplined current scale at any duration. These benefits and values must be clearly labeled not guaranteed.

Section 12. Standards for Supplemental and Concept Illustrations

A. A supplemental or concept illustration may be provided so long as:

- (1) It is incorporated into or accompanied or preceded by a basic illustration which complies with this regulation;
- (2) Any non-guaranteed items shown are not more favorable to the policy owner than the corresponding items based on the insurer's disciplined current scale; and
- (3) It contains the statement in Section 10F if non-guaranteed benefits and values are illustrated.

B. If a supplemental or concept illustration shows that, at an insurer's disciplined current scale or any lower scale greater than guaranteed, 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.

Comment: The placing of this paragraph implies that vanishing premiums can only be shown in a supplemental illustration. One of the topics for discussion should be whether that is the will of the group, and if so, is it clear as now drafted?

Alternative 3A. Signature requirements in section on format, record retention requirements here.

Section 13. Delivery of Illustration and Record Retention

- A. (1) If a policy is applied for as illustrated, a copy of that illustration signed as required in Section 9, shall be submitted to the insurer at the time of policy application. A copy must also be provided to the applicant.
- (2) If the policy is issued other than as illustrated, a revised basic illustration shall be sent with the policy and signed at the time the policy is delivered. A copy shall be provided to the insurer and the policy owner.
- B. If the basic or revised illustration is produced by the insurer and mailed to the applicant or policy owner, no signature shall be required.
- C. A copy of the signed illustration for the policy as issued, shall be retained by the insurer until three (3) years after the policy is no longer in force. A copy need not be retained if no policy is issued.

Alternative 3B. Eliminate Section 9 and incorporate information on statements here.

Section 13. Delivery of Illustration to Policy Owner

- A. The insurer must provide an illustration to the policy owner not later than at the time of policy delivery reflecting the values implicit in the policy as issued.
- B. (1) If the policy issued is not the same as the one originally illustrated, a new policy illustration shall be prepared, labeled "Revised Illustration," that corresponds to the policy issued, and is in compliance with this regulation.
- (2) A statement directly following the numeric summary shall be signed and dated by the policy owner reading as follows: "I have received a copy of this illustration and understand that any non-guaranteed items illustrated are subject to change, either higher or lower. 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.

Alternative 4B: Included in statement of applicant:

Note: Illustrated values are not guaranteed except where clearly indicated as guaranteed. An illustration is not an estimate of future results. An illustration is not a prediction of future results.

- C. (1) Whether the illustration was prepared under the control of the insurer, or from any other source, the agent must provide the policy owner, not later than the time of policy delivery, and the insurer, not later than ten (10) business days after the time of policy delivery, with an illustration reflecting the concepts used in the initial illustration, and the values implicit in the policy being issued.
- (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 items 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.
- D. Copies of the illustrations and statements described in Subsections A and B above shall be retained by the insurer until three (3) years after the policy is no longer in force.

Comment: The requirements for illustrations here overlap to a great extent with the policy summary requirements in the Life Disclosure Model Regulation. Should a drafting note be added to alert states to this possibility? Consider changes to other models where overlap and inconsistencies may occur.

Section 14. Annual Report; Notice to Policy Owners

- A. In the case of a policy designated as one for which illustrations will be used, the insurer shall provide an annual report on the status of the policy containing the following information and providing instructions for obtaining more information about the policy:

Comment: Add requirements for content of annual report.

- B. If the annual report does not contain an in-force illustration, and no diminution of illustrated values has occurred during the past year, it shall contain the following notice displayed prominently:

IMPORTANT POLICY OWNER NOTICE: You should consider requesting more detailed information about your policy to understand how it has performed and may perform in the future. You should not consider replacement of your policy or make changes in your coverage without requesting an updated illustration. You may request such an illustration by calling [insurer's phone number], writing to [insurer's name] at [insurer's address] or contacting your agent at [agent's phone].

Comment: The working group is considering adding a suggestion to call the insurance department if the illustration is not delivered.

C. If the annual report does not contain an in-force illustration, and there has been a diminution of previously illustrated values, it shall contain the following notice displayed prominently:

IMPORTANT POLICY OWNER NOTICE: During the past year, previously illustrated values for your policy in the area of [describe which values have diminished] have diminished and may have an impact on your expectations. You should consider more detailed information about your policy to understand how it has performed and may perform in the future. You should not consider replacement of your policy or make changes in your coverage without requesting an updated illustration. You may request such an illustration by calling [insurer's phone number], writing to [insurer's name] at [insurer's address] or contacting your agent at [agent's phone].

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

Comment: The earlier draft contained a requirement to provide the updated illustration within 30 days of the request.

Comment: The working group needs to identify the items to be included in the updated illustration. Is it supposed to match the basic or the concept illustration? The insured may have changed his or her mind about the way the policy is to be handled. Without including such things as "vanishing premiums," policy loans, etc., it is not too meaningful. It would be most useful if the updated illustration was designed to fit the needs of the policy owner. The insurer won't have this information.

Section 15. Annual Certifications

A. 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.

B. The board of directors of each insurer shall appoint an illustration actuary to annually certify to the board and to the commissioner that the scales used in insurer authorized illustrations are in conformance with the actuarial standards of practice.

C. The illustration actuary shall:

- (1) Be a member in good standing of the American Academy of Actuaries;
- (2) Be familiar with the standards of practice regarding life insurance policy illustrations;
- (3) Not have been found by the commissioner, following appropriate notice and hearing to have:
 - (a) Violated any provision of, or any obligation imposed by, the Insurance Law or other law in the course of his or her dealings as an illustration actuary;
 - (b) Been found guilty of fraudulent or dishonest practices;
 - (c) Demonstrated his or her incompetence, lack of cooperation, or untrustworthiness to act as an illustration actuary;
 - (d) Submitted to the commissioner during the past five (5) years a certification that was rejected by the commissioner because it did not meet the provisions of this regulation including standards set by the Actuarial Standards Board; or
 - (e) Resigned or been removed as an illustration actuary within the past five (5) years as a result of acts or omissions indicated in any adverse report on examination or as a result of a failure to adhere to generally acceptable actuarial standards; and
- (4) Not fail to notify the commissioner of any action taken by a commissioner of another state similar to that under Paragraph (3) above.

D. (1) The illustration actuary shall file a certification with the board and with the commissioner:

- (a) Yearly for all policies for which illustrations are used;
- (b) Prior to the time the scale being used for a policy form changes; or
- (c) Before marketing a new policy form.

(2) If an error in a previous certification is discovered, the illustration actuary shall notify the commissioner promptly.

E. If an illustration actuary is unable to certify any policy form illustration the insurer intends to market, the actuary shall notify the commissioner promptly of his or her inability to certify.

F. A responsible officer of the insurer, other than the illustration actuary, also shall certify annually that the illustration formats and scales used in illustrations provided by it to its agents meet the requirements of this regulation.

Comment: How can this be changed so that it doesn't encourage companies to use outside vendors and assume no responsibility? Need to add some responsibility for what agent does?

G. The annual certifications shall be provided to the commissioner each year by [insert date].

Comment: The date for filing annual certifications could be the same date as for filing annual statements.

H. If an insurer appoints a different illustration actuary, the insurer shall notify the commissioner of that fact immediately.

Section 16. Penalties

In addition to any other penalties provided by the laws of this state, an insurer or agent that violates a requirement of this regulation shall be guilty of a violation of Section [cite state's unfair trade practices act].

Section 17. 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 18. Effective Date

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

ATTACHMENT TWO-B

Life Disclosure Working Group of the Life Insurance (A) Committee Washington, D.C. February 9-10, 1995

The Life Disclosure Working Group of the Life Insurance (A) Committee met in Washington, D.C., on Feb. 9-10, 1995. Robert E. Wilcox (Utah) chaired the meeting. The following working group members were present: Tom Foley, Vice Chair (Fla.); Don Koch (Alaska); Daphne Bartlett (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Tony Higgins (N.C.); Ted Becker (Texas); and Fred Nepple (Wis.).

1. Meeting with Securities and Exchange Commission (SEC)

Commissioner Robert E. Wilcox (Utah) reported that several members of the working group met during the morning with the representatives from the SEC. He said it was a very productive meeting and introduced Bob Dorsey (SEC). Commissioner Wilcox said that, while the members of the working group recognized that there were differences between variable and non-variable life, there were more similarities than differences. He said the working group thought it important that in the areas of similarity the products were regulated similarly. He said the purpose of the meeting with the SEC had been to coordinate as much as possible the process and to share ideas so that each group was not developing its rules in a vacuum. The working group also decided to conduct a similar discussion with the National Association of Securities Dealers (NASD). Tom Foley (Fla.) pointed out that the SEC's time frame for completing its project was within a year, which was consistent with the goals of the NAIC's working group. Commissioner Wilcox said the attendees had discussed the Actuarial Standards Board (ASB) standards being developed, and the SEC had expressed interest in working with that group where its standards carry over to variable life. Carl B. Wilkerson (American Council of Life Insurance — ACLI) said that his association had also been having an ongoing discussion with the SEC. He pointed out that there are three layers of regulation of variable life insurance: SEC, NASD and the NAIC variable life regulation. Mr. Wilkerson said that the first level of regulation under federal securities laws required approval of sales material. He said the NASD rules applied to supplemental sales illustrations. Mr. Wilkerson pointed out that, while under the rules of the SEC an insurer can illustrate at 12%, it must also illustrate a 0% return. The NASD rules say that the rate selected for the personalized illustration must be reasonable. He said there are significant penalties for violations, including antifraud penalties, Racketeer Influenced and Corrupt Organizations (RICO) triple damages, and a private cause of action. Mr. Dorsey said that it was important to take into consideration that the rules basically had not changed since the early development of variable life insurance in the 1970s.

Commissioner Wilcox said the main concern of the Life Disclosure Working Group was that the regulations not drive the marketplace. He said it was important that similar rules apply to variable and non-variable life whenever possible. If the regulations were out of kilter, it could drive consumers into or out of the variable life marketplace. He said the consumer should decide based on his or her needs instead of the illustration. He pointed out that the SEC looks at investment element of the process, so its focus is different from the NAIC's. Commissioner Wilcox pointed out that the NASD is not a federal agency, but a self-regulating organization. Mr. Wilkerson opined that the NASD was a quasi-governmental organization because it was authorized by the SEC.

Mr. Foley said that there is a long history of problems with life insurance illustrations, and he asked if there is any evidence of abuse in illustrations for variable life. Mr. Dorsey said that the SEC wanted to take any problems into consideration when designing its new form. S. Reed Ashwill (National Association of Independent Life Brokerage Agencies—NAILBA) suggested one problem was that many of the illustrations did not include the name of the underlying fund. He said there was nothing to tie the illustration to the fund, so it was difficult to tell whether the fund would fit the investment philosophy of the individual. Mr. Dorsey said that decision had been intentional. Mr. Ashwill said he did not think it gave consumers enough information and cautioned that regulators should not assume a purchaser is more sophisticated than he really is.

Judy Faucett (Coopers & Lybrand), an NAIC consultant, said that two or three years ago many variable life policies were being illustrated at 12% with a vanishing premium. She suggested that within several years it will become clear that those premiums will not vanish, and it will be interesting to see whether consumers understood their purchase. She pointed out that the industry thought there was understanding of life products until the vanishing premium problem arose in the last few years. Mr. Foley said he would like to be able to apply the disciplined current scale to variable life, but did not yet know how to do that. Commissioner Wilcox said he was encouraged that the NAIC had opened up a healthy dialogue that would help to complete the variable life insurance project.

2. Actuarial Standards Board (ASB) Report

Frank Irish (ASB) distributed a new draft of the standard of practice for review. He said the most difficult concepts discussed at the recent meeting were self-supporting and lapse-supported illustrations. He said these twin issues are difficult and very technical. Mr. Irish said that tests were now being done to see if it was possible to identify abusive illustrations. He said if the company depended on a tontine effect to support the illustration, he hoped that the new tests would catch it. He said he should be able to report on this testing at the March NAIC meeting.

Ted Becker (Texas) asked if the actuary had an obligation to continually reweigh the information to see if the illustration continued to meet the standards. Mr. Irish said the actuarial standards were written to require recertification once a year. He said the standard of practice had not yet tackled the problem of what to do if there were changes during the year. Commissioner Wilcox suggested that the standard should say that, if the situation changed during the year, the illustration should change to reflect that even though certification only took place once a year. Richard Ostuw (Metropolitan Life) asked if there was a safe harbor that could be built into the standard of practice. For example, if the company thought it would see an improvement because it had changed its underwriting standards, when could that be illustrated? Commissioner Wilcox said the only safe harbor was conservatism. He did not think it was appropriate to show any changes until the improvements could be demonstrated. Barbara Lautzenheiser (Lautzenheiser and Associates) asked if it would be appropriate to file a certification whenever something had changed instead of annually. Commissioner Wilcox responded that in major companies changes were going on all the time. The purpose of the yearly certification was to provide a fixed interval for the illustration actuary to in effect say everything is still okay. Mr. Foley compared it to the valuation actuary who works all year on his project, but only certifies once a year.

Mr. Irish said a second issue that the drafting group had recognized was whether the self-support and lapse-support tests should be applied to the policy as a whole, or whether the actuary should be required to apply the test to each cell within the policy form. He asked whether it was possible to have cross-subsidies between ages, underwriting classes, etc., as long as they were modest. He also asked if it was necessary for each payment pattern to stand on its own. Mr. Becker suggested that if each cell was not required to stand on its own, a particular mix of business could lead to company insolvency. He thought perhaps it was not necessary to test every cell, but representative combinations. Mr. Becker pointed to a phrase in the self-supporting requirement of the standard of practice that said, for example, the age 35 class may not meet the self-supporting test on a stand-alone basis but the self-supporting test could be met by other age classes and met for the policy form in the aggregate when all age classes were combined. He said he thought that was not appropriate; that the age 35 should stand on its own. Mr. Irish pointed out that that was a common industry practice. Mr. Foley said the industry practice was to use better numbers for years that were used for comparison in Best's and Consumers Union reports. Commissioner Wilcox said the word "modest" variations in the ASB standards made regulators nervous, and asked if the ASB could define what it meant by the term. Bill Koenig (Northwestern Mutual) said the question of the age 35 differential was an important one and was in the standard on purpose. He said the nub of the question was whether insurers should be allowed to do this. He said there was disagreement at the ASB's drafting meeting. Commissioner Wilcox suggested that using the term "incidental" instead of "modest" would make regulators feel more comfortable. He said it would mean that the subsidization was not being designed into the illustration.

Mr. Becker asked about the section in the standard of practice that talked about crediting gains from other sources and he asked if that was appropriate. Mr. Irish pointed out that this had been moved from the sales illustrations to the in-force illustration section. Daphne Bartlett (Calif.) said this practice sounded like a persistency bonus to her.

Discussion next turned to whether it was appropriate to have an illustration that identified the interest rate but that interest rate did not bear a reasonable relationship to the assumption underlying it. Mr. Ashwill said that it was important to add a

footnote to explain the mortality assumptions. Commissioner Wilcox questioned the need for this because the average consumer would not understand it. Chris Kite (FIPSCO) said that there may be two products that are similar in value but one will have a higher interest rate and charge higher expenses. It is clear from looking at the illustration that the two have similar ending values. Commissioner Wilcox said this would be misleading to a consumer because it would be assumed that a policy paying 7% was not as good as the one paying 8%. He said he thought it was misleading when tradeoffs between elements were used to affect the interest rate. Ms. Bartlett said if the policy form broke out the different elements of the pricing, the illustration should break them out also. Mr. Ashwill said that, as an agent, he wanted to see this information. Mr. Koenig said that once the standards of practice are in place, that information would not be needed because of the requirement that the illustration be supportable. Mr. Becker recommended showing the various components so that the consumer would know if the policy has a high expense charge. Roger Strauss (Iowa) opined that those numbers would not mean anything to the average consumer. He suggested that if the interest rate can be manipulated, it should not be shown. Ms. Faucett responded that in most states there is a requirement that the interest rate be shown for universal life policies. Mr. Foley said he had to believe that, through disciplined current scale, the abuses would be eliminated. He thought that to complicate the illustration further seemed to fly in the face of what the working group was trying to do. Mr. Kite suggested that the components could be broken out in a supplemental illustration for those who were interested. He said the data would be overwhelming for many.

Mary Griffin (Consumers Union) said she had been impressed with the draft illustration prepared by Mr. Becker's office. She said she thought it was a move in the right direction. It broke out the components in a clear manner so that the consumer would be able to tell what the charges were on different policies. Mr. Foley said that the two concepts could easily be combined if the basic illustration had the totals, but the details could be shown in a supplemental illustration on an additional page if the consumer requested them. Commissioner Wilcox agreed that was a reasonable compromise. Mark Peavy (NAIC/SSO) suggested language that required a display of each of the elements if any one element was displayed. Tony Higgins (N.C.) asked if this meant that, if the illustration showed the interest rate, then it would be required to show other components. Commissioner Wilcox clarified that dividends could still be shown as one column. The disclosure of the interest rate without showing a separate interest amount would not require all of the elements to be displayed. Mr. Peavy said it had been his intent in drafting the language that if any interest amount was disclosed then all of the other amounts would have to be disclosed also. Mr. Foley suggested that it would be appropriate to give the ASB direction to prepare documents which could bring rationality to each of the elements and report back at the next meeting.

Commissioner Wilcox said he had a concern about the inherent unfairness in a contract without rational charges for mortality, expenses, etc. He asked if it was the responsibility of this group to change that or just to require disclosure. Mr. Becker responded that the Life Nonforfeiture Working Group of the Life and Health Actuarial Task Force would allow unlimited expenses. He said the only way to deal with the problem was through disclosure. Ms. Bartlett said she did not think it was appropriate to interfere with how a company allocated its charges. She said she thought the consumer should be informed that there was a mortality charge, but she did not think it was the working group's business to dictate how the company allocated that charge. Ms. Faucett said she sensed that not all consumers wanted that level of information. She said those who did should be able to ask for it. John Dinius (Aetna) said that he represented a universal life company and said that an illustration that unbundled everything would look more complicated and that would affect sales. George Coleman (Prudential) suggested adding a footnote that the interest rate included various components and the consumer could ask for the parts. He suggested that fewer words would be more comprehensible to most consumers. Michael DiPiazza (Metropolitan Life) explained that his company had used focus groups in attempting to implement the requirements of the NAIC's regulation on illustrations. He said there was indignation on the part of consumers when they saw extra columns. They perceived it as a way to cloud the facts. He also said he saw confusion about the stated interest rate. He said consumers thought they should be able to take the cash value times the interest rate and get the credited amount. Mr. DiPiazza said that stating the separate components gave credibility to the lie that consumers would understand what all of this meant. Mr. Ashwill said that it had been a goal of the working group to make illustrations an educational tool. He said it would also help agents if all the components were shown. Ms. Lautzenheiser opined that this encouraged comparison with investments rather than an emphasis on the fact that this is an insurance product. Ms. Griffin said the debate is characterized as two extremes in this discussion and suggested the working group search for a middle ground. She said the illustration should not be complicated but it was important to show the various charges. Mr. Foley moved that the issue be sent back to the ASB to invite them to consider language to provide more rationality and to provide information to the working group at its next meeting. Following review the working group would decide if more columns were needed. That motion was seconded and adopted. Fred Nepple (Wis.) asked if a charge was not rational, did that mean it could not be charged or it could not be illustrated? The working group agreed that the result was that it could not be illustrated. Mr. Strauss moved that the illustration clearly state that the interest rate includes components other than interest and information on the other components is available. This motion was seconded and adopted.

Mr. Irish said the group developing the standard of practice also discussed persistency bonuses extensively. Commissioner Wilcox asked if it was the current position of the ASB that persistency bonuses would be eliminated based on the tests being developed. He suggested that if some persistency bonuses were still possible, then it would be necessary to specifically define and prohibit them in the model regulation.

Ms. Griffin asked for clarification of the affect of the ASB standard. She asked if the standard of practice would be applicable to an actuary whether or not the state had adopted the model. Mr. Irish responded that the principle purpose of a standard of practice was to assist an actuary in complying with the regulation. Ms. Griffin expressed disappointment at this position. She said when the draft was finished and the ASB's work was done it might take a long time before states would adopt the regulation. She had hoped that as soon as the standard of practice was complete actuaries would comply. Commissioner Wilcox asked it was possible that parts of the standard could be identified as things that all actuaries should consider. Don Koch (Alaska) asked if that was wise, because it might actually override some state regulations. Mr. Coleman said that as a practical matter, as soon as one state had adopted the regulation most of the companies would comply with the regulation, at least if they did business in more than one state. Commissioner Wilcox pointed out the advantage of finalizing the model

regulation before some states decided to adopt something much more draconian. Mr. Foley reminded the attendees that some states did not need legislative authority to adopt the illustration standards being developed by the working group. He said Florida expected to adopt the regulation as soon as it was complete. Mr. Higgins said his state also had authority under the Unfair Trade Practices Act and was becoming weary because of the length of the process, and might not wait until the regulation was done to put something in place.

Commissioner Wilcox asked Mr. Peavy to review the requirements in the Actuarial Memorandum and Model Regulation that define the requirements for the valuation actuary. The working group agreed to add as many of these requirements as appropriate to this regulation, too. Charlotte Liptak (Transamerica) asked if the working group envisioned having more than one illustration actuary. Commissioner Wilcox responded that the regulation envisioned only one, but he might have a staff of assistants.

3. Illustrations Used in Connection with the Sale of Life Insurance Model Regulation

Commissioner Wilcox outlined some of the changes that would be necessary to the model regulation and said he thought it was appropriate to put together an ad hoc drafting group to do that since there would not be time to complete drafting during the Feb. 9-10 meeting. He asked Carolyn Johnson (NAIC/SSO) to assist a group of volunteers consisting of Lester Dunlap (La.), Ms. Bartlett, Linda Lanam (Life Insurance Company of Virginia), Ms. Liptak, William Fisher (Massachusetts Mutual), Michele Van Leer (John Hancock), and Mr. Coleman. Commissioner Wilcox suggested that he meet with this group at a West Coast location within the next couple of weeks so that a draft would be ready for discussion at the March meeting.

4. Report of the Ad Hoc Group on the Illustration Draft

Mr. Coleman said that the draft illustration which had been prepared did not include the changes made to the model regulation at the last meeting because the drafting group did not have time to incorporate that new information. Ms. Lanam explained that the group had prepared two types of illustrations: first, an illustration with the minimum that is required in the regulation, and secondly, other illustrations that include information that could be included at the company's option. Commissioner Wilcox asked Ms. Lanam to point out areas where the ad hoc group needed guidance from the regulators. Ms. Lanam suggested that the signatures should go after the numeric summary because if the illustration is designed properly the descriptions and definitions could be separated and referred to during the presentation. She suggested that the drafting group felt it was necessary to provide some explanation of the terms used in the illustration. Commissioner Wilcox said that in early discussions the working group had talked about a common glossary of terms that could be used from company to company to provide some similarity. He suggested that now would be a good point to develop that standard glossary, and asked the ad hoc group to take on that project. He said it was important to create a standard set of nomenclature between policies, because otherwise the same term might mean different things in different policies. Ms. Bartlett asked if the working group envisioned a requirement in the regulation that these glossary terms be used. She suggested a reference to them in the regulation but that the terms not be included in the regulation so that others could be added later. She expressed concern about the use of jargon, asking the regulators to be sensitive to the use of consumer-friendly language. Ms. Griffin said the key features document that she had submitted earlier included terms to define and she suggested that the ad hoc group use those terms. Scott Cipinko (National Alliance of Life Companies—NALC) suggested that testing for consumer-friendly language be done. He said there were three levels of language to consider: consumers, actuaries and legal language. He cautioned that if there was any inconsistency in these three levels, the problem would end up being decided by a jury.

Ms. Lanam explained that while working through the drafting process, the ad hoc group had concluded that it was more appropriate to show the vanishing premium as part of the basic illustration, rather than in a supplemental illustration. Mr. Coleman also agreed that if the consumer intended to use an abbreviated payment schedule, he needed to see this in his basic illustration. Ms. Lanam said that the supplemental illustration had originally been conceived as something to show sophisticated arrangements such as buy/sell agreements, split dollar purchases and when the supplemental illustration showed everything except the plain vanilla policy there was a great deal of duplication. She asked that the working group discuss this further. She suggested it was important for consumers to focus on what would happen with the decisions they made such as the amount of premium they wanted to pay. Ms. Lanam suggested that the basic illustration include the things that were in the contract, and the supplemental illustration show things that were outside the contract. Commissioner Wilcox suggested that might mean there could be multiple basic illustrations. He asked if there was a benefit in having a basic form that came in a specified format no matter what. Mr. Becker said he would support this concept because he thought it would help individuals compare policies. Ms. Faucett said this would create a problem when riders were used to make participating policies look more like universal life. She said there had been some discussion at the last meeting as to how to illustrate riders. Mr. Kite said his company had developed software that put paid up addition riders, term riders, etc. in the illustrations, and he offered to provide samples to the working group.

Ms. Lanam pointed out that the current regulation contains no specific requirements for the placement of the signature page. She suggested that if the company or its agent elected to run the signatures as a separate page, there needs to be sufficient information so that it is not possible to simply switch that page with a page from another illustration. Commissioner Wilcox responded that it is a good idea to have a brief identifier on every page of the illustration; perhaps the date and time or a code number for each illustration. Commissioner Wilcox asked Mr. Kite to consider how security could be provided so that agents would not be able to use the illustration system in innovative or creative ways that were beyond the scope of the regulation.

Ms. Lanam said the drafting group also found another difficulty in the placement of the guarantees and the non-guaranteed elements. She said they had come to the conclusion that if they were going to be side by side the guarantees should be on the left and the non-guaranteed elements on the right. She said some companies might want to illustrate the guarantees on top and the non-guaranteed elements on the bottom, and some companies might wish to have a whole page for guaranteed

elements and the following page for non-guaranteed elements. She said she thought it was important that if the non-guaranteed elements ended up on a different page, that page should refer back to the page with the guaranteed elements. Ms. Lanam said the sample illustration showed the sensitivity index only on the numeric summary, not on the full illustration ledger. Ms. Bartlett said she thought the sensitivity was likely to get lost if it was just on the summary, and should be included on the full ledger illustration. Mr. DiPiazza said there is a logistic problem in using 8½ inch by 11 inch paper. He said trying to show the sensitivity index is too much information to fit easily on a page. He said his company had decided it could not put guaranteed and non-guaranteed elements on the same page because consumers found it confusing. Commissioner Wilcox pointed out that a sensitivity column would add a third page. Mr. DiPiazza responded that if too many columns are put on one page, it becomes less and less understandable to the consumer. Mr. Cipinko urged the drafters to provide flexibility so that the company could decide whether to fit its illustration on one page or more for its particular type policy. Upon motion duly made and seconded, the working group voted to require the sensitivity analysis only on the numeric summary and to place the summary on the same page as the signature.

Commissioner Wilcox said that in the draft of guarantees only that the working group had prepared earlier, there was a requirement for additional information to describe what was meant by the rating classification. He asked if the working group felt it was necessary to include that information in this draft. Ms. Lanam said it was her assumption that the agent would probably use the highest possible rating, but thought that a corrected illustration would take care of that problem. Commissioner Wilcox pointed out that if the highest rating was always illustrated, that was a bait and switch technique. Mr. DiPiazza expressed the opinion that an explanation of risk classification was not helpful to most consumers. Mr. Higgins said the original purpose of the requirement had been so that the individual would know whether what was being illustrated to him was the class for which he would probably qualify. Mr. Cipinko opined that if copious disclosure was required it might encourage a purchase for the wrong reason. One company's preferred rate might actually cost less than another's standard rate. Ms. Bartlett suggested that this topic was more properly subject to regulation in another area than illustrations and moved that no description be required. This motion was seconded and adopted.

Commissioner Wilcox said that in the summary there was a requirement for numbers for the fifth, 10th, and 20th year and for age 65. He asked if it would be appropriate to change that to age 70, since more and more people will not retire until after the age 65. The working group agreed that this would be appropriate.

Ms. Lanam said that the drafting group had envisioned that the last page of the illustration would be for things that were state specific, such as a yield index. Commissioner Wilcox said he liked the ideal of building these within the illustration instead of having separate sets of pages to meet the different state requirements. The working group agreed that this was an appropriate result.

Mr. DiPiazza explained some of the things that his company had learned from focus groups. He said the company had been trying to improve the entire sales process and to improve its image, using an outside consulting firm. He said the process included seven initiatives on how agents should conduct themselves at the time of sale and one of these was illustrations. Mr. DiPiazza provided sample illustrations for the working group's perusal. He said what the working group is considering is what consumers consider to be the minimum they need. He encouraged the working group to hasten the process of model development so that it became the law of the land. He said it was the right thing to do. Commissioner Wilcox complimented Metropolitan Life for its proactive stance. He said it would have a positive impact throughout the industry. He said if other major companies provided similar information, consumers would come to expect it. He asked Mr. DiPiazza if there were other things that consumers would have liked that were not included in the illustration. Mr. DiPiazza responded that the information on his sample illustration, with the help of an agent, was the most useful. He said consumers had trouble relating to an index. Mr. Dinius asked Mr. DiPiazza what his focus groups said about the sensitivity analysis. He noted that the sample illustration provided by Mr. DiPiazza used 1% less than disciplined current scale and he asked if that was meaningful to the focus groups. Mr. DiPiazza said the focus groups had asked why not use a number in the middle rather than 1% less.

Mr. Ashwill provided a sample illustration that is of the type used by brokers to provide basic information for a price comparison of a large number of term policies. Commissioner Wilcox pointed out that the illustration was incomplete according to the standards of the model and suggested that it would be necessary to produce a basic illustration for all these companies and put them together in one document. Mr. Ashwill said this was backward because the intent of the illustration was to help a consumer pick the ones he was interested in and then those would be expanded to provide a full illustration. Gina Roth (New York Life) said her company specifically prohibited the use of its information on a spreadsheet such as Mr. Ashwill was distributing without an additional basic illustration. Commissioner Wilcox appealed to the technical experts for information to help in formulating an appropriate response to this issue.

Mr. Coleman said the other assignment of the ad hoc group had been to consider what should be included in an annual report. He said he had surveyed the technical resource advisors and found that most of them used forms that were essentially the same, differing only in detail. He said that traditional policies usually included the death benefit, cash value, paid up additions, current dividends, application of current dividend, and the amount of any outstanding loan. He said universal life policies included the beginning cash value, the current mortality charges, policy values, surrender charges, and surrender values. Mr. Coleman said he would summarize the results of his survey and send them to the members of the working group. Mr. Strauss asked if this summary was what the insurers currently were doing or what the ad hoc group was recommending, and Mr. Coleman responded that he was reporting on current practice.

5. Potential for Conflict with Other NAIC Models

Mr. Koch said that one of the issues that had been brought up at the prior meeting was the possibility that this illustrations model might conflict with other NAIC models. Commissioner Wilcox asked Ms. Johnson to distribute a memo she had

prepared which briefly summarized the other NAIC models dealing with the illustration issue. He asked Ms. Johnson to prepare detailed summaries of what potential conflicts existed and to mail copies of those models to the regulators on the working group so that a further discussion could be held at the spring National Meeting in Miami.

Having no further business, the Life Disclosure Working Group adjourned at 3:30 p.m.

ATTACHMENT TWO-C

Life Disclosure Working Group
of the Life Insurance (A) Committee
Kansas City, Missouri
January 5-6, 1995

The Life Disclosure Working Group of the Life Insurance (A) Committee met in Kansas City Marriott Hotel in Kansas City, Mo., at 12:30 p.m. on Jan. 5, 1995. 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.); and Ted Becker (Texas).

Commissioner Robert E. Wilcox (Utah) said the working group intended to make significant progress on the Illustrations used in Connection with the Sale of Life Insurance Model Regulation to prepare a revised draft to distribute at the spring National Meeting in Miami, and also to provide further information to the Actuarial Standards Board (ASB) as it prepared the actuarial guideline on life insurance illustrations. Commissioner Wilcox said the focus at the meeting would be on the concepts to be included in the model law, and he asked Carolyn Johnson (NAIC/SSO) to translate that into whatever changes should be made to the model draft.

1. Annual In-Force Illustration Requirement

Commissioner Wilcox said that one of the major issues that had been discussed at the winter National Meeting had been whether to require an annual in-force illustration. He said the working group had asked at that time for comments on the feasibility of insurers complying with this requirement. Commissioner Wilcox asked if any of the interested parties in attendance wished to comment further. Chris Kite (FIPSCO) said the illustration requirement bore a close relationship to the group's discussion on sensitivity. He said that if the original illustration showed different possibilities, the consumer was more informed about the potential for change. He saw less need for an annual illustration if a range of possibilities has been illustrated originally.

Gina Roth (New York Life) asked if the requirement would apply to new policies or to every one the company had ever sold. She also asked if a new illustration would be required if there had been no changes in the assumptions. Commissioner Wilcox said the view of the working group was that the requirements should apply to policies issued after the effective date of the regulation. However, some of the comments received suggested that once the capacity was in place, companies might provide this valuable service to their other policyholders. In answer to Ms. Roth's second question, Commissioner Wilcox said the proposal was that the illustration should go out every year, but that issue was still on the table. Scott Cipinko (National Alliance of Life Companies—NALC) said he had surveyed his membership and learned many companies did not have the money available to set up the complex computer systems that would be required to provide an in-force illustration. Barbara Lautzenheiser (Lautzenheiser and Associates) asked if the working group was still considering having focus groups evaluate the illustration. She said this would be an opportunity to find out how much value a policyholder saw in an in-force illustration. Commissioner Wilcox said some of the benefits to the yearly updated illustration would go beyond what the consumer would see. He said it would add discipline to the illustration process and this would raise the overall quality of the product. John Matthews (Allstate Life) asked if consumers would perceive this update as junk mail. He described what his company had been providing to its policyholders, but it had gotten feedback that the consumers did not find the information helpful.

Mr. Kite said that a key element was missing in the in-force illustration requirement. He said it was essential to know the consumers' goals in order to provide an illustration that was meaningful. Commissioner Wilcox responded that the working group's thought had been just to provide a generic illustration, with information that a specialized illustration could be requested.

Tony Higgins (N.C.) said the comments that had been received from interested parties led him to suggest again that it might be more appropriate to issue an alert to policyholders if there have been any changes that would adversely affect the policy, and he read a provision from a New Hampshire regulation with such a requirement. Mr. Higgins said he thought it would have more impact if just information about something that might affect the policyholder adversely was provided with a status report. Lester Dunlap (La.) agreed and said he thought this was particularly appropriate if the policy had been sold with a vanishing premium illustration. He said that consumers needed follow-up to understand if the vanishing premium was not scheduled to end at the time illustrated. George Coleman (Prudential) agreed with the idea of providing information on what had changed. Judy Faucett (Coopers & Lybrand), an NAIC consultant, said that buyers have not been educated that an in-force illustration is available. She thought a notice to them regularly would help make them aware and educate the consumers. Roger Strauss (Iowa) asked if the notice would just say something had changed or would contain numbers showing what the changes had been. William Fisher (Massachusetts Mutual) said that was a very complex issue. He said if dividend numbers had stayed the same, that would actually be a reduction because a dividend should have increased.

Don Koch (Alaska) said that if a company discarded an information request, there was no evidence for a market conduct examiner that a request for an in-force illustration had been made. Mr. Higgins suggested that the notice should contain three sources: the agent's name and telephone number, the company's telephone number and the insurance department's telephone number. He said this suggestion had been made by Joseph Belth (Insurance Forum) and he thought it would help prevent a situation where the policyholder did not receive any response.

Tom Foley (Fla.) said he supported Mr. Higgins' idea to the extent that it would focus on benefits to the consumer. He said one benefit of the annual updated illustration would be to encourage companies to discipline themselves when products are offered so that they created illustrations that could be fulfilled. He said if the same result could be reached with an annual status report, he would be in favor of that alternative. He said he thought it was important to standardize what should be included in the annual report, and he suggested that Commissioner Wilcox appoint a small group of technical advisors to bring suggestions for an annual report format. Mr. Higgins added that he was afraid an annual report would tend to become junk mail. He said it needed to contain a bright alert that changes had occurred. Upon motion duly made and seconded, the working group voted to require all policies with non-guaranteed elements to provide an annual status update with prescribed minimum information. The status report should include a bold notice to notify of any changes that might potentially be adverse and include necessary information as to how to obtain an updated illustration showing how the policyholder might be affected.

Linda Lanam (Life Insurance Company of Virginia) said it was difficult to ask companies to keep track of the reasons why persons had purchased a policy and what they intended to do with them (vanish, policy loan, different premiums). She said her company was working on a standard brochure to explain how to read the annual report. She also cautioned the working group that it needed to recognize that a significant number of people would not read the annual reports or understand them. Commissioner Wilcox said this pointed to a collective failure of the industry to educate people.

2. Format for Illustration

Commissioner Wilcox said it was important that the working group make clear what should be included in a standard illustration. He asked the members of the working group and the interested parties to review the statement of standards the working group prepared in September 1994. He said Section 4 spelled out the requirements for the illustration format. He emphasized that the standards were intended to make the illustration somewhat consistent from company to company. Each illustration would not necessarily contain the same number of pages, but they would be in the same order. Jim Ellis (General American) saw a problem with the requirement for a form number. He said that made the illustration state specific, and suggested a generic form identification instead. Commissioner Wilcox asked if there was a problem if the form number requirement applied only if it would produce different results. Mr. Fisher said some states use the form number on an illustration to check that the policy has been approved, and it would be important to alert them that this would no longer work. Mr. Coleman asked why any kind of form designation was necessary on an illustration. Ted Becker (Texas) said the form designation was very important if the policyholder had not yet received his policy. Commissioner Wilcox agreed that it was important to show this on an illustration so the consumer knew what the company was trying to illustrate. He reminded the attendees that there might be several illustrations of different policies being considered. The working group spent some time discussing whether the terms "generic name" and "generic type" meant something different or the same.

Commissioner Wilcox asked for a small group of technical advisors who would prepare a sample illustration using the standards in the model regulation. Mr. Foley added that this work should be completed by the end of January to give the members of the working group time to review it. Ms. Lanam, Mr. Cipinko, Mr. Kite, Mr. Coleman, Ms. Roth, and S. Reed Ashwill (National Association of Independent Life Brokerage Agencies—NAILBA) volunteered to serve on this drafting committee. Daphne Bartlett (Calif.) said she thought it was important that the basic illustration indicate whether it was prepared during the sales presentation or presented at the time of policy delivery. She said it would help a consumer distinguish if he had received one illustration at the time of sale and another at policy delivery.

3. Inclusion of Variable Life in Model Draft

Tony Spano (American Council of Life Insurance—ACLI) said that his organization had provided extensive comments to the working group about variable life insurance. He said his association's position was that variable life insurance should not be included in the illustration regulation, but should be regulated through changes to the Variable Life Insurance Model Regulation. Commissioner Wilcox said the working group thought that the requirements for both non-variable life and variable life policies should be consistent. He asked if it was the ACLI's position to focus on the differences. Mr. Spano replied that there are fundamental differences between variable life and other life products, and emphasized the importance of not conflicting with existing requirements. Mr. Koch asked if there were any conflicts in the draft of the model regulation so far. Bob Elconin (IDS Life) gave two examples. He said the statement signed by the applicant does not make sense in a variable environment, and he said there are no current or guaranteed rates in a variable policy. He emphasized that there are already three layers of regulation of variable life products: the Securities and Exchange Commission (SEC), the National Association of Securities Dealers (NASD), and the NAIC's variable life regulation. Mr. Kite said the most important aspect of the illustration regulation that should be applied to variable life was that the cost assumptions should follow the actuarial standards being developed by the ASB. Commissioner Wilcox emphasized that it was important that all types of products play by the same rules. Mr. Higgins agreed that variable life is increasing its market share, and it is important to put similar limitations on variable life illustrations as are put on other types of life insurance illustrations. Mr. Koch suggested that the working group take a look at the Variable Life Insurance Model Regulation to see if it was reasonable to add requirements to that model that would be consistent with the new illustrations regulation being developed. He did not think it would be desirable to have insurers look at several different models to find out the requirements on one issue. Mr. Coleman asked the working group to be cognizant of the fact that the SEC is considering changes to its requirements and information on that can be found in the ACLI comments. Mr. Dunlap asked how close the SEC was to implementing any changes and Mr. Kite responded that, given

the speed with which the federal changes were being made, perhaps it would be helpful for the working group to give the SEC its work product. Ms. Faucett said that it might be five years before the federal requirements were in place.

Ms. Lanam suggested that the insurers that sell variable life insurance give copies of their informational materials to the members of the working group so that they could see what type of material is distributed. She said the prospectus contains something very similar to a basic illustration. She offered to annotate the pages that were presented to the working group so it was clear what elements were required and where there was flexibility.

4. Questions on November Memorandum

a. Coordination with the Second Standard Nonforfeiture Law for Life Insurance

Commissioner Wilcox said that it would not be necessary to coordinate the draft with the Second Standard Nonforfeiture Law for Life Insurance because the Life and Health Actuarial (Technical) Task Force had decided to suspend work on that draft and rethink its goals. He suggested that the working group prepare its model and the Life and Health Actuarial Task Force could coordinate with the illustrations model regulation.

b. Sensitivity Index

Ms. Bartlett said that since she had first reviewed the regulation draft three weeks earlier she had some ideas about what should be included in the model in the area of a sensitivity index. She said the interest component of an illustration was different from the other components (mortality, expense, persistency) because the other elements were largely controlled by the company, but the interest component was dependent upon the economy at large. She said it was important to recognize that companies could not have large difference from each other in interest rates. She suggested grading in the interest rate over a period of time to standardized assumptions. She said that this would be an appropriate substitute for the sensitivity index. She saw several advantages. It eliminated the portfolio versus new money problem because one could grade down, and the other might need to grade up. She said the numbers generated by the illustration would be more realistic, and it might actually create a situation where the company's results would be above illustrated values. She also said this would minimize the need for in-force illustrations. Mr. Foley said the working group had discussed standardized assumptions at length and had been unable to resolve some of the concerns they had. Ms. Faucett said that she thought that companies should not be permitted to grade up because it allowed them to show interest at a higher rate than they were currently paying. Mr. Foley said using the grading to standardized assumptions concept in the sensitivity column would allow the advantages Ms. Bartlett pointed out. Ms. Bartlett suggested grading to an interest rate of 6%. She said that was a rough guess as to what average rates might be over the lifetime of a policy. She said she was less concerned with exactly what the number was, but she thought it should be something within the realm of possibility. Ms. Roth said it was important to decide if the company would be using its *earned* interest rate or its *crediting* rate. She said if the company used its earned rate they would be able to subtract expenses and then might actually be below the guaranteed rate. Commissioner Wilcox asked if the 6% Ms. Bartlett suggested was to be the earned rate or the credited rate. Ms. Bartlett responded that she really did not have strong feelings either way, but thought the point was not to allow illustration of the same rate forever when interest rates go up and down. Ms. Lautzenheiser said she was uncomfortable with the use of any standardized numbers because it promoted mediocrity. She said she was less uncomfortable with using it as a sensitivity index. She opined that the more complex the columns of numbers got, the less likely consumers were to understand it. The working group was unable to reach a decision and decided to table the issue.

c. Statement to be Signed by Applicant

Mr. Higgins said that he thought the statement in the draft that was required to be signed by the applicant was a litigation shield. Ms. Lanam said the companies are concerned that years later, a policyholder will come and say he had been told something different so companies really need a litigation shield. Mr. Fisher said part of the reason for this application statement was to get the consumer to focus on what had been said. Mr. Higgins responded that in reality the agent just says, "sign here and here and here," and the consumer does not even read the statement he is signing. Mr. Ashwill suggested putting it in bold type just above the signature to draw attention to it. Commissioner Wilcox asked if anyone was ready to make a motion to change the statement in the draft. Hearing no motion, the application statement was not changed.

d. Vanishing Premiums

Next the working group considered several issues related to "vanishing premiums." Commissioner Wilcox asked if the draft clearly indicated that a basic illustration was not allowed to show vanishing premiums. Mr. Ashwill asked if the basic illustration should use level premiums in all years, or the higher premium that would be required to allow for a vanish. The working group agreed that level premiums should be shown. The working group also considered whether the term "vanish" should be prohibited. Commissioner Wilcox said the reason for the aversion to "vanish" is to show that premiums really are due, but are just paid from a policy loan or the dividends. Mr. Strauss said he thought how the vanishing premium is shown was important. He said it was important to show the premium dollars and then an asterisk that indicated it could be paid from the policy accumulation. Mr. Ellis said he had thought the previous decision was to show two premium columns, one with dollar figures all the way, and one with dollars to a point and then asterisks. Ms. Lanam said that the computer system in use at her company could not handle an illustration that showed a dollar amount in the premium column without adding that amount instead of subtracting it from the account value. Ms. Faucett suggested that the small group preparing a sample illustration show one with a vanish, and one without, to help the working group decide if that was clear. Mr. Coleman said that if the vanishing premium was only allowed on a

supplemental illustration, it would be necessary to change the cover page. He said he would prefer to see it as a part of the basic illustration. Mr. Koenig saw some advantage to showing a large accumulation, so that the consumer could see what would happen if the policy accumulations were allowed to remain.

e. Annual Certification

The working group next discussed the annual certification included in Section 12 of the draft. Mr. Higgins pointed out that when the working group had decided not to require an actuary's signature on each illustration, the company had agreed to take responsibility for the illustration. Mr. Coleman said the company is already liable by reason of tort and contract law. He said the certification as worded in the standards for the model established liability on the part of the company for things the company did not even know about. Mr. Foley asked how to encourage companies to sign and still have it mean something if the certification contained the wording in the current draft. Otherwise he said companies could just use outside vendors. Ms. Lanam said the company could sign a certification that the numbers in the illustration are appropriate, but could not certify to the department that no noncomplying illustrations had been used. She said the company would have no way to know whether this had happened, and they did not want liability for something they had no control over. The working group decided to leave Section 12 as it was in the Dec. 3, 1994, draft. John States (State Farm) offered to provide language that would clarify this issue.

f. Penalties

Commissioner Wilcox said the penalties included in Section IX of the standards are not mentioned in the model and asked whether it was appropriate to include them. Greg Hardy (ACLI) said that the Unfair Trade Practices Act already addressed the issue of penalties. He saw a constitutional problem with granting equitable remedies to the insurance department. Ms. Lanam agreed that even if there was not a constitutional problem, it was certainly something that would be raised to the department. She said it was important, though, that the model refer to the Unfair Trade Practices Act. Mr. Koch suggested that the Unfair Trade Practices Act referred to *practices* and that would be a drawback to the insurance department. Mr. Strauss referred the working group to the legal opinion that had been provided by NAIC staff that there was a possibility of challenge. The working group decided not to include a penalty provision.

The working group adjourned at 5 p.m., and reconvened at 8:30 a.m. on Jan. 6, 1995. The same working group members were in attendance.

5. ASB Compliance Guidelines

Commissioner Wilcox asked Frank Irish (ASB) to begin with an overview of the second draft of the ASB's actuarial compliance guideline for illustrations. Mr. Irish reviewed the draft dated Dec. 2, 1994, and identified areas where the model needs to be more specific so that the guideline can be more specific. Mr. Irish pointed out that much work needs to be done on the draft, but it would give the working group an idea of where the Actuarial Standards Board was headed. Mr. Irish said there had been considerable discussion over whether this document should be a standard of practice or a compliance guideline. He explained that a standard of practice describes the current practices. He said this document went beyond that, for it was drafted in response to an external force asking actuaries to comply. For this reason the drafters had decided it was more appropriate for this to be an actuarial compliance guideline. Mr. Irish pointed out that Section 1.2 limits the scope of this document to actuaries complying with the model as adopted in a state. He said it did not apply to those actuaries who are not subject to the model but did encourage other actuaries to consider it as guidance.

Mr. Irish said Section 5.2 described the appointment of an illustration actuary in a more detailed fashion than the model regulation. He said this was appropriate but that it was important that the NAIC's model refer to an appointment from the board. Mr. Irish asked for guidance on Section 5.4.6 on in-force illustrations. He asked if it was still necessary to include this section since the working group had decided not to require in-force illustrations. Commissioner Wilcox responded that, in his opinion, it was still necessary to include standards for in-force illustrations since the draft would require that these be available upon request.

Mr. Foley pointed out that variable life and annuities are currently included in the compliance guideline and suggested that, since the working group decided not to include them in the model, they should be eliminated from the compliance guideline. He asked if the working group decision would require three compliance guidelines to be drafted by the ASB. Mr. Irish responded that he did not have an answer to that question at this time. Mr. Foley said he anticipated that the working group would have the variable life and annuities drafts completed by the end of 1995.

The working group next considered lapse-supported pricing as defined in the ASB draft. Mr. Becker asked if the compliance guideline should distinguish between participating and nonparticipating policies. He said it seemed appropriate to him to do so. Mr. Irish said that the drafters of the compliance guidelines did not want to distinguish, because they wanted to treat all nonguaranteed elements. He said if there was any language in the compliance guideline implying unbundling, he wanted to change it. Commissioner Wilcox suggested that it was important to look at the assumptions separately, and Mr. Irish agreed. Commissioner Wilcox asked that interest assumptions be considered separately. He said consumers would not understand mortality or expense assumptions but would understand interest rate assumptions. He asked if these could be changed artificially by adjusting the other assumptions and expressed concern that the drafters were leaving an opportunity for deception. Mr. Becker said that if the ASB did not want to discuss unbundling, the working group should do so. He said if policy provisions implied unbundling, they needed to be examined. Ms. Bartlett pointed out that it was important to place a burden on the actuary not to illustrate in such a way that it would mislead a consumer. She suggested that the standards

might be getting into too much detail. She said she thought the group was losing focus while getting into the details of the product and making it much more complicated than it needed to be. She suggested concentrating on ethical concerns.

Mr. Ashwill asked if a bonus that was guaranteed could be illustrated. Commissioner Wilcox responded that if the amount also was guaranteed it could be illustrated because it was actually an endowment. If the guaranty was a percentage of the cash value, which is not guaranteed, then it was not actually a guaranty and could not be illustrated. Mr. Strauss asked if the working group had not previously decided that no persistency bonuses could be illustrated. The working group agreed that was so. Charlotte Liptak (TransAmerica Occidental) described a plan that, if a policyholder paid the premium regularly, paid a persistency bonus. It was based only on policyholder action, and she asked if this was appropriate to illustrate. The working group agreed that the action Ms. Liptak described was not a persistency bonus. Mr. Becker said the situation described should be handled by the standard nonforfeiture law for life insurance. He said this was one of the elements the Life and Health Actuarial Task Force had been trying to recognize.

Mr. Irish said the working group had expressed interest in having reasonable assumptions and asked for guidance in this area. Mr. Foley made a motion that the illustrated non-guaranteed policy elements must be reasonable and consistent with the policy provisions and the underlying experience factors, both by individual component and year-by-year incidence. Mr. Higgins seconded the motion. Mr. Coleman asked how this motion differed from what the ASB compliance guideline draft now said. Commissioner Wilcox pointed out that the difference was that the individual factors must be separately reasonable year-by-year. Mr. Irish asked about the part of the motion referencing year-by-year. He said he remembered Commissioner Wilcox's earlier concern that the companies not be forbidden from smoothing out the dividends in the early years. He said it was almost impossible to do otherwise because of high early costs. Ms. Faucett said the working group had recognized that because of high acquisition cost, some smoothing would be needed. Commissioner Wilcox asked if this needed to be in the NAIC draft and he suggested that it would be appropriate to put in the compliance guideline. Mr. Irish said that bonuses also might be an item that would be smoothed out. Commissioner Wilcox pointed out that the drafting standard of the working group said that persistency bonuses may not be illustrated. Mr. Irish asked if this also included terminal dividends. Mr. Koch asked how a terminal dividend differed from a persistency bonus, and Mr. Becker responded that there was a philosophical difference. He explained that a persistency bonus was more on the line of a tontine. Mr. Irish agreed that it was a very gray area and expressed concern that this might leave a large loophole. Commissioner Wilcox said that if a company made a decision to hold back a portion of the money until surrender of the policy, everyone would get an equal share, so this was different than a persistency bonus. Mr. Higgins said this practice did not concern him, but illustration of it did. Commissioner Wilcox suggested that the working group would then have to say that a persistency bonus or a terminal dividend could not be illustrated. Mr. Kite said that some companies did not call it a persistency bonus but rather a reduction of investment cost and suggested that, if the working group attempted to discourage persistency bonuses, companies would just call them something else. Mr. Koch reminded the attendees that the Life Disclosure Working Group was not saying that companies could not pay a persistency bonus, just that they could not illustrate it. Commissioner Wilcox directed the working group to the motion before it and the motion was adopted unanimously.

Bill Koenig (Northwestern Mutual) asked for the thoughts of the working group as to when it is permissible to illustrate changes in practices. Some examples in the actuarial guideline are changing underwriting standards, changing commission levels, or cutting staff. Commissioner Wilcox suggested that, if changes in staff had been accomplished, some experience would be needed to show that the company was still able to work efficiently. Members of the working group expressed discomfort with illustrating any possible improvement because of cuts in staff. Members of the working group asked for clarification on how changing underwriting standards would lead to improvements in the illustration. Mr. Koenig responded that if the company decided to increase blood testing, they could estimate how that would change their expenses. Ms. Faucett asked if that would improve mortality experience for a class by just moving someone to another class. Mr. Becker asked if the end result was that fewer people would qualify for coverage. Commissioner Wilcox said this was addressed in the regulation with disclosure of the class being illustrated.

Mr. Irish asked for working group guidance on the issue of disproportionate charging of expenses to new business by the way overhead is allocated. Ms. Bartlett said that overhead cannot be exactly allocated, at some point pricing has to reflect nonallocated amounts. She said she did not think it was part of the working group's task to tell companies how to allocate their overhead. Mr. Irish suggested some literature that actuaries could read to help crystallize their viewpoint on this issue, and Commissioner Wilcox asked the actuaries in the working group to consider this issue further.

Mr. Koch suggested that it was important for the working group to take a look at the model replacement regulation and review it for any conflicts. He asked if this would require an additional charge to the working group. Commissioner Wilcox asked Ms. Johnson to check existing models for conflicts and report back to the working group. Then it would be able to decide if an additional charge was needed.

Mr. States asked if it was necessary to clarify the model draft to say that a basic illustration must always be given with a supplemental illustration. Commissioner Wilcox pointed out that the way the model was now drafted, a supplemental illustration could be given at the time of sale, and the basic illustration at the time of delivery. He said the working group would want to clarify that this was not permissible. Mr. States asked if the illustration was to apply to riders also. Commissioner Wilcox responded that the rider is part of the contract, so needs to be included in any illustration. Ms. Faucett said a long-term care rider would be very difficult to illustrate. Commissioner Wilcox said that if riders were not included in this illustration, it would change the premium. Mr. Strauss suggested that a disclosure could be included on the cover sheet instead. He asked the volunteers who were drafting a sample illustration to consider this issue.

Having no further business, the Life Disclosure Working Group adjourned at 12:30 p.m.