LIFE INSURANCE (A) COMMITTEE

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1995 Proc. 4th Qtr. 763
1995 Proc. 3rd Qtr. 673

Dwight K. Bartlett III, Chair—Md.
Patrick E. Kelly, Vice Chair—D.C.

CONTENTS

MINUTES

The Life Insurance (A) Committee met in the Mackinac Room of the Westin Hotel in Detroit, Mich., at 11 a.m. on March 26, 1996. A quorum was present and Dwight K. Bartlett III (Md.) chaired the meeting. The following committee members or their representatives were present: Patrick Kelly, Vice Chair (D.C.); Terri Vaughan (Iowa); Chris P. Krahling (N.M.); Jim Long (N.C.); Glenn Pomeroy (N.D.); Kerry Barnett (Ore.); and Robert E. Wilcox (Utah).

1. Report of the Life Disclosure Working Group

Commissioner Robert E. Wilcox (Utah) reported that the working group had considered the interaction of the Life Insurance Illustrations Model Regulation with other NAIC models and state provisions that might be based on them. A letter was prepared for the NAIC members, alerting them to potential overlap that might need to be addressed when the Life Insurance Illustrations Model Regulation is adopted in the state. Commissioner Wilcox said the working group also is prepared to answer questions about the illustrations model and the Actuarial Standards Board is ready to address questions about the actuarial standard of practice. He said the working group intends to prepare documents with answers to questions so that regulators can speak with one voice for consistency.

Commissioner Wilcox said the working group has a number of charges and has decided to address them by appointing subgroups of members. One of the charges is to address churning issues and New Jersey has agreed to chair a new subgroup to look at that issue. Because New Jersey recently conducted an extensive market conduct examination of one of its domestics, these regulators feel they are in a good position to apply the results of their examination to the NAIC's work. Another subgroup is working on annuity illustrations and has prepared a draft for comments. Commissioner Wilcox said the issue of annuity illustrations is turning out to be more difficult than originally anticipated and he did not believe it would be possible to complete that project by the Summer National Meeting as had been indicated in the original work plan. Commissioner Wilcox drew the committee's attention to a revised life insurance buyer's guide attached to the working group's minutes. He said the group is encouraging comment on all areas of the buyer's guide but particularly on the issue of cost indices. A subgroup was appointed to look at the issue of variable life illustrations and met with the Securities and Exchange Commission (SEC) to begin building a relationship with that organization. He reported that an additional meeting will be April 4, 1996, with the SEC and the National Association of Securities Dealers (NASD).

Commissioner Dwight K. Bartlett III (Md.) asked if the issue of churning is primarily a consumer disclosure issue. Commissioner Wilcox responded that it is, and the draft of the buyer's guide emphasized disclosure. He said the working group would determine what else is necessary and would have a recommendation for further action if it appeared that disclosure would not be an adequate way of dealing with the problem.

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

2. Report of the Annuities Working Group

Jerry Fickes (N.M.) reported that the Annuities Working Group also is concerned about the short time frame in which to accomplish some of its tasks. He said the primary goal is to produce a quality product and, if necessary, the working group would ask for more time. The working group discussed charitable gift annuities and the appropriate regulation of the product. Mr. Fickes said the group is beginning with a review of state laws already on the books and intends to get information from organizations that issue charitable gift annuities. This discussion pointed out the importance of a comprehensive definition of an annuity and the working group discussed equity-indexed annuities and other types of annuities that might need to be included in a definition.

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

Commissioner Bartlett asked Commissioner D. Joseph Olson (Mich.) to report on an activity in his state where the definition of an annuity was important. Commissioner Olson said that in the Confederation Life insolvency a group had put forth the opinion that a structured settlement is an annuity. The group's argument is that when a property/casualty company is involved in the settlement of a tort claim and makes periodic payments of the settlement, it is actually issuing an annuity. To carry the analysis further, if the property/casualty carrier buys an annuity from a life carrier, that is reinsurance. The group's contention is that these "reinsurance" claims are of a lower priority than claims of policyholders. Commissioner Olson said he thought this was an extraordinary interpretation and said it suggested that many property/casualty companies had been violating state laws by issuing annuities.

3. Report of the Genetic Testing Working Group

Dixon Larkin (Utah) said the working group's report contained the latest draft of the white paper being prepared to serve as a resource to states on the issue of genetic testing. He described the presentation that will be made at the Summer National Meeting in New York, which will serve as a source of information and a forum for debate that will certainly be spirited. He emphasized that the paper being prepared is designed to serve as a resource rather than to recommend one position for states to adopt. Commissioner Bartlett thanked Dr. Larkin for his participation in this group and said that the regulators were certainly fortunate to have him chair the group because of his unique qualifications. Upon motion duly made and seconded, the Genetic Testing Working Group report was received (Attachment Three).

4. Report of the Viatical Settlements Working Group

Tom Foley (N.D.) said the driving force behind the continuation of this working group is the need to review the changing marketplace. The NAIC models originally had been developed when the purpose of a viatical settlement was to provide relief for AIDS patients. It appears the market is now shifting to provide a market for seniors with health problems, and this significantly changes the marketplace. Mr. Foley said that the working group would attempt to bring actuarial aggregate pricing principles to this industry and is reviewing the Viatical Settlements Model Act and Regulation to see if changes were necessitated by the change in market. Upon motion duly made and seconded, the report of the Viatical Settlements Working Group was received (Attachment Four).

5. Report of the Synthetic GIC Working Group

Rhonda Davis (D.C.) reported on behalf of Reginald Berry (D.C.), chair of the working group. She said the working group had developed an outline of a model regulation on synthetic guaranteed interest contracts (GICs) and is beginning to develop a model. The working group is aware that at least two other committees are considering synthetic GIC issues and have arranged to coordinate with those other committees. Upon motion duly made and seconded, the Synthetic GIC Working Group report was received (Attachment Five).

6. Report of the Life and Health Actuarial (Technical) Task Force

Mr. Foley reported that the task force revised the NAIC Model Rule for Recognizing a New Mortality Table for Use in Determining Reserve Liabilities for Annuities that had been removed from the Executive (EX) Committee consent agenda and had a draft ready for further consideration. Significant progress has been made in gathering information on an alternative approach for life insurance nonforfeiture. Mr. Foley said the task force is not quite ready to make a recommendation on a regulatory approach. After the approach has been finalized, Mr. Foley anticipates an extensive report to the A Committee and to the Commissioners Roundtable to inform other regulators of the implications of the task force's decision.

In addition, a discussion on the Valuation of Life Insurance Policies Model Regulation (known as Regulation XXX) revealed that the members of the task force were of somewhat different opinions as to the adoption of this model. Commissioner Bartlett reported that he had made a plea at the Roundtable for uniform adoption of the model and plans to send a letter to all the NAIC members reminding them of the importance of uniform adoption (Attachment Six). Commissioner Wilcox expressed appreciation to Commissioner Bartlett for bringing this issue to the attention of all regulators. He encouraged the members of the A Committee to lead the way in adoption, and pointed out the support from the American Academy of Actuaries. Commissioner Wilcox reported that Utah is moving forward with adoption and encouraged other states to take similar action. Commissioner Bartlett said Maryland also is moving forward with adoption of this regulation. Commissioner Bartlett thanked Mr. Foley for the task force's work and said its work on life nonforfeiture would shape the life insurance industry in the 21st century.

Upon motion duly made and seconded, the report of the task force was received.

Having no further business, the Life Insurance (A) Committee adjourned at 11:50 a.m.

Dwight K. Bartlett, Chair, Md.; Patrick E. Kelly, Vice Chair, D.C.; Terri Vaughan, Iowa; Chris P. Krahling, N.M.; Edward Muhl, N.Y.; Jim Long, N.C.; Glenn Pomeroy, N.D.; Kerry Barnett, Ore.; Robert E. Wilcox, Utah

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ATTACHMENT ONE

Life Disclosure Working Group
Detroit, Michigan
March 25, 1996

The Life Disclosure Working Group of the Life Insurance (A) Committee met in Mackinac of the Westin Hotel in Detroit, Mich., at 1 p.m. on March 25, 1996. Robert E. Wilcox (Utah) chaired the meeting. The following working group members or their representatives were present: Tom Foley, Vice Chair (N.D.); Don Koch (Alaska); Sheldon Summers (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Paul DeAngelo (N.J.); Rick Morse (N.Y.); Tony Higgins (N.C.); Robert Katz (Ohio); and Ted Becker (Texas).

1. Adopt Report on Review of Other Models

Commissioner Robert E. Wilcox (Utah) said the Life Disclosure Working Group had compared the Life Insurance Illustrations Model Regulation with other NAIC models that states might have adopted that potentially overlap the illustrations model. The result of the two conference calls held by the working group was to draft a letter alerting NAIC members to changes they might make in other regulations. Upon motion duly made and seconded, the report on review of NAIC models was adopted (Attachment One-A).

2. Review of Questions Raised About the Life Insurance Illustrations Model Regulation

Commissioner Wilcox explained that one of the working group charges was to serve a resource to answer questions about the new illustration regulation as states began to implement the model. He reviewed a set of questions that had been received from Donna Claire (Claire Thinking, Inc.) which were taken from Actuaries on Line. Ms. Claire explained that the questions that were strictly regulatory would be forwarded to the working group, those that were strictly actuarial would be forwarded to the Academy of Actuaries, and those that were ambiguous would be sent to both bodies. The working group briefly reviewed the questions and discussed how they might implement the process of preparing responses to those questions. Commissioner Wilcox asked states and others with questions to forward them to Carolyn Johnson (NAIC/SSO) so that they could be circulated to the working group and others for response. Don Koch (Alaska) asked if the questions and answers would be published, and Commissioner Wilcox suggested that it was important to work out a way to get this information out. He said it was of broader concern than just the interested parties list and asked if the National Alliance of Life Companies (NALC) and the American Council of Life Insurance (ACLI) could assist in the distribution of the information. He suggested taking a list of companies, asking the associations to mail to those that were ACLI or NALC members, and having the NAIC make a mailing to the others that were interested in receiving information.

3. Discuss Issues Related to Churning of Life Insurance Policies

Paul DeAngelo (N.J.) said that New Jersey had started a task force in June 1995 to study the market conduct practices of one of its domestic companies. As New Jersey moved to the end of its examination process, Mr. DeAngelo said that he thought it was appropriate to bring the results of the examination within the framework of the NAIC. When he saw the charge to the Life Insurance (A) Committee to identify issues related to churning and replacement of life insurance, he decided that was the appropriate place to discuss the results of the examination. He suggested that a new subgroup be formed under the Life Disclosure Working Group to look at issues related to churning. Tom Foley (N.D.) said this was a good way to approach the charge that had been given to the Life Insurance (A) Committee, and thought it would be very helpful if New Jersey would chair a subgroup to deal with this issue. Commissioner Wilcox said the working group had not yet gotten a very good start on this charge, and he expressed gratitude to Mr. DeAngelo for offering his assistance. He suggested that several members of the Life Disclosure Working Group should offer to participate in this subgroup because they had a good feel for the whole picture and encouraged others from Mr. DeAngelo's group to join. Mr. DeAngelo offered to draft a work plan that would fit the charge and present it to the working group in June. Commissioner Wilcox asked states that were interested in participating in this effort to notify Ms. Johnson.

4. Discuss Model Regulation on Annuity Illustrations

Tony Higgins (N.C.) reported that the subgroup he chairs had revised the Life Insurance Illustrations Model Regulation to take out areas that clearly do not apply to annuities and to add issues that had not been dealt with in a life insurance regulation. He said the main problem facing his subgroup was the short timeframe that was allowed under the charge, and he asked for an extension to allow the group to prepare the best quality document possible. Commissioner Wilcox agreed that it was appropriate to request that the A Committee modify the charge. Mr. Higgins said that in that case an interim meeting of the subgroup would not be held, as he had previously planned, because of the short time between the Spring and Summer National Meetings.

Mr. Higgins announced that the Life Insurance Illustrations Regulation was final in North Carolina, with an effective date of Jan. 1, 1997. Commissioner Wilcox said that the final version of Utah's regulation had been filed and would be final as soon as it was reviewed. Lester Dunlap (La.) announced that a public hearing on the Louisiana regulation would be held in May. Roger Strauss (Iowa) said that the rule-making process was beginning in Iowa in the summer of 1996. Mr. Foley said a hearing would be held in North Dakota on May 1. He said in the life disclosure regulation already adopted in North Dakota a policy summary was required. He modified that existing regulation to avoid overlap with the rule on illustrations by providing that the policy summary would be a basic illustration if the company had chosen to illustrate. Otherwise the policy summary required in the life disclosure regulation could show guarantees only. Mr. Higgins said North Carolina recognizes the need to review its other regulations to make sure there is not overlap with the illustration regulation.

Upon motion duly made and seconded, the report of the subgroup was received (Attachment One-B).

5. Report on the Generally Recognized Expense Table

Tim Harris (Milliman and Robertson) reported that a small group under the auspices of the Society of Actuaries had been appointed to work on development of a generally recognized expense table, as referenced in the model. He asked if the working group was in favor of different tables to reflect different types of distribution systems, for example, for a company with branch offices or a company using direct mail. He said the method of covering expenses of a field force or general agency were different if the company had branch offices. Commissioner Wilcox asked if there were costs beyond the cost of running the distribution system and Mr. Harris responded that the costs really depended upon the type of marketing system in use. Mr.

Foley asked if the group would be ready to have a table for working group adoption in June 1996. Commissioner Wilcox said that in order to complete adoption at the Summer National Meeting, it would be necessary to expose the document to interested parties before that, and suggested a target date of May 1.

6. Discuss Amendments to Life Insurance Buyer's Guide

Mr. Dunlap said that a small group consisting of Mr. Higgins, Brenda Cude (University of Illinois Cooperative Extension Service), and Chris Kite (FIPSCO) and himself had rewritten the buyer's guide (Attachment One-C) keeping in mind a number of basic concepts: 1) revise the illustrated policy interest rates to conform to the newly adopted life illustrations model; 2) rewrite the sections describing the type of life insurance to reflect the products available in today's market; 3) address the importance of maintaining the policy in force rather than replacing a policy; and 4) update to better address the cost comparison indices. Mr. Dunlap said the subgroup needed the assistance of the whole working group in determining the value of cost indices to determine how to revise that section. He said once that revision had been accomplished, he thought the product would be ready to adopt. Commissioner Wilcox asked if this meeting was the first exposure of the draft. He said it was very important to get comments and invited those in attendance to respond to the draft in writing to Ms. Johnson. He invited comments also on the issue of cost indices. Mr. Foley suggested using the term "permanent insurance" rather than "cash value" because of the possibility of a change in the life nonforfeiture law. Commissioner Wilcox suggested that this change might be far enough in the future that it may not be appropriate to include in this draft but should be considered.

7. Discuss Model Regulation of Variable Life Insurance Illustrations

Rick Morris (N.Y.) said that a small subgroup consisting of Mr. Foley, Commissioner Wilcox and himself had met on March 12 with representatives from the Securities and Exchange Commission (SEC). He said the purpose of the meeting was to give representatives from the SEC a quick overview of the general account illustrations regulation adopted by the NAIC and to suggest its use as a framework for variable life illustrations. Recognizing that the disciplined current scale incorporated recent historical experience, he suggested to the SEC that protections had been built into the model and the actuarial standard of practice that would allay their concerns about historical experience. The use of historical experience is an issue being considered by the SEC, and the current position of the organization will be reviewed. He reported that another meeting will be held with the SEC and the National Association of Securities Dealers (NASD) on April 4 for further discussion.

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

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ATTACHMENT ONE-A

Life Disclosure Working Group Report
on Review of NAIC Models

The Life Disclosure Working Group of the Life Insurance (A) Committee met by conference call on Dec. 13, 1995, and on Jan. 12, 1996. Robert E. Wilcox (Utah) chaired the meetings. The following working group members or their representatives participated: Tom Foley, Vice Chair (N.D.); Don Koch (Alaska); Daphne Bartlett (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Rick Morse (N.Y.); Tony Higgins (N.C.); and Ted Becker (Texas).

Commissioner Robert E. Wilcox (Utah) began the Dec. 13 conference call by announcing that the Actuarial Standards Board (ASB) had given final approval to the Actuarial Standard of Practice that will accompany and facilitate interpretation of the Life Insurance Illustrations Model Regulation.

Commissioner Wilcox began the Jan. 12 conference call by asking the states represented on the call to report on their intentions with regard to adoption of the Life Insurance Illustrations Model Regulation. Tony Higgins (N.C.) reported that a hearing had been held on the proposed regulation and a few changes would be made before adoption. Tom Foley (N.D.) reported that North Dakota had begun a review of existing regulations, and intended to resolve any conflicts by changing other regulations. Roger Strauss (Iowa) said his state intended to adopt the model but had not yet begun the process. Don Koch (Alaska) said Alaska was working on a draft and intended to remain faithful to the model. He said his state had a different drafting style, so some alterations would be needed. Lester Dunlap (La.) reported that Louisiana was working on the illustrations model and an advertising rule also, and his state planned to stay close to the model language. Daphne Bartlett (Calif.) reported the life insurance agents' association had prepared a bill based on the model that was being introduced in the legislature. Commissioner Wilcox said the Utah regulation would be final within 60 days, with a Jan. 1, 1997, effective date.

Commissioner Wilcox asked representatives from the insurance industry who were participating in the call if they had taken a position. Scott Cipinko (National Alliance of Life Companies—NALC) said that, while his association had some concerns about the references to the Actuarial Standards Board, it would rather see states adopt the model than have to deal with many variations. William Albus (National Association of Life Underwriters—NALU) said his association had assembled an information packet for its members and stressed the importance of uniformity of adoption.

Commissioner Wilcox said the main purpose of the conference calls was to analyze the Life Insurance Illustrations Model Regulation and its impact on other NAIC models. He asked Carolyn Johnson (NAIC/SSO) to list the alternatives before the working group if any inconsistencies were found. Ms. Johnson said the alternatives were (1) to add drafting notes to the illustrations regulation alerting states to the inconsistencies; (2) to write a letter to the states listing the inconsistencies with a suggestion that they review their laws before adopting the illustrations regulation; (3) to make amendments to the regulations that conflicted or overlapped with the illustrations regulation; or (4) to add drafting notes to the other NAIC models with potential overlap or conflict.

1. Life Insurance Disclosure Model Regulation

Ms. Bartlett said that the Life Insurance Disclosure Model Regulation was out of date, and suggested deleting it from the official NAIC model laws and putting any pieces the working group still felt were relevant in the illustrations model regulation. Mr. Foley said the working group should ask itself the purpose of this project. The project could result from a simple desire to facilitate state adoptions, or to fix all disclosure problems in the NAIC models. He said the answer would result in a significant difference in the route the working group chose to take. Ms. Bartlett said there was a great deal of conflict in the disclosure regulation because it used the current scale rather than the disciplined current scale, and she also said there was much duplication in the disclosure model. Commissioner Wilcox said it was important to eliminate conflict, but another level of work altogether would be to improve the disclosure model. He said it was appropriate to look at a short-term solution and a long-term solution. Ms. Bartlett said that a short-term solution would be to add a drafting note to the illustrations model saying that, in any regulation that talked about illustrations, states should substitute the term "disciplined current scale" for any other non-guaranteed scale terminology. She suggested writing a letter to the commissioners to alert them of any possible problems, and starting work on detailed drafting later. Mr. Koch said he would like to see the models that contained inconsistencies or duplication fixed, but he thought a letter would be a good short-term solution. Rick Morse (N.Y.) said that the New York drafters made an effort to enfold their earlier solicitation (disclosure) regulation into their new illustrations regulation and found it a very difficult process, and said he thought it was imperative to get something to the states as soon as possible. He agreed the best approach would be to lay out possible overlap and conflict in a letter to the states. He said uniformity of implementation of the illustrations regulation was important, and if the process dragged on too long it would cost consumers.

To analyze the discrepancies in the Life Insurance Disclosure Model Regulation, the members of the working group reviewed point by point a list drafted by Mark Peavy (NAIC/SSO) showing the possible conflicts or duplications between the two models. The first decision made by the working group was to revise the buyer's guide attached to the Life Insurance Disclosure Model Regulation to include concepts from the Life Insurance Illustrations Model Regulation. Mr. Dunlap agreed to chair a subgroup to work on that project, and Mr. Higgins and Mr. Koch agreed to assist.

The next topic of discussion was the policy summary required by the Life Insurance Disclosure Model Regulation. The working group agreed that insurers could be exempted from the requirement to deliver a policy summary if an illustration was used. They decided it was not appropriate to delete the requirement for a policy summary because some insurers would not be subject to the illustration regulation because they had chosen not to use illustrations, or because the policy was under $10,000. Mr. Foley pointed out that a company that did not wish to be subject to the illustrations model regulation could agree not to use an illustration and then use a policy summary that provided information in a way not in accordance with the illustrations model. Commissioner Wilcox suggested that the solution to this problem would be to take out all information on non-guaranteed elements from the policy summary. The working group agreed this would be an easy solution. Mr. Peavy pointed out that the policy summary required information to be listed separately for the policy and each rider, and the illustrations model required the riders to be included in the basic illustration. Commissioner Wilcox suggested it would be appropriate to change the Life Insurance Disclosure Model Regulation so that each rider did not need to be broken out separately. The working group members considered several other discrepancies between the policy summary and the illustration and decided that even though these were not the same there was not a direct conflict. George Coleman (Prudential) said he wanted to give some thought to the implications of doing away with the policy summary, which includes costs indices. He pointed out that one of the charges suggested by the working group was to review the indices used in the Life Insurance Disclosure Model Regulation, and expressed concern that the working group now was talking about deleting them completely. Commissioner Wilcox responded that the indices are a subject for consideration in the future after all of the illustrations models for variable life and annuities are completed. He said that hopefully at that point states will have enough experience with the new model to make it easier to decide whether indices are needed. Mr. Foley suggested that the working group get the reaction of Jim Hunt (Consumer Federation of America) on the suggestion about the indices.

The working group next reviewed Appendix D to the Life Insurance Disclosure Model Regulation, which contained policy information for a universal life policy or indeterminate premium policy. The working group agreed that, since most of this information was directly based on non-guaranteed elements, it would be appropriate to delete the entire appendix.

Ms. Johnson pointed out that most state laws or regulations were not based on the most recent version of the Life Insurance Disclosure Model Regulation, and offered to make a report to the working group of the type of regulation adopted by most of the states.

2. Rules Governing the Advertising of Life Insurance

The working group discussed possible conflicts with the rule governing the advertising of life insurance and did not see any direct conflicts that needed to be resolved in this model regulation. Mr. Coleman pointed out that Section 15B of the advertising rule should be revised to reference disciplined current scale in keeping with the rules in the illustration model.

3. Illustrated Interest Projections

Commissioner Wilcox asked Ms. Johnson to study this model and see if there was any valuable information in it that was not included in the illustrations regulation. If not, the working group agreed that it would be appropriate to delete this model from the official NAIC models publication.

4. Universal Life Model Regulation

A review of the Universal Life Insurance Model Regulation convinced the members of the working group that no additional changes needed to be made to that model regulation, in light of the drafting note in the illustrations model that recommended deletion of parts of the Universal Life Regulation. Commissioner Wilcox pointed out that most, if not all, universal life policies would be illustrated so the illustrations regulation would apply to those types of policies. An analysis of the model regulation showed that it covered a great deal more than disclosure, so repeal of this model regulation was not an appropriate solution.

5. Replacement of Life Insurance and Annuities Model Regulation

Commissioner Wilcox pointed out that one of the charges suggested by the working group was to look at the issue of churning, and a review of this model regulation would be appropriate in connection with that charge. A review of Mr. Peavy's list indicated to the working group that there were no immediate problems that needed to be addressed in that model regulation to prevent conflicts. However, the working group did agree that it would be appropriate that a change be made where a ledger statement was to be provided to a replacement candidate, so that the requirements in the illustrations model would be used in that replacement illustration.

6. Next Steps

Commissioner Wilcox reviewed the tasks before the working group: rewrite the Life Insurance Buyer's Guide; and draft a letter to the commissioners with instructions on how to modify their existing laws and regulations at the time the Life Insurance Illustrations Model Regulation was adopted.

Commissioner Wilcox asked Ms. Johnson to put together a first draft of the letter using the information discussed during the conference call, and during the second conference call this draft was reviewed and refined. The working group discussed the letter section by section and revised as necessary. After review the working group decided it would be appropriate for Commissioner Wilcox to distribute the letter (Attachment One-A1) to the NAIC membership at the Jan. 20 Commissioners Conference.

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ATTACHMENT ONE-A1

TO: NAIC Members
FROM: Robert E. Wilcox, Chair, Life Disclosure Working Group
DATE: January 21, 1996
RE: Life Insurance Illustrations Model Regulation

In December the NAIC membership adopted a new Life Insurance Illustrations Model Regulation to address some of the problems we have all been experiencing as consumers complain that their "vanishing" premiums haven't vanished and the high returns they expected haven't materialized. Even though the working group will be submitting versions to deal with variable life and annuities later, I urge you to join me in adopting this model as quickly as possible to protect our citizens. Dwight Bartlett, Chair of the Life Insurance (A) Committee, called the model adoption a "watershed activity in the regulation of life insurance."

As the members of the Life Disclosure Working Group were drafting, they were aware that the provisions they were recommending might conflict or overlap with some existing NAIC models that may have served as the basis for regulations in your state. Because of the importance of completing work on the model regulation, the group did not take time to address those possible inconsistencies before completing the model. The working group has now stepped back to review the other models that might overlap, and discussed how to address this problem. In order to assist you with quick adoption of the model, this letter contains a discussion of the major inconsistencies or duplications you are likely to encounter as you review your laws and regulations. As time allows, the group will consider amendments to the NAIC models, but this discussion will allow you to move forward expeditiously.

I. Life Insurance Disclosure (Solicitation) Model Regulation (#580)

This NAIC model has changed significantly over the years, and most states have not adopted the later enhancements into their own regulations. The model began in 1976 with a brief regulation on life insurance solicitations that included requirements for a buyer's guide and a policy summary. More than half of the state provisions are similar to this initial model. In 1983 the title of the model was changed to "Life Insurance Disclosure Model Regulation" and more information about the calculation of indices was added. A definition of non-guaranteed elements and some standards for policy data were also included. The buyer's guide was revised to include information on universal life. In 1989 an optional version of the regulation was adopted with calculation of a yield index, which has been implemented in only one state. Other more recent enhancements which have been adopted by few states include disclosures for prepaid funeral plans, a form for interest sensitive products and disclosures for policies sold to persons over age 60.

Because of the variations in state law, this section will give an overview of the most common areas to review in order to make sure there are not inconsistencies between your existing rules and the new illustrations model.

A. Policy Summary.

(1) Most states require delivery of a policy summary before accepting a premium. Many of the requirements in the policy summary duplicate the material provided in an illustration and add little or no benefit at extra cost. The working group recommends that the policy summary not be required where an illustration is used. It is not appropriate to delete the policy summary from state requirements because companies may choose to exclude themselves from the requirements of the model on illustrations for one or more policy forms. However, in order that companies not be able to circumvent the requirements of the illustrations regulation, your disclosure regulation should be changed to allow only guaranteed elements to be shown in the policy summary.

Suggested amendatory language: These sentences may be added to your disclosure regulation where appropriate:

> ~~A policy form subject to the requirements of [insert citation to illustrations regulation] shall be exempt from the requirement to deliver a policy summary.~~ ~~The policy summary shall contain information only about amounts guaranteed under the contract. States should delete any reference to illustration of elements not guaranteed in the policy.~~ A policy summary is not required to include information available in the policy form or illustration. If an illustration subject to the requirements of [insert citation to illustrations regulation] is used in the sale of a policy, a policy summary does not have to be provided. Only guarantees may be shown in the policy summary.

(2) Amending the policy summary requirement means that the cost indices included in the policy summary would be shown also only on a guaranteed basis, or perhaps not at all for a policy form subject to the illustrations regulation. As time allows, the working group intends to study the issue of comparison indices more thoroughly. If you would like to maintain a state requirement for the distribution of cost indices, it is suggested that you add a Section 8C to the illustrations model to provide for cost indices as a supplemental illustration.

Suggested amendatory language: C. A supplemental illustration shall be provided containing the cost indices specified in [cite requirement in life disclosure (solicitation) regulation] using non-guaranteed elements calculated according to the standards required in this regulation.

B. Buyer's Guide.

The working group is currently reviewing the buyer's guide with the goal of including information from the new illustrations regulation. States should consider allowing companies the option of using this enhanced buyer's guide when it is available.

Suggested amendatory language: "The insurer shall provide to each applicant the buyer's guide in Appendix A or another life insurance buyer's guide approved by the commissioner or the National Association of Insurance Commissioners."

C. Other areas that some states may need to address.

The NAIC disclosure model includes illustration formats for interest sensitive products, and if you have adopted these, they should be deleted because they are supplanted by the illustrations model. ~~Any requirements for indices to use in policy comparison also should be limited to guarantees only. As time allows, the working group intends to study the issue of comparison indices more thoroughly.~~

II. Rules Governing the Advertising of Life Insurance (#570)

The only conflict identified in the model regulation was a reference to "current scale" which should be changed to "illustrated scale" in keeping with the standard used in the illustrations regulation. The definition of "nonguaranteed policy element" should be reviewed to prevent conflict with the definitions in the illustrations model.

III. Universal Life Model Regulation (#585)

The illustrations model contains a drafting note recommending states delete disclosure requirements contained in the state's universal life regulation. They have been supplanted by the illustration model requirement; and most companies marketing universal life products will probably use illustrations, and be subject to the requirements of the illustrations regulation. The Universal Life Regulation served as a pattern for the requirements for annual disclosure. The Statement of Policy Information for Applicant, with formats for interest sensitive products, is the same document as was recommended for deletion under the Life Insurance Disclosure Model Regulation.

IV. Replacement of Life Insurance and Annuities Model Regulation (#613)

The requirement for a ledger statement provided to a replacement candidate should ~~require~~ specify that nonguaranteed elements be based on the "current illustrated scale" required by the illustrations regulation, if the company chooses to sell the policy utilizing an illustration. This requirement is applicable to all policies issued on or after the effective date of your illustrations regulation.

You, of course, will review your own laws and regulations for inconsistencies, but this discussion will allow you to pinpoint some of the areas for review.

The Life Disclosure Working Group plans to gather and maintain information about states taking action to adopt this model. Please send a copy of your draft and a summary of any deviations from the model to Carolyn Johnson at the NAIC Kansas City office as soon as you begin the adoption process.

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ATTACHMENT ONE-B

Report of the Annuity Illustrations Subgroup
of the Life Disclosure Working Group

The Annuity Illustrations Subgroup of the Life Disclosure Working Group met by conference call on Feb. 13, 1996, and in Detroit, Mich., on March 24, 1996. Tony Higgins (N.C.) chaired the meetings. The following participated: Don Koch (Alaska); Sheldon Summers (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Jerry Fickes (N.M.); Rick Morse (N.Y.); Tom Foley (N.D.); Robert Katz (Ohio); Ted Becker (Texas); and Robert E. Wilcox (Utah).

The subgroup began by reviewing a preliminary draft of the Annuity Illustrations Model Regulation prepared by the chair, with comments from members of the group (Attachment One-B1). Tony Higgins (N.C.) asked for comments from the committee members on the draft. Commissioner Robert E. Wilcox (Utah) said that the group was off to a good start. Jerry Fickes (N.M.) suggested that everyone should know that the subgroup was working under a tight timeframe and suggested that comments on the draft should be submitted quickly for consideration.

Roger Strauss (Iowa) said he thought the working group needed to address some of the broad questions, such as does the regulation apply to variable annuities and plans regulated under the Employee Retirement Income Security Act (ERISA). He also asked if the company had a choice as to whether or not to illustrate. Mr. Higgins said he thought the regulation should apply to 403(b) plans and any situation where the individual made the purchasing decision. He asked if it was appropriate to exclude all group annuity products. Mr. Fickes said the problem with exempting groups was that regulators would immediately see trusts springing up to sell annuity products. Rick Morse (N.Y.) said the key consideration in New York was whether the nonforfeiture law applied. He suggested exempting unallocated annuities.

Mr. Morse said this draft demonstrates that the Life Insurance Illustrations Model Regulation already adopted by the NAIC represents a good chassis on which to build an alternative regulation. He said that the group he chaired, which was preparing a variable life illustration regulation, expected to also begin with the existing illustrations model. He said he thought the issue of whether to mandate an illustration was very important and he also saw the question of whether a hypothetical illustration could be used as a very important issue. He pointed out that 40% of annuities are sold through banks, and they might not be interested in personalizing illustrations. Mr. Morse said that the current focus on annuities was on the tax deferral benefit rather than on the life payout.

Mr. Higgins said one question that could be disposed of quickly was whether there was a need for a model on annuities. Some comments suggested that there was no problem, so no need for a model. Mr. Fickes said that New Mexico Department received more complaints about misleading annuity illustrations than any other issue. Lester Dunlap (La.) agreed that many complaints were in this area because many people did not understand the appropriate use of annuities.

Mr. Higgins suggested that he was amenable to the suggestion to use a generic illustration for sales and then to provide a personal illustration at policy delivery. Tom Foley (N.D.) asked if it was the intent of the subgroup to include immediate annuities in the regulation. He asked if the group would be concerned about the payout phase or just the accumulation phase. Mr. Foley opined that most company sales emphasize accumulation only and not the payout phase, but he said that might be more emphasized in the future as baby boomers age. Ted Becker (Texas) asked if modified guaranteed annuities were included, and Mr. Higgins responded that it was clear there were a number of decisions to make as far as what type of annuities were included. Mr. Higgins summarized that the subgroup needed to decide whether the regulation would apply to immediate and deferred annuities, to variable and general account plans, and he asked whether it was appropriate to consider a lapse support and self-support test in this type of product.

Mr. Morse said some of the issues in variable life will apply also to variable annuities. He suggested this group go forward with general account annuities, and the Life Disclosure Working Group could look at variable annuities after working on variable life illustrations.

Mr. Strauss asked whether the working group would be requesting the assistance of the Actuarial Standards Board (ASB) in coming up with tables and disciplined current scale for this model. Commissioner Wilcox said the Society of Actuaries was developing an expense table, and he suggested it seemed sensible to ask the same group to recommend whether a similar table would be required for annuities. He suggested that, if it was necessary, it was important for them to get started now.

Mr. Higgins said that in addition to the big issues there were quite a number of technical drafting issues that needed to be addressed, such as whether to use the term "contract" or "policy" and whether to use "premium" or "consideration." He asked the working group to consider also whether or not it was advisable to include an in-force illustration requirement in this regulation. Commissioner Wilcox opined that it would be useful to have an in-force illustration available as a report card of how the annuity was doing. He said it was also helpful in replacements and expressed his preference for an in-force illustration to be available upon request. Mr. Fickes agreed that it would be important to allow people to know if they were actually getting what they thought they had purchased. Mr. Higgins pointed out several areas that he thought deserved special attention by the drafting group. He said he had added language to Section 6A(9) because the Life and Health Actuarial (Technical) Task Force was considering a nonforfeiture law that did not require cash values. He also pointed out the newly added Sections 6D(1)(d), (e), (f) and (g), which were intended to restrict what was illustrated in two-tiered annuities. Mr. Higgins said another issue was what should be included in the annual report to the annuity contract holders.

After the regulators had an opportunity to comment, Mr. Higgins opened the floor to the audience for comments. John Booth (American Council of Life Insurance—ACLI) said he was comforted to hear that the working group was not planning to rush this document through by June. He said he thought the group needed to take more time to study all of the issues. He said annuities were a very different problem than life insurance, and the issues needed to be approached differently. He asked the subgroup to consider an all-day meeting to discuss the issues. He reminded the regulators that insurers were competing with banks and he hoped that whatever regulation came out of the working group's efforts would not shackle insurance companies and lessen competition. Mr. Booth said that the Internal Revenue Service (IRS), the Securities and Exchange Commission (SEC) and the Department of Labor also regulated annuities to some extent. He asked the working group to be cognizant of the need not to duplicate or conflict with other regulation. Commissioner Wilcox suggested that regulators needed to examine the nature of the other regulation rather than just backing off if someone else was regulating the field. He said that in some cases, significant insurance regulation was required to provide adequate protection. Commissioner Wilcox questioned one remark made by Mr. Booth that asked the regulators to take a fresh approach to illustration of annuities. He said it was preferable to regulate annuity illustrations as similarly as possible to life insurance so that the market was not driven by the form of life insurance or annuity illustrations. He was concerned that "fresh approach" meant that regulators would start with a clean piece of paper and he was reluctant to do that.

Mr. Fickes asked Mr. Booth if it was possible to provide the subgroup with actual dollar amounts of annuity sales, reserves and premiums in comparison to life insurance. Mr. Booth said it was his understanding that annuity premiums were about double those of life insurance. Mr. Higgins said the root of the problem before the group was the fact that insurers are competing with banks and that the focus of annuities should be on life income rather than use as an accumulation vehicle. He said consumers were looking at annuities as a substitute for certificates of deposit.

Scott Cipinko (National Alliance of Life Companies—NALC) said that some of the people gathered might feel that they have been involved in the same project for several years, but he cautioned regulators to realize that this is really a different project. He asked the group to start by deciding what is regulated, who is regulating it, and how effective that regulation is. He suggested it was important to coordinate with the Annuities Working Group, which also reports to the Life Insurance (A) Committee. Commissioner Wilcox said he thought regulators have learned a great deal from the process of developing the Life Insurance Illustrations Model Regulation, and that this effort has provided a model for the NAIC in developing model legislation. He said the model is a virtual consensus product, and predicted the end result will be broad adoption. He said a lot of the credit for this result came from taking the time needed to finish the product properly. He opined that it was important to set deadlines, but if those deadlines needed to be changed the working group should do so.

Linda Lanam (Life of Virginia) said she would be serving as the coordinator for the technical resource advisors. She suggested that the advisors could be most helpful at this time if they had a list of questions from the regulators that they could address. Mr. Higgins asked Carolyn Johnson (NAIC/SSO) to distill questions from the minutes and the interested party comments received by the working group and invited regulators to submit other questions to Ms. Johnson.

Craig Raymond (ITT Hartford) said he was representing the American Academy of Actuaries (AAA) group on annuities and offered the assistance of his group with whatever needs might be addressed by the actuarial profession. He said he was pleased to hear that the June deadline was not firm and suggested that a basic set of principles on which to build would be very helpful. Mr. Raymond said that two members of his committee were also on the Actuarial Standards Board (ASB) and that would make the interface with the ASB work more smoothly. Mr. Higgins asked Mr. Raymond if he saw anything in the preliminary draft already distributed that would cause the ASB or the Academy concern. Mr. Raymond said that he felt strongly that it was important to allow the account value to be shown in the illustration. He said major reasons for the illustration were to educate the consumer and show him how the policy works, and neither of those results could be obtained without showing the account value. Mr. Higgins said he would need to be convinced that it was appropriate to show on an illustration something that the consumer would never get.

Mr. Higgins announced that an interim meeting of the working group would be held and suggested that the date could be set at the Life Disclosure Working Group meeting when it would be clear whether any other subgroups of the working group might want to meet at the same time.

Commissioner Wilcox said that there are a number of people involved in this effort who had not been involved with the Life Disclosure Working Group earlier and explained the procedure for working with interested parties. He said it was useful for members of the working group to have a number of people focus their comments so that the working group was not overwhelmed with responses. He said the group being coordinated by Ms. Lanam was not an official committee but served a useful function for the working group. He said that in addition to comments produced by this group, consumers and others who desired could submit their own comments.

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ATTACHMENT ONE-B1

ANNUITY ILLUSTRATIONS MODEL REGULATION
Draft: 2/26/96

Table of Contents

Section 1. Purpose

The purpose of this regulation is to provide rules for annuity policy illustrations that will protect consumers and foster consumer education. The regulation provides illustration formats, prescribes standards to be followed when illustrations are used, and specifies the disclosures that are required in connection with illustrations. The goals of this regulation are to ensure that illustrations do not mislead purchasers of annuity policies and to make illustrations more understandable. Insurers will, as far as possible, eliminate the use of footnotes and caveats and define terms used in the illustration in language that would be understood by a typical person within the segment of the public to which the illustration is directed.

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

This regulation applies to all group and individual annuity policies issued after the effective date of the regulation.

Section 4. Definitions

For the purposes of this regulation:

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

B. "Basic illustration" means a ledger or proposal used in the sale of an annuity policy that shows both guaranteed and non-guaranteed elements.

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

D. "Currently payable scale" means a scale of non-guaranteed elements in effect for a policy form as of the preparation date of the illustration or declared to become effective within the next ninety-five (95) days.

E. "Disciplined current scale" means a scale of non-guaranteed elements constituting a limit on illustrations currently being illustrated by an insurer that is reasonably based on actual recent historical experience, as certified annually by an illustration actuary designated by the insurer. Further guidance in determining the disciplined current scale as contained in standards established by the Actuarial Standards Board may be relied upon if the standards:

(1) Are consistent with all provisions of this regulation;

(2) Limit a disciplined current scale to reflect only actions that have already been taken or events that have already occurred;

(3) Do not permit a disciplined current scale to include any projected trends of improvements in experience or any assumed improvements in experience beyond the illustration date; and

(4) Do not permit assumed expenses to be less than minimum assumed expenses.

F. "Guaranteed elements" means the premiums, benefits, values, credits or charges under a policy that are guaranteed and determined at issue.

G. "Illustrated scale" means a scale of non-guaranteed elements currently being illustrated that is not more favorable to the policy owner than the lesser of:

(1) The disciplined current scale; or

(2) The currently payable scale.

H. "Illustration" means a presentation or depiction that includes non-guaranteed elements of an annuity policy over a period of years and that is either a basic illustration, in force illustration or a supplemental illustration.

I. "In force illustration" means an illustration furnished at any time after the policy that it depicts has been in force for one year or more.

J. "Illustration actuary" means an actuary meeting the requirements of Section 10 who certifies to illustrations based on the standard of practice promulgated by the Actuarial Standards Board.

K. "Lapse-supported illustration" means an illustration of a policy form failing the test of self-supporting.

L. (1) "Minimum assumed expenses" means the minimum expenses that may be used in the calculation of the disciplined current scale for a policy form. The insurer may choose to designate each year the method of determining assumed expenses for all policy forms from the following:

(a) Fully allocated expenses;

(b) Marginal expenses; and

(c) A generally recognized expense table based on fully allocated expenses representing a significant portion of insurance companies and approved by the [National Association of Insurance Commissioners or by the Commissioner].

(2) Marginal expenses may be used only if greater than a generally recognized expense table. If no generally recognized expense table is approved, fully allocated expenses must be used.

M. "Non-guaranteed elements" means the premiums, benefits, values, credits or charges under a deferred annuity policy that are not guaranteed or are not determined at issue.

N. "Policy owner" means the owner named in a deferred annuity policy or the certificate holder in the case of a group policy.

O. "Premium outlay" means the amount of premium assumed to be paid by the policy owner or other premium payer out-of-pocket.

P. "Self-supporting illustration" means.

Q. "Supplemental illustration" means an illustration furnished in addition to a basic illustration that meets the applicable requirements of this regulation, and that may be presented in a format differing from the basic illustration, but may only depict a scale of non-guaranteed elements that is permitted in a basic illustration.

Section 5. General Rules

A. An illustration used in the sale of an annuity policy shall satisfy the applicable requirements of this regulation, be clearly labeled "annuity illustration" and contain the following basic information:

(1) Name of insurer;

(2) Name and business address of producer or insurer's authorized representative, if any;

(3) Name, age and sex of proposed annuitant;

(4) Underwriting or rating classification upon which the illustration is based;

(5) Generic name of the policy, the company product name, if different, and policy form number; and

(6) Dividend option election or application of non-guaranteed elements, if applicable.

B. When using an illustration in the sale of an annuity policy, an insurer or its agents or other authorized representatives shall not:

(1) Represent the policy as anything other than an annuity policy;

(2) Use or describe non-guaranteed elements in a manner that is misleading or has the capacity or tendency to mislead;

(3) State or imply that the payment or amount of non-guaranteed elements is guaranteed;

(4) Use an illustration that does not comply with the requirements of this regulation;

(5) Use an illustration that at any policy duration depicts policy performance more favorable to the policy owner than that produced by the illustrated scale of the insurer whose policy is being illustrated;

(6) Provide an applicant with an incomplete illustration;

(7) Represent in any way that premium payments will not be required for each year of the policy in order to maintain the illustrated benefits, unless that is the fact;

(8) Use an illustration that is "lapse supported"; or

(9) Use an illustration that is not "self supporting."

C. If an interest rate used to determine the illustrated non-guaranteed elements is shown, it shall not be greater than the rate of return underlying the disciplined current scale.

Section 6. Standards For Basic Illustrations

A. Format. A basic illustration shall conform with the following requirements:

(1) The illustration shall be labeled with the date on which it was prepared.

(2) 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").

(3) The assumed dates of payment receipt and benefit pay-out within a policy year shall be clearly identified.

(4) If the age of the proposed annuitant is shown as a component of the tabular detail, it shall be issue age plus the numbers of years the policy is assumed to have been in force.

(5) 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 contract premium, the illustrated payments shall be identified as premium outlay.

(6) Guaranteed benefits and values available upon surrender, if any, for the illustrated premium outlay or contract premium shall be shown and clearly labeled guaranteed.

(7) If the illustration shows any non-guaranteed benefits and values available upon surrender, they shall not be based on a scale more favorable to the policy owner than the insurer's illustrated scale at any duration. These benefits and values shall be clearly labeled non-guaranteed.

(8) The guaranteed elements, if any, shall be shown before corresponding non-guaranteed elements and shall be specifically referred to on any page of an illustration that shows or describes only the non-guaranteed elements (e.g., "see page one for guaranteed elements").

(9) The value available upon surrender of a policy 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 surrender charges, withdrawals, policy loans and policy loan interest, as applicable. A contract subject to [cite the state law corresponding to the NAIC Standard Nonforfeiture Law for Deferred Annuities] that does not provide cash surrender benefits or does not provide death benefits at least equal to the minimum nonforfeiture amount prior to the commencement of annuity payments shall include a statement in a prominent place in the basic illustration that these benefits are not provided.

(10) Illustrations may show policy benefits and values in graphic or chart form in addition to the tabular form.

(11) Any illustration of non-guaranteed elements shall be accompanied by a statement indicating that:

(a) The benefits and values are not guaranteed;

(b) The assumptions on which they are based are subject to change by the insurer; and

(c) Actual results may be more or less favorable.

B. Narrative Summary. A basic illustration shall include the following:

(1) A brief description of the policy being illustrated, including a statement that it is an annuity policy;

(2) A brief description of the premium outlay or contract premium, as applicable, for the policy. For a policy that does not require payment of a specific contract premium, the illustration shall show the premium outlay that must be paid to guarantee the benefits illustrated;

(3) A brief description of any policy features, riders or options, guaranteed or non-guaranteed, shown in the basic illustration and the effect they may have on the benefits and values of the policy;

(4) Identification and a brief definition of column headings and key terms used in the illustration; and

(5) A statement containing in substance the following: "This illustration assumes that the currently illustrated non-guaranteed elements will continue unchanged for all years shown. This is not likely to occur, and actual results may be more or less favorable than those shown."

C. Statements. Statements substantially similar to the following shall be included and signed by the applicant, or the policy owner in the case of an illustration provided at time of delivery, as required in this regulation.

(1) A statement to be signed and dated by the applicant or policy owner reading as follows: "I have received a copy of this illustration and understand that any non-guaranteed elements illustrated are subject to change and could be either higher or lower. The agent has told me they are not guaranteed."

(2) A statement to be signed and dated by the insurance producer or other authorized representative of the insurer reading as follows: "I certify that this illustration has been presented to the applicant and that I have explained that any non-guaranteed elements illustrated are subject to change. I have made no statements that are inconsistent with the illustration."

D. Tabular Detail.

(1) A basic illustration shall include the following for at least each policy year from one (1) to twenty (20) and for every fifth policy year thereafter ending at age 100, policy maturity or final expiration, and for any year in which the premium outlay and contract premium, if applicable is to change:

(a) The premium outlay and mode the applicant plans to pay and the contract premium, as applicable;

(b) The corresponding guaranteed value available upon surrender, as provided in the policy;

(c) The corresponding non-guaranteed value available upon surrender, based on the illustrated scale;

(d) The guaranteed lifetime monthly income available as provided in the policy;

(e) The guaranteed monthly income for the minimum period required to avoid surrender penalties as provided in the policy;

(f) The non-guaranteed lifetime monthly income based on the illustrated scale; and

(g) The non-guaranteed monthly income, based on the illustrated scale, for the minimum period required to avoid surrender penalties as provided in the policy.

(NOTE: (d), (e), (f) and (g) are intended to restrict what is illustrated for "two-tiered" annuities. They probably need to be placed somewhere else in the regulation)

(2) For a policy that provides for a contract premium, the guaranteed value available upon surrender shall be that generated by the payment of the contract premium.

(3) Non-guaranteed elements may be shown if described in the policy. In the case of an illustration for a policy on which the insurer intends to credit terminal dividends, they may be shown if the insurer's current practice is to pay terminal dividends. If any non-guaranteed elements are shown, they must be shown at the same durations as the corresponding guaranteed elements, if any.

Section 7. Standards for Supplemental Illustrations

A. A supplemental illustration may be provided as long as:

(1) It is appended to, accompanied by or preceded by a basic illustration that complies with this regulation;

(2) The non-guaranteed elements shown are not more favorable to the policy owner than the corresponding elements based on the scale used in the basic illustration;

(3) It contains the same statement required of a basic illustration that non-guaranteed elements are not guaranteed; and

(4) For a policy that has a contract premium, the contract premium underlying the supplemental illustration is equal to the contract premium shown in the basic illustration. For policies that do not require a contract premium, the premium outlay underlying the supplemental illustration shall be equal to the premium outlay shown in the illustration.

B. The supplemental illustration shall include a notice referring to the basic illustration for guaranteed elements and other important information.

Section 8. Delivery of Illustration and Record Retention

A. If a basic illustration is used by an insurance producer or other authorized representative of the insurer in the sale of a policy and the policy is applied for as illustrated, a copy of that illustration, signed in accordance with this regulation, shall be submitted to the insurer at the time of policy application. A copy also shall be provided to the applicant.

B. If the policy is issued other than as applied for, a revised basic illustration conforming to the policy as issued shall be sent with the policy. The revised illustration shall conform to the requirements of this regulation, shall be labeled "Revised Illustration" and shall be signed and dated by the applicant or policy owner and producer or other authorized representative of the insurer no later than the time the policy is delivered. A copy shall be provided to the insurer and the policy owner.

C. If no illustration is used by an insurance agent or other authorized representative in the sale of a policy or if the policy is applied for other than as illustrated, the producer or representative shall certify to that effect in writing on a form provided by the insurer. On the same form the applicant shall acknowledge that no illustration conforming to the policy applied for was provided and shall further acknowledge an understanding that an illustration conforming to the policy as issued will be provided no later than at the time of policy delivery. This form shall be submitted to the insurer at the time of policy application. If the policy is issued, a basic illustration conforming to the policy as issued shall be sent with the policy and signed no later than the time the policy is delivered. A copy shall be provided to the insurer and the policy owner.

D. If the basic illustration or revised illustration is sent to the applicant or policy owner by mail directly from the insurer, it shall include instructions for the applicant or policy owner to sign the duplicate copy of the illustration for the policy issued and return the signed copy to the insurer. The insurer's obligation under this subsection shall be satisfied if it can demonstrate that it has made a diligent effort to secure a signed copy of the numeric summary page. The requirement to make a diligent effort shall be deemed satisfied if the insurer includes in the mailing a self-addressed postage prepaid envelope with instructions for the return of the signed numeric summary page.

E. A copy of the basic illustration and a revised basic illustration, if any, signed as applicable, along with any certification that either no illustration was used or that the policy was applied for other than as illustrated, 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.

Section 9. Annual Reports and Notices to Policy Owners

The insurer shall provide each policy owner with an annual report on the status of the policy that shall contain the information specified in this regulation.

A. The report shall include the following:

(1) The beginning and end date of the current report period;

(2) The net cash surrender value at the end of the previous report period and at the end of the current report period;

(3) The total amounts that have been credited or debited to the policy surrender value during the current period; and

(4) The amount of outstanding loans and withdrawals, if any, as of the end of the current report period.

B. If the annual report does not include an in force illustration, 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 may perform in the future. You should not consider replacement of your policy or make changes in your coverage without requesting a current illustration of your policy. You may annually request, without charge, such an illustration by calling [insurer's phone number], writing to [insurer's name] at [insurer's address] or contacting your agent. If you do not receive an illustration of your policy within 30 days from your request, you should contact your state insurance department."

C. Upon the request of the policy owner, the insurer shall furnish an in force illustration of current and future benefits and values based on the insurer's present illustrated scale. This illustration shall comply with the requirements of Sections 5A, 5B, 6A and 6D. No signature or other acknowledgment of receipt of this illustration shall be required.

D. If an adverse change in any non-guaranteed element that could affect the policy has been made by the insurer since the last annual report, the annual report shall contain a brief notice of that fact and the nature of the change prominently displayed. The notice shall also include a statement as to how the change could affect the future values in the original illustration.

Section 10. Annual Certifications

A. The board of directors of each insurer shall appoint one or more illustration actuaries.

B. The illustration actuary shall certify that the disciplined current scale used in illustrations is in conformity with the Actuarial Standard of Practice for Compliance with the NAIC Model Regulation on Annuity Illustrations promulgated by the Actuarial Standards Board, and that the illustrated scales used in insurer-authorized illustrations meet the requirements of this regulation.

C. The illustration actuary shall:

(1) Be a member in good standing of the American Academy of Actuaries;

(2) Be familiar with the standard of practice regarding annuity policy illustrations;

(3) Not have been found by the commissioner, following appropriate notice and opportunity for 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; or

(d) 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;

(4) Not fail to notify the commissioner of any action taken by an insurance regulator of another state similar to that under Paragraph (3) of this subsection;

(5) Disclose in the annual certification whether, since the last certification, a currently payable scale applicable for business issued within the previous five (5) years and within the scope of the certification has been reduced for reasons other than changes in the experience factors underlying the disciplined current scale. If non-guaranteed elements illustrated for new policies are not consistent with those illustrated for similar in force policies, this must be disclosed in the annual certification. If non-guaranteed elements illustrated for both new and in force policies are not consistent with the non-guaranteed elements actually being paid, charged, or credited, this must be disclosed in the annual certification; and

(6) Disclose in the annual certification the method used to allocate overhead expenses for all illustration:

(a) Fully allocated expenses;

(b) Marginal expenses; or

(c) A generally recognized expense table based on fully allocated expenses representing a significant portion of insurance companies and approved by the [National Association of Insurance Commissioners or by the commissioner].

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

(1) Annually for all policies; and

(2) Before a new policy is illustrated.

(3) If an error in a previous certification is discovered, the illustration actuary shall notify the board of directors of the insurer and the commissioner promptly of his or her inability to certify.

E. If an illustration actuary is unable to certify the scale for any policy illustration the insurer intends to use, the actuary shall notify the board of directors of the insurer and the commissioner promptly of his or her inability to certify.

F. A responsible officer of the insurer, other than the illustration actuary, shall certify annually that the illustration formats meet the requirements of this regulation and that the scales used in insurer-authorized illustrations are those scales certified by the illustration actuary.

G. The annual certifications shall be provided to the commissioner each year by a date determined by the insurer.

H. If an insurer changes the illustration actuary responsible for all or a portion of the company's policies, the insurer shall notify the commissioner of that fact promptly and disclose the reason for the change.

Section 11. Penalties

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

Section 12. 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 13. Effective Date

This regulation shall become effective [date] and shall apply to policies sold on or after the effective date.

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ATTACHMENT ONE-C

LIFE INSURANCE BUYER'S GUIDE
Draft: 3/15/96

Drafting Note: The language in the Buyer's Guide is limited to that contained in the following pages of this Appendix, or to language approved by ~~[title of supervisory authority].~~ the commissioner. However, companies can vary the type style and format and are encouraged to enhance the readability, design and attractiveness of the Buyer's Guide.

[The face page of the Buyer's Guide shall read as follows:]

Life Insurance Buyer's Guide

This guide can help you get the most for your money when you shop for life insurance. It can help you ~~answer questions about~~:

- ~~Buying Life Insurance~~ Choose the Type of Policy That's Right For You
- ~~Deciding~~ Decide How Much Insurance You Need
- Find~~ing~~ a ~~Low Cost Policy~~ Policy That Meets Your Needs and Fits Your Budget
- ~~Things to Remember~~ Make Smart Decisions When You Buy a Policy

Prepared by the National Association of Insurance Commissioners

The National Association of Insurance Commissioners is an association of state insurance regulatory officials. This association helps the various insurance departments to coordinate insurance laws for the benefit of all consumers.

This guide does not endorse any company or policy.

Reprinted by. . .

IMPORTANT THINGS TO ~~REMEMBER~~ CONSIDER

1. Review your ~~particular~~ own insurance needs and circumstances. Choose the kind of policy ~~with~~ that has benefits that most closely fit your needs. Ask an agent or company to help you.

2. Be sure that you can handle ~~the~~ premiums ~~payments are within your ability to pay~~. ~~Don't look only at the initial premium, but take account of any later premium increase.~~ Can you afford the initial premium? If it increases later, can you still afford it?

3. Ask about cost comparison index numbers and check several companies which offer similar policies. Remember, smaller index numbers generally ~~represent~~ mean a better buy. [Later note on cost indices applies to this paragraph also.]

4. Don't sign an insurance application until you review it carefully to be sure all the answers are complete and accurate.

5. Don't buy life insurance unless you intend to stick with it. It can be very costly if you quit during the early years of the policy.

6. Don't drop one policy and buy another without a thorough study of any possible benefits. Replacing your insurance can be very costly. In any case, don't drop your old policy until you have received the new one.

7. Read your policy carefully. Ask your agent or company about anything that is not clear to you.

8. Review your life insurance program with your agent or company every few years to keep up with changes in your income and your needs.

Buying Life Insurance

When you buy life insurance, you want coverage that fits your needs ~~and doesn't cost too much~~.

First, decide how much you need—and for how long—and what you can afford to pay. Keep in mind the major reason you need life insurance is to cover the financial effects of unexpected or untimely death. Life insurance can also be one of many ways you build benefits for the future.

Next, ~~find out~~ learn what kinds of policies are available to meet your needs and pick the one that best suits you.

Then, find out how to choose the combination of policy premium and benefits that emphasizes protection in case of early death, or benefits in case of long life, or a combination of both.

It makes good sense to ask a life insurance agent or company to help you. An agent can ~~be particularly useful in~~ help you review~~ing~~ your insurance needs and ~~in giving~~ give you information about the kinds of policies that are available. If one kind of policy doesn't seem to fit your needs, ask about others.

This guide provides only basic information. You can get more facts from a life insurance agent or company or ~~at~~ from your public library.

What About ~~Your Present~~ the Policy You Have Now?

Think twice before dropping a life insurance policy you already have to buy a new one. It is seldom in your interest to replace a policy. Here are some things you should consider:

- If you decide to replace your policy, don't cancel your old policy until you have received the new one.

- It can be costly to replace a policy. Much of what you paid in the early years of the policy you ~~now~~ have now ~~was used~~ paid for the company's ~~expense~~ cost of selling and issuing the policy. ~~This expense will be incurred again for~~ You will pay this type of cost again if you buy a new policy.

- If you are older or your health has changed, premiums for the new policy will often be higher. You may not be able to buy a new policy if you are not insurable.

- You may have valuable rights and benefits in ~~your present~~ the policy you now have that are not in the new one, such as the right to buy more insurance at certain ages.

- If the policy you have now no longer meets your needs, ~~Y~~you may not have to replace it. You might be able to change ~~your present policy or even~~ it or add to it to get the coverage or benefits you now want.

- There may be circumstances where a new policy may not pay benefits. For example, the policy may not pay for death by suicide for a number of years.

If you are thinking of buying a new policy, ~~C~~check with the agent or company that issued you the one you have now.~~present policy—get both sides of the story. In any case, don't give up your present policy until you are covered by a new one.~~ When you bought your old policy, you may have seen an illustration of the amounts of cash value your policy might accumulate. Before replacing your policy, ask your agent for an updated illustration. Check to see how the policy has performed and what you might expect in the future, based on the amounts the company is paying now.

How Much Do You Need?

~~To decide how much life insurance you need, figure out what your dependents would have if you were to die now, and what they would actually need. Your new policy should come as close to making up the difference as you can afford.~~ Here are some questions to ask yourself:

- How much do I contribute to the family budget? If I were to die prematurely, how would my survivors, especially my children, get by? Does anyone else depend on me financially, such as a parent, grandparent, brother or sister?

- Do I have children for whom I'd like to set aside money to complete their education in the event of my death?

- Will there be debts my family must repay after my death?

- Do I have family members or organizations to whom I would like to leave money?

- Will there be estate taxes to pay on my property after my death?

~~In figuring~~ As you figure out what you have to meet these needs, count ~~your present~~ the life insurance you have now, including any group insurance where you work or veteran's insurance. Don't forget Social Security and pension plan survivor's benefits. Add other assets you have: savings, investments, real estate and personal property. Which assets would your family sell or cash in to pay expenses after your death?

~~In figuring what you need, think of income for your dependents—for family living expenses, educational costs and any other future needs. Think also of cash needs—for the expenses of a final illness and for paying taxes, mortgages or other debts.~~

What Is the Right Kind of Life Insurance?

All life insurance policies agree to pay an amount of money when you die. But all policies are not the same. Some ~~provide permanent coverage~~ give coverage for your lifetime and others cover you only for a specific number of years ~~temporary coverage~~. Some build up cash values and others do not. Some policies combine different kinds of insurance, and others let you change from one kind of insurance to another. Your choice should be based on your needs and what you can afford.

~~A wide variety of plans is being offered today. Here is a brief description of two basic kinds—term and whole life—and some combinations and variations. You can get detailed information from a life insurance agent or company.~~

There are two basic types of life insurance: term insurance and cash value insurance. Term insurance generally has lower premiums, but does not build up cash values that you can use in the future. Cash value life insurance may be one of several types; universal life, variable life and whole life are all types of cash value insurance.

Term Insurance covers you for a term of one or more years. It pays a death benefit only if you die in that term. Term insurance generally ~~provides~~ offers the largest ~~immediate death~~ short-term insurance protection for your premium dollar. It does not build up cash value. You might buy a term policy when you have a specific need—to pay off a mortgage or other loan in the event of your death or to pay household expenses until your children are grown, for example.

You can renew m~~M~~ost term insurance policies ~~are renewable~~ for one or more additional terms even if your health has changed. Each time you renew the policy for a new term, premiums will be higher. ~~Check the premiums at older ages and how long the policy can be continued~~ Ask what the premiums will be if you continue to renew the policy. Also ask if you will no longer be able to renew the policy at some point. For a higher premium, some companies will give you the right to keep the policy in force for a guaranteed period at the same price each year. At the end of that time you may need to pass a physical examination to continue, and premiums may increase dramatically.

Many term insurance policies can be traded before the end of a conversion period for a ~~whole~~ cash value life policy—even if you are not in good health. Premiums for the new policy will be higher than you have been paying for the term insurance.

~~Other policies may have special features which allow flexibility as to premiums and coverage. Some let you choose the death benefit you want and the premium amount you can pay. The kind of insurance and coverage period are determined by these choices.~~

Cash value life insurance will pay you an amount even if you cancel the policy before you die. You may combine cash value life insurance with term insurance for the period of your greatest need for life insurance to replace income.

You may borrow against ~~the~~ a policy's cash value~~s~~ by taking a policy loan. ~~Any~~ If you don't pay back the loan and the interest on ~~the loan~~ it, ~~that you do not pay back will be deducted~~ the amount you owe will be subtracted from the benefits when you die, or from the cash value if you stop paying premiums and cancel the policy. A loan on your cash value or withdrawal of your cash value can be used to increase your income in retirement or to help pay for needs such as college costs without canceling the policy. However, to build up cash value, you must pay relatively higher premiums in the earlier years of the policy.

~~One~~ Universal Life is a kind of flexible ~~premium~~ policy ~~often called universal life,~~ that lets you vary your premium payments. ~~every year, and even skip a payment if you wish.~~ You can also adjust the face amount of your coverage. The premiums you pay (less expense charges) go into a policy account that earns interest~~, and~~. ~~e~~Charges for the insurance are deducted from the account. ~~Here, insurance continues as long as there is enough money in the account to pay the insurance charges.~~ If your premium payments plus the interest your account earns is less than the cost of your insurance, your account value will drop. If it keeps dropping, eventually your coverage will end. To prevent that, you may need to start making premium payments, or increase your premium payments, or lower your death benefits. Even if you can choose to stop premiums, the advantage of continuing to pay premiums is that you build up more cash value.

~~Endowment insurance policies pay a sum or income to you if you live to a certain age. If you die before then, the death benefit is paid to the person you named as beneficiary.~~

Variable Life is a special kind of insurance where the death benefits and cash values depend upon investment performance of one or more separate accounts, which may be invested in mutual funds or other investments. Be sure to get the prospectus ~~provided by~~ from the company when buying this kind of policy and STUDY IT CAREFULLY. ~~The method of cost comparison outlined in this Guide does not apply to policies of this kind~~. You will have higher death benefits and cash value if the underlying investment does well. Your benefits and cash value will be lower if the investments you chose didn't do as well as you expected.

Whole Life Insurance covers you for as long as you live if your premiums are paid. ~~The common type is called straight life or ordinary life insurance—y~~You generally pay the same amount in premiums for as long as you live. ~~These~~ When you first take out the policy, premiums can be several times higher than you would pay initially for the same amount of term insurance. But they are smaller than the premiums you would eventually pay if you were to keep renewing a term policy until your later years.

Some whole life policies let you pay premiums for a shorter period such as 20 years, or until age 65. Premiums for these policies are higher ~~than for ordinary life insurance~~ since the premium payments are squeezed into a shorter period.

In return for a higher initial premium, ~~W~~whole life policies ~~develop~~ build cash values. If you stop paying premiums, you can cancel the policy and take the cash or you can cancel the policy and use ~~used~~ the cash value to ~~buy continuing~~ keep insurance protection for a limited time or in a reduced amount. ~~(Some term policies that provide coverage for a long period also have cash values.)~~

~~Combinations and Variations. You can combine different kinds of insurance. For example, you can buy whole life insurance for lifetime coverage and add term insurance for the period of your greatest insurance need. Usually the term insurance is on your life—but it can also be bought for your spouse or children.~~

Life Insurance Illustrations

You may be thinking of buying a policy where cash values, death benefits, dividends or premiums may vary based on events or situations the company does not guarantee (such as interest rates). If so, you may get an illustration from the agent or company that helps explain how the policy works. The illustration will show how the cash value or other items that are not guaranteed will change as interest rates and other factors change. The illustration will show you what the company guarantees. It will also use other numbers to show you what *could* happen in the future based on what the company is currently paying. Remember that nobody knows what will happen in the future. You should be prepared to adjust your financial plans if the cash value doesn't increase as quickly as shown in the illustration. You will be asked to sign a statement that says you understand that some of the numbers shown in the illustration are not guaranteed.

Finding a ~~Low Cost~~ ~~Policy~~ Good Value in Life Insurance

After you have decided which kind of life insurance is best for you, compare similar policies from different companies to find which one is likely to give you the best value for your money. A simple comparison of the premiums is not enough. There are other things to consider. For example:

- Do premiums or benefits vary from year to year?
- How much cash value builds up under the policy?
- What part of the premiums or benefits is not guaranteed?
- What is the effect of interest on money paid and received at different times on the policy?

Note to Life Disclosure Working Group: Before considering extensive changes to this section; the Buyer's Guide Subgroup would like input from regulators and others on the appropriate use of cost indices. If regulators decide their value in the current environment is diminished, much of the bracketed material should be deleted.

[Cost comparison index numbers, which you get from life insurance agents or companies, take these sorts of items into account and can point the way to better buys.

Cost Comparison Indexes. There are two types of cost comparison index numbers. Both assume you will live and pay premiums for the next 10 or 20 years.

1. The Surrender Cost Comparison Index helps you compare costs over a 10 or 20 year period assuming you give up (surrender) the policy and take its cash value at the end of the period. It is useful if you consider the level of cash values to be of special importance to you.

2. The Net Payment Cost Comparison Index helps you compare costs over a 10 or 20 year period assuming you will continue to pay premiums on your policy and do not take its cash value. It is useful if your main concern is the benefits that are to be paid at your death.

The two index numbers are the same for a policy without cash values.

~~Guaranteed and Illustrated Figures. Many policies provide benefits on a more favorable basis than the minimum guaranteed basis in the policy. They may do this by paying dividends, or by charging less than the maximum premium specified. Or they may do this in other ways, such as by providing higher cash values or death benefits that the minimums guaranteed in the policy. In these cases the index numbers are shown on both a guaranteed and currently illustrated basis. The currently illustrated basis reflects the company's current scale of dividends, premiums or benefits. These scales can be changed after the policy is issued, so that the actual dividends, premiums or benefits over the years can be higher or lower than those assumed in the indexes on the currently illustrated basis.~~

~~Some policies are sold only on a guaranteed or fixed cost basis. These polices do not pay dividends; the premiums and benefits are fixed at the time you buy the policy and will not change.~~

Using Cost Comparison Indexes. The most important thing to remember is that a policy with smaller index numbers is generally a better buy than a similar policy with larger index numbers.

Compare index numbers only for similar policies—those which provide essentially the same benefits, with premiums payable for the same length of time. Make sure they are for your age, and for the kind of policy and amount you intend to buy.] Remember that no one company offers the lowest cost at all ages for all kinds and amounts of insurance.

~~Small differences in index number should be disregarded, particularly where there are dividends or nonguaranteed premiums or benefits. Also, small differences could easily be offset by other policy features, or difference in the quality of service from the agent or company. When you find small differences in the indexes, your choice should be based on something other than cost.~~

[~~Finally, k~~Keep in mind that index numbers cannot tell you the whole story.]You should also consider other factors:

- ~~The pattern of policy benefits~~How quickly does the cash value grow?~~.~~ Some policies have low cash values in the early years that build ~~rapidly~~ quickly later on. Other policies have a more level cash value build-up. A year-by-year display of values and benefits can be very helpful. (The agent or company will give you a ~~P~~policy ~~S~~summary or an illustration that will show benefits and premiums for selected years.)

- ~~Any~~ Are there special policy features that may be particularly suited to your needs~~.~~?

- ~~The methods by which~~ How are nonguaranteed values ~~are~~ calculated~~.~~? For example, interest rates are an important factor in determining policy ~~dividends~~ returns. In some companies ~~dividends~~ increases reflect the average interest earnings on all of that company's policies regardless of whene~~ver~~ issued. In others, the ~~dividends~~ return for policies issued in a recent year, or a group of years, reflect the interest earnings on ~~those~~ that group of policies; in this case, ~~dividends~~ amounts paid are likely to change more rapidly when interest rates change.

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ATTACHMENT TWO

Annuities Working Group
Detroit, Michigan
March 25, 1996

The Annuities Working Group of the Life Insurance (A) Committee met in the Nicolet Room of the Westin Hotel in Detroit, Mich., at 9 a.m. on March 25, 1996. Jerry Fickes (N.M.) chaired the meeting. The following working group members or their representatives were present: Sheldon Summers (Calif.); Roger Strauss (Iowa), Tony Higgins (N.C.), Tom Foley (N.D.), and Ted Becker (Texas).

Jerry Fickes (N.M.) read the charges and the work plan of the working group. Upon motion duly made and seconded, the work plan was adopted.

1. Discuss Drafting Model Law on Charitable Gift Annuities

Mr. Fickes said the Ad Hoc Working Group on Annuities did a survey in 1995 and discovered a great variation in state laws governing charitable gift annuities. He said some states regulated the annuities as insurance, some states exempted the charitable gift annuities completely, and some states had a limited type of regulation. Mr. Fickes said he had received input from charitable organizations that spoke in favor of a type of limited regulation. Tom Foley (N.D.) asked how the insurance department had the authority to regulate a charity. Mr. Fickes responded that the working group would be considering a limited type of regulation of reserves, market conduct, and other minimal regulation because the charities were delivering a product with life contingencies. Tony Higgins (N.C.) said that regulation of multiple employer welfare arrangements (MEWAs) was a good example of a limited type of regulation. He said North Carolina had a registration and reserving requirement for MEWAs without full regulating as an insurer. Mr. Higgins also reported that North Carolina law prohibits charitable organizations from providing annuities and treats them as unauthorized insurers. Mr. Foley asked how North Carolina was able to determine if the charities were operating in the state. Mr. Higgins responded that the agent community informed them of the unauthorized insurers. Brian Kreger (Empire Life) pointed out that the regulators would not be attempting to regulate the entity but rather the product. He suggested that a definition of an annuity was necessary first to help clearly define what the regulators would be trying to control.

2. Discuss Drafting Model Definition of Annuities

Mr. Fickes said he had asked four organizations to come to the Summer National Meeting with a recommendation for a definition of annuities. He said those organizations were the National Alliance of Life Companies (NALC)—an organization of small insurers, the National Association of Life Underwriters (NALU)—an organization representing agents, the American Council of Life Insurance (ACLI)—an organization representing companies, and the American Academy of Actuaries (AAA)—representing the actuarial profession. He asked these four organizations to be prepared at the next meeting with suggestions for a definition of annuities. Mr. Foley asked if the intent was to include equity indexed annuities. He said these had been discussed earlier at the Life and Health Actuarial (Technical) Task Force meeting. Francis "Rick" Morse (N.Y.) said he had seen a number of these annuities filed in New York. He said they were of two types. One was funded by the general account and had guarantees that reflected the requirements of the nonforfeiture law, guaranteed principle and a 3% return. The investment strategy of the annuity provider is to invest some of the funds to meet the minimum guarantees and to put the rest of the funds into a hedging instrument that would help the company match an index. He said under most equity index contracts the company could adjust the percentage of participation in the index in the contract. Because of the design of the product, the company has to use part of the funds to provide for the guarantees, so not as much is left to use in other investments. He said the advantage of this type of product is to give the insured a low risk on the down side and an opportunity for increase in value. He said these products are not registered with the Securities and Exchange Commission.

3. Discuss Charge to Consider Annuities and the Senior Population

Mr. Fickes asked Galen Ullstrom (Mutual of Omaha) to describe his company's efforts to determine suitability and appropriate disclosure to seniors participating in the annuity market. Mr. Ullstrom described the disclosure form that was used by his company and said the company also attempted to determine suitability for investment in an annuity. He said one of the most important issues was to make sure the consumer understood they were not buying a certificate of deposit, since usually the funding had been in a bank account, and the annuity was sold through the bank. The disclosure requirements also made clear that there was a surrender charge for early withdrawal of the annuity. Mr. Fickes asked Mr. Ullstrom, and other companies that were doing the same type of marketing to seniors, to provide their forms of disclosure to Carolyn Johnson (NAIC/SSO) for distribution to the members of the working group. Mr. Foley asked if the insurers had taken these steps in response to complaints. Mr. Ullstrom said there had been some complaints which had been handled on a case-by-case basis. He said generally these were people who did not understand what they had purchased. Mr. Fickes asked if Mutual of Omaha had a maximum issue age and Mr. Ullstrom responded that generally the annuities were not issued past age 85. He said occasionally an individual was not interested in having access to the cash, but merely wanted it to grow in a tax-deferred manner, and then a sale past the age of 85 might be suitable. Mr. Fickes asked members of the working group to review complaints in their state and forward information to Ms. Johnson for distribution to other working group members. Mr. Fickes suggested that the NAIC National Meeting in June be for a two-hour period.

Having no further business, the Annuities Working Group adjourned at 10 a.m.

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ATTACHMENT THREE

Genetic Testing Working Group
Detroit, Michigan
March 24, 1996

The Genetic Testing Working Group of the Life Insurance (A) Committee met in the Richard Room of the Westin Hotel in Detroit, Mich., at 11 a.m. on March 24, 1996. Dixon Larkin (Utah) chaired the meeting. The following working group members were present: Don Koch (Alaska); Ron Kotowski (Ill.); Robert G. Lange (Neb.); Kip May (Ohio); Mary Alice Bjork (Ore.); Rhonda Myron (Texas); and Kathleen Connor (Wash.).

Dixon Larkin (Utah) distributed the genetic testing white paper in its most recent draft (Attachment Three-A). He said that additional sections are still being drafted and a bibliography would be added. In addition, he said that consumers and industry each would be invited to attach a two-page position paper. Dr. Larkin said it was the goal of the working group that the white paper serve as a resource for state regulators. Commissioner Linda Ruthardt (Mass.) asked if the working group had considered coordination with the Americans with Disabilities Act. She said the Human Genome project particularly was concerned with how to balance new technology with existing concerns. Commissioner Ruthardt noted that genetic testing was not the same as HIV testing. With HIV it is clear one will contract the disease, whereas genetic testing may just indicate a particular susceptibility to a condition. Wendy McGoodwin (Council for Responsible Genetics) asked if the report would be made final in June. She asked when the report would be distributed to interested parties for an opportunity for final comments. Dr. Larkin said the working group needed to provide a copy of the paper to the Accident and Health Insurance (B) Committee for evaluation, so distribution would have to be within the next month. Ms. McGoodwin said she was concerned about the section labeled "working group recommendations," and wanted an opportunity to respond to those recommendations. Dr. Larkin clarified that the "recommendation" section should be entitled "summary" and that the working group would be offering suggestions for several alternative approaches, rather than one decision of the working group.

Dr. Larkin announced that an educational symposium would be held at the Summer National Meeting in New York City. The tentative plan is to have a brief presentation by the working group, a half-hour presentation by life insurance industry representatives and a half-hour presentation by consumer representatives. This would be followed by 15 to 20 minutes allotted for questions and answers.

Nicole Tapay (NAIC/DC) reported on a number of federal bills on genetic testing that are now pending. She said the House would vote on the health insurance portability bill within a week, and amendments were being added to apply to genetic testing. Kathleen Connor (Wash.) prepared a chart of key features of several of the bills pending. It was suggested that this chart be added to the genetic testing paper for informational purposes.

Arnold Dicke (U.S. Life) said he had recently attended a seminar sponsored by the American Council of Life Insurance (ACLI) on genetic testing. He said one of the most interesting pieces of information he learned was about genetic therapy, which could really change the morbidity and mortality tables. He pointed out how little we know and how fast the information is changing. He said right now genetic testing is very expensive, but that it also changing. Roberta Meyer (ACLI) said that papers had been prepared for that conference that could be distributed for background information.

Kip May (Ohio) reported that the Ohio Task Force on Genetic Testing had finished its report on genetic testing in health insurance and he reviewed some aspects of that report for the working group. He said that Ohio placed a 10-year moratorium on genetic testing in the health insurance arena, and that the report studied the effects on testing on underwriting.

A short discussion of the state laws already in place on genetic testing followed. Ms. Meyer said that only 10 states had true genetic testing statutes, and none of those placed a limit on testing in the life insurance area. She said two states required that underwriting follow sound actuarial principles, Colorado had a limitation on group disability income insurance, and the rest were limited to health insurance.

Commissioner Ruthardt said that insurers are concerned about people gaming the system where the potential insured knows of the genetic defect, but the insurer does not. She asked the working group to consider the issue of fairness. Dr. Larkin said that the redraft of the white paper had focused mainly on making an even-handed presentation. He asked working group members to consider recommendations to the parent committee on the future of the working group after completion of the white paper. He asked the working group to think about whether the working group should stay together to address further issues or whether its task was finished.

Having no further business, the Genetic Testing Working Group adjourned at noon.

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ATTACHMENT THREE-A

Report of the Genetic Testing Working Group
to the Life Insurance (A) Committee
White Paper on Genetic Testing

Table of Contents:

Regulatory Options:
- Survey of State Legislation
- Federal Proposals
- Policy Options

Genetic Testing Working Group Recommendations

Consumer Position Paper

American Council of Life Insurance (ACLI) Position Paper

Bibliography

The Genetic Testing Working Group was created following the NAIC National Meeting in Denver in 1994. The charge to the working group was to analyze the appropriateness of insurers using genetic testing in applications for insurance coverage. The working group conducted open hearings on genetic testing at the national NAIC meetings held in Baltimore, Minneapolis and _____ in 1994 and in _____, St. Louis, and Philadelphia in 1995. In addition members of the working group participated in various seminars specifically addressing genetic testing held across the country. Also, various states have held hearing and developed various model laws. This paper is designed to provide a brief, hopefully easily understood, primer on genetic testing, its current status and issues raised by its use; an overview of actions taken by the various states; suggestions as to possible regulatory options; recommendations by the working group; and finally a compilation of the statutes enacted by the states.

Introduction

Each person has his or her own unique combination of 23 pairs of genes or chromosomes, the basic units of human heredity. These genes form the human genome. The human genome is the genetic blueprint of the human body. The code is made up of about three billion chemical "letters" or nucleotides, the chemical units that create each person's chromosomes. The genetic code is formed by combinations of only four amino acids, cytosine, tyrosine, guanine and adenine, in various combinations. These nucleotides are arranged in pairs, forming a twisting, ladderlike structure, known as a double helix, called deoxyribonucleic acid ("DNA"). If stretched out, each cell's genetic code would be about three feet in length.

Each cell of the human body contains the entire genetic code for an individual, consisting of about 100,000 genes. Genes order the production of proteins and other chemicals that go into making up the human body. When a gene is altered or mutated, the wrong message is sent to the production mechanism of the cell, which can, in turn, cause the body to malfunction, creating genetic disease. Genetic disease may be either inherited or acquired. Inherited disease arises as a result of the chromosomes received directly from parents, as in cystic fibrosis. These diseases may be from dominant genes, requiring only a single gene from one parent. Or they may be from recessive genes, requiring a gene from each parent. Genetic disease may also arise from alteration of the genetic code after birth, an acquired disorder. Certain forms of cancer are most likely this type of disease, since the gene which controls the growth of a specific cell appears to be damaged so that the normal cell loses control, expanding locally and spreading distantly, ultimately killing the patient. Alterations to genes may also increase the likelihood of an individual developing a disease, even though the disease itself is not genetic in origin.

DEFINITION OF GENETIC TESTING

There has been no generally accepted term that precisely defines "genetic testing." The term implies that a piece of the human genetic code is examined to determine if the chemical sequence is proper. However, this is not currently possible except in the most sophisticated laboratories. Rather, the underlying genetic code must be deciphered through indirect evidence.

In those states were legislation has been adopted addressing genetic testing, the definition has been relatively restrictive, limiting the definition to those tests which examine the genetic code or direct gene products. In addressing the issue of defining genetic testing, insurers have advocated extremely tight restrictions, limiting such testing to laboratory testing of human DNA or chromosomes. On the other side of the issue, some advocacy groups have advocated much broader definitions, including a prohibition against inquiring into the applicant's family history or even the ages or health of one's parents as a form of a genetic test.

The Task Force on Genetic Testing of the Working Group on the Ethical, Legal and Social Implications of the Human Genome Project:

> "Genetic tests" - The analysis of human DNA, chromosomes, proteins or other gene products to determine the presence of disease-related genotypes, mutations, phenotypes or karyotypes for clinical purposes. Such purposes include prediction of disease risks, identification of carriers, monitoring, diagnosis or prognosis, but do not include tests conducted purely for research.

The Working Group suggests the working definition be:

> "Genetic screening or testing" means a laboratory test of a person's genes or chromosomes for abnormalities, defects, or deficiencies, including carrier status, that are linked to physical or mental disorders or impairments, or that indicate a susceptibility to illness, disease, or other disorders, whether physical or mental, which test is a direct test for abnormalities, defects, or deficiencies, and not an indirect manifestation of genetic disorders.

CURRENT STATE OF GENETIC TESTING

Perhaps the most famous genetic project currently is the Human Genome Project. The Human Genome project is a worldwide project initiated approximately five years ago in an attempt to analyze the human genetic code. It is anticipated that the project will take about 15 years and cost about $3 billion. At the present time, scientists estimate that they have identified genes responsible for about one-half of the 6,500 known inherited diseases caused by a single defective gene, including the genes responsible for cystic fibrosis and neurofibromatosis. In addition, certain genetic abnormalities have been discovered which predispose individuals to certain diseases, such as breast cancer in women who inherit the BRCA-1 abnormality or indicate a high probability of cancer in families who have a history of hereditary non-polyposis colon cancer.

The project hopes to accomplish two goals. First is to map the genome, to determine the location of each of the thousands of genes. Second is to sequence the genome, to determine the order of each of the chemical letters making up the genetic code. By achieving this, scientists hope to be able to examine an individual's genetic code to identify any abnormality that might exist in the sequence of the code and then determine how that abnormality might affect the individual by ascertaining which structure or function might be changed by the location of the abnormality on the map of the genome. To date less that one percent of the genome's three billion units have been sequenced or deciphered.

Most current "genetic tests" examine either gene products or macroscopic structures resulting from the action of a specific gene. Many genetic syndromes are diagnosed solely through the physical examination of the patient. Other genetic tests examine the chemicals created by the body from the genetic code, for example testing of newborns for treatable metabolic diseases such as phenylketonuria (PKU). Many states mandate such neonatal testing. Still other diseases are diagnosed by a combination of these two methods.

On a microscopic basis, chromosomes themselves may be examined to determine if is there is a cellular chromosomal abnormality, as when an amniocentesis is performed on a pregnant woman looking for Down Syndrome connected with trisomy.

Genetic testing is of variable utility. This is particularly evident in autosomal regressive conditions, where the genetic abnormality must be inherited from both parents. For example, with cystic fibrosis two individuals who carry the single abnormal gene will not develop the disease. However, should those individuals have children together, those children carry a 25% risk of inheriting both abnormal genes and will then certainly develop the disease. Therefore carrier status is not predictive of future disability for those individuals. In autosomal dominant conditions such as Huntington's Chorea, the presence of a single gene means those individuals will develop the disease if they live long enough. These individuals are essential presymptomatic with the disease process, since the only condition under which the disease will not develop is an early death. The identification of the gene is therefore highly predictive of future disability. Intermediate between these two conditions are the complex gene-influenced conditions which have a predisposition toward the development of a disease. For example a woman who inherits the BRCA-1 abnormality has a high probability of developing breast cancer. However about 15% will not develop the disease. Therefore the predictive value of the genetic abnormality is of significance, but places the individual in an intermediate risk exposure, lying between the recessive and dominant genetic disorders.

The working group sought responses to several questions regarding the current status of genetic testing. The first was whether insurers were currently requiring applicants to submit to genetic testing. We found that, at the present time, insurers are not requiring genetic testing as a prerequisite to coverage. Second was whether insurers were using genetic test results from any source in underwriting. It was found that, although no insurers are now requiring genetic testing, if the results of genetic testing are in an applicant's medical record and are relevant, insurers are likely to include such results in the underwriting process.

GENETIC TESTING ISSUES

LIFE AND DISABILITY INCOME INSURANCE

Life and disability income insurance policies provide financial security in the form of benefits to the policyholder's beneficiaries and to or for the benefit of the insured, respectively. By contrast, health insurance contract provide indemnification for the cost of medical services rendered the insured.

~~Most life~~ Life and disability income insurance may ~~assurance is individually~~ be underwritten either individually or on a group basis. Both the underwriting and pricing of these policies are ~~is~~ performed at the inception of these contracts. Usually once issued, neither the terms of nor the premiums for these individual policies can be changed regardless of changes in the nature of the insured risk or the length of time ~~during which~~ the contract is in effect. These policies also cannot generally be terminated except for nonpayment of premium. Most life insurance policies are individual in nature. By contrast, most health insurance is provided by employer group contracts and hence, re-priced annually and can be canceled under certain circumstances.

Some group life and disability income policies have provisions allowing the modification of premiums for groups as a whole. However, an individual may not be singled out for premium increases based on health factors. Also, while policies cannot be terminated except for nonpayment of premiums, some policies do expire after a stated period of time.

At the end of 1993, the most recent year for which there are published statistics, life insurance in force in the United States amounted to $11,105 billion. Seventy-eight percent of all American households and 154 million Americans owned life insurance at the end of 1993. Life insurance purchases during the year totaled $1.7 trillion. Two thirds of that amount were for individual ordinary life insurance.

Of the $11,105 billion of life insurance in force at the end of 1993, 57.9% ($6,428.4 billion) was ordinary individual life insurance which continues to be the principal type of life insurance protection for Americans This type of insurance is purchased by individuals to meet individual needs. Group live insurance in force at the end of 1993 totaled $4,456.3 billion and represented 40.1% of the life insurance in force in the United States.

The process of risk classification is used primarily in underwriting individual life and disability income insurance. Through the process of risk classification and underwriting, insurance companies place applicants for coverage into groups or classes. Each class is comprised of individuals who pose the same or comparable levels of risk. All the members of the class pay the same premiums. This is how insurers attempt to achieve fairness among insureds by matching premiums to the risks presented so that all those who present the same level of risk pay the same premiums.

On one side, individuals with any type of genetic abnormality, even if that abnormality is not predictive of any increased morbidity or mortality, are concerned that they will not be able to get insurance. On the other, life and disability insurers are concerned that, if an individual has knowledge of a genetic condition which is either presymptomatic or highly dispositive to developing a disease, that individual has an increased incentive to obtain higher levels of insurance without disclosing what may be a highly predictive risk underwriting factor.

HEALTH INSURANCE

Health insurance is sold on a group and individual basis. Most major medical insurance coverage is provided on a group basis by an employer. Insurers classify risk for health insurance for groups either by the group's own claims experience, or by data from the claims experience of other similar groups in the same industry. The premium rates are also set according to these factors. Major medical coverage pays for most medical expenses incurred for hospital and physician services at a percentage of the amount billed, after a deductible has been satisfied. Many policies limit coverage to a lifetime maximum, which is rarely exhausted.

The smaller the group, the fewer people there are to spread the expense ~~cost~~ of high cost claims;~~;~~ therefore, insurers may ~~individually~~ medically underwrite smaller groups on an individual basis. Many states have enacted small employer laws that require insurers to accept all employees of a small employer so underwriting does not result in exclusion from the group. Some states have laws or regulations that limit or prohibit medical underwriting, impose rating restrictions which prohibit an insurer from varying rates for small groups beyond certain thresholds or limit the degree to which an insurer can vary a group's rates based upon an individual's medical history or claims experience.

Sole proprietors, small employers, and individuals applying for major medical coverage experience medical underwriting. If a person has a medical condition that the insurer determines is unacceptable because of potential high medical expenses, in most states the insurer may reject the applicant, or issue a policy that excludes the preexisting condition for some period of time, or may never cover the condition. For this reason many states have laws that provide major medical coverage to individuals through a state high risk pool, while a few states require an insurer, such as Blue Cross Blue Shield, to accept these individuals. Insurers reject or limit coverage according to data that demonstrates that certain medical conditions, such as diabetes and cancer, will result in medical expenses. Other types of health insurance such as long-term care insurance, Medicare supplement insurance and limited indemnity coverage are also medically underwritten. However, federal and state laws require insurers to issue Medicare supplement insurance policies to applicants the first six months they receive Medicare Part B and reach 65 years of age, regardless of individual health conditions.

Premiums for individual insurance coverage are set according to the individual's age, sex, and geographic residence because these are reliable factors that indicate claims experience and medical expenses in the area where a person resides.

With the increasing adoption of open enrollment requirements among the states, the utility of genetic information in underwriting health insurance is rapidly disappearing, since open enrollment requires the insurer to accept all applicants, regardless of health status. Despite these changes, several legislators ~~Senators Mack and Hatfield~~ have recently introduced legislation at the federal level to prohibit the use of genetic information in the health insurance area as well as restrict the use in other insurance lines.

AVAILABILITY OF INSURANCE COVERAGE

Health insurance is the fundamental means to health care for many people. Life insurance is a primary means to future financial security. If an individual's genetic information indicates a potentially adverse genetic condition, genetic testing could threaten the individual's ability to obtain either coverage. In response to test results, an insurer may increase premiums, exclude coverage for a condition from coverage even if the individual is healthy, or deny insurance altogether. An individual's access to health care and future financial security may be threatened or closed.

RISK CLASSIFICATION

Risk classification is a critical element for any insurance system. It is one step in the process insurers use to classify and divide individuals into groups with similar claims experience, and to thereby gain an estimate of expected costs. By classifying the risk associated with projected claims, this procedure protects the insurer's solvency and allows individuals in the class to pay the lowest price compatible with projected costs.

Risk classification also attempts to offset the negative impact of adverse selection. Adverse selection describes a situation in which the individuals most likely to purchase insurance are those with the highest risk of incurring losses. A case study on adverse selection (also known as antiselection) appears in the March/April 1996 issue of the American Academy of Actuaries' publication, *Contingencies.*

The viability of a voluntary insurance system is dependent upon insurers' capacity to avoid or limit the impacts of adverse selection through risk classification. To do this, insurers must have access to the same material knowledge as the insurance applicant. Risk classification also promotes equity among consumers, whereby each person pays a premium commensurate with the individual's risk. For example, nonsmokers pay less in insurance premiums than smokers.

CONFIDENTIALITY

As a medical test, a genetic test becomes part of an individual's medical record. Consumers have justifiable concerns that private medical information well be circulated to persons other than the individual or his or her medical practitioner.

BURDEN OF KNOWLEDGE

Learning about a genetic condition may create a serious mental and emotional burden for an individual, depending on the condition and its likelihood or potential for injuring the individual's health. An individual has no control over the condition. Depression, hopelessness and psychological trauma are obvious concerns. Family discord arising from unknown or undiscovered hereditary conditions are possible. Finally, the knowledge may have no therapeutic value for an individual if nothing can be done to prevent or deal with the condition. The lack of therapeutic value of the testing itself, as well as of the test results, is especially troubling because the testing at the outset was not done for the individual's medical benefit or by the individual's choice, but for the economic interest of a third party, the insurer. However, it is important to note that requiring an individual to disclose genetic results from a test previously performed does not raise the burden of knowledge issue. The burden of knowledge also varies by the type of test performed. For example, informing an individual of a high cholesterol level associated with a familial syndrome is different than revealing that an individual may be at risk for developing a life-threatening condition at some later time in life.

DISCRIMINATION

A perfectly health individual who has a potentially adverse genetic condition (if such an individual may be properly described as "perfectly healthy") may be the object of discrimination by insurers, employers and others if these parties know about the genetic condition in advance of taking some specified action. Similarly, an individual who has this knowledge, while others do not, may behave differently when buying insurance or taking other actions. ~~This discrimination may spill into other areas including employers, insurers and others.~~ Essentially, the individual runs the risk of being negatively stereotyped or categorized regardless of the individual's current health, though insurance involves, by its very nature, the sorting of individuals into risk classes. In any case, the question arises as to whether or not knowledge of a genetic condition will result in unfair categorization.

EFFECT ON CURRENT POLICYHOLDERS

A policyholder who learns of a genetic condition will recognize that a change in employment may threaten health care and future economic security. The individual's freedom to move from one job to another and the freedom to move from one type of coverage to another may be circumscribed. The individual's employment may even be threatened. Finally, a healthy person with a potentially serious genetic condition may be treated unnecessarily as having a chronic, fatal disease~~.~~

Text yet to be drafted for these sections:

Regulatory Options
- Survey of State Legislation
- Federal Proposals
- Policy Options

Genetic Testing Working Group Recommendations

Consumer Position Paper

ACLI Position Paper

Bibliography

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ATTACHMENT FOUR

Viatical Settlements Working Group
Detroit, Michigan
March 25, 1996

The Viatical Settlements Working Group of the Life Insurance (A) Committee met in the Nicolet Room of the Westin Hotel in Detroit, Mich., at 3 p.m. on March 25, 1996. Tom Foley (N.D.) chaired the meeting. The following working group members or their representatives were present: Michael Bownes (Ala.); Don Koch (Alaska); Carol Ostapchuk (Fla.); Ron Kotowski (Ill.); Lester Dunlap (La.); Frederick P. Schumpe (Mo.); Steve Maluk (N.Y.); Tom Jacks (N.C.); John Crawford (Okla.); Mary Alice Bjork (Ore.); Don Switzer (Texas); and Eleanor Perry (Vt.).

Commissioner Glenn Pomeroy (N.D.) described a recent opportunity he had to participate in a National Conference of Insurance Legislators (NCOIL) meeting where a two-hour hearing on viatical settlements was held. He said it was a balanced and thorough presentation on the NAIC's model law and regulation, company concerns, and regulators' concerns. He said the legislators were very responsive and asked thoughtful questions.

1. Report on Effort to Develop a Uniform Application

Eleanor Perry (Vt.) said a small group had put together a uniform application form to collect information on officers and other principals (Attachment Four-A). She said there was not enough consistency in state regulations to include more information. Commissioner Pomeroy asked if it was her sense that it was appropriate to take another look at the NAIC's models so that there would be more consistency. Ms. Perry said she was not sure the model addresses the current marketplace, because the model was not developed with cancer patients and senior citizens in mind. Tom Jacks (N.C.) said the regulators need the viatical settlement industry to tell them about the current marketplace. Gary Choades (Viaticus) said that currently approximately 40% of his company's business is outside of the AIDS community. He saw this as a trend for the future because others needed the service companies like his could provide. Rhonda Myron (Texas) said her office has recently been getting calls from banks that want to lend money with the life insurance policy as security, and they were concerned that they might need to be licensed as viatical settlement providers. Commissioner Pomeroy asked Mr. Choades if he saw a need for changes in the models as the market evolved. Mr. Choades responded that the core of the models are universally accepted in the states, but inconsistencies occur principally in two areas: 1) licensing brokers and 2) pricing. He said states are not in agreement on how to treat intermediaries, and people with longer expectancies impact pricing of the viatical settlements. Commissioner Pomeroy said that one additional change would be helpful in the NAIC's models. He said medical information accumulated in examinations of the companies needs to be kept confidential and he suggested that the confidentiality provision in the model might need to be strengthened. He also said that he would like to consider a specific prohibition against the secondary marketing of viatical settlements because of insurable interest concerns.

2. Report on Actuarial Analysis of Minimum Payouts

Tom Foley (N.D.) reported that David Hippin (Hippin Actuarial Consultants) had a contract with Vermont and while he was still under contract had agreed to provide an actuarial analysis to the working group. Ms. Perry reported that Vermont had used up its consulting funds so Mr. Hippin was no longer under contract to Vermont. Mr. Foley said that, with the assistance the NAIC actuarial staff, he would attempt to prepare an actuarial analysis before the Summer National Meeting.

Mr. Choades said that some states were letting the market determine the pricing range rather than setting maximum discounts as suggested in the NAIC's model. He pointed out that Louisiana does not regulate the market beyond a 24-month period, but leaves longer expectancies open. He said the premiums paid counted as part of the consideration for the purpose of determining the minimum payout. Mary Alice Bjork (Ore.) said the original working group that drafted the model had very little information on which to base the payout requirements, and had relied on representations from the industry as to average payments. She said no actuarial study had been done at that time. Commissioner John Crawford (Okla.) asked who determined the life expectancy—whether it was done actuarially or by a doctor's opinion. Mr. Choades responded that the life expectancy of an individual was an educated guess at best, and was determined on an individual basis. Carol Opstachuk (Fla.) opined that it would take a number of years to get reliable statistics to use in any kind of table. She reported that the pending Florida bill provision that allowed for no regulation of viatical settlement payouts was not favored by the insurance department, but was recognized as the only way to get the bill through. Don Koch (Alaska) agreed that when the original model had been developed, the working group recognized it had no good numbers on which to base an actuarial standard and would not have for some time. Recognizing that some sort of limit was necessary to protect consumers, the numbers included in the model were chosen. Mr. Koch said that use of viatical settlements for long term needs would only exacerbate the problem. Ms. Perry agreed that the longer life expectancy of people now viaticating policies created several difficulties within the existing model. She suggested that a long term viatical settlement was not really the same type of product as had been sold in the industries' early years.

Commissioner Crawford asked if the industry had looked at payments of accelerated benefits for guidance. Mr. Choades said that was not of mnch assistance because the accelerated benefit was generally restricted to those with a short life expectancy. He said it is the longer lives that have created the most challenges.

3. Report on Federal Bill to Clarify Tax Status of Viatical Settlements

Mr. Choades reported that tax free treatment for viatical settlements for those who are chronically ill or had a short life expectancy had been included in the balanced budget bill that was vetoed by President Clinton. He said in recent weeks similar amendments had been added to the congressional health bills on portability. He pointed out the difference between putting the provisions in a tax bill and in a health care bill.

4. Report on State Efforts to Adopt New Laws

Bob Heisler (Ill.) reported on the new Illinois bill which he said was very similar to the NAIC model. Carolyn Johnson (NAIC/SSO) pointed out that it differed from the Illinois bill introduced last year in that no capital and surplus requirements were included in this bill and the viatical settlement brokers were not required to be licensed as insurance agents. Mr. Heisler said this bill holds the viatical company responsible for any improprieties of the brokers.

Ms. Bjork said Oregon rules have been adopted recently and include a requirement for $150,000 of unimpaired capital. She said the industry had responded unfavorably to this position, although the law gave the commissioner authority to adopt a capital requirement. Mr. Choades said the industry had not understood what this meant, but rather thought it meant a bond or something similar.

Guenther Ruch (Wis.) reported that a bill was also pending in Wisconsin. He asked who the solvency requirement was intended to protect. He said he understood that disclosure requirements and minimum payouts were designed to protect the terminally ill but they were already paid so didn't need the protection of a capital and surplus requirement. He asked if the purpose was to protect investors. Mr. Choades pointed out that the NAIC model and most of the state laws have an escrow requirement so consumers are protected in that manner. He said that in some states companies were allowed to provide payments in installments rather than in one lump sum. He said in some states that option was not allowed and if payments in installments were desired, an annuity would be purchased.

Lisa Weinmann (N.D.) explained a recent development in her state. She said the Securities Department in North Dakota has interpreted their viatical settlement law to require a license of anyone who solicited investors in the state. She asked if any other states had had a similar experience.

5. Any Other Matters

Ms. Bjork offered to provide to the working group information that had been gathered in Oregon on the secondary market issue.

A small group consisting of Ms. Perry, Mr. Jacks and Lester Dunlap (La.) agreed to look at the model and identify areas where change might be needed. Some comments have previously been received from the viatical settlement industry and Ms. Johnson was asked to send out another request to the interested parties list. Mr. Foley suggested that at the Summer National Meeting in New York the working group seek information from consumers and others. He asked Ms. Johnson to contact the American Association of Retired Persons (AARP), organizations of people with AIDS and others who were consumers with an interest in this issue.

Having no further business, the Viatical Settlements Working Group adjourned at 4:35 p.m.

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ATTACHMENT FOUR-A

APPLICATION FOR A LICENSE
AS A VIATICAL SETTLEMENT PROVIDER

Application is hereby made for a license as a Viatical Settlement Provider in the state of

______________________.

PART A: COMPANY AND PRINCIPALS; IDENTIFICATION

1. Company Name:

2. Federal Tax ID Number:

3. Location of Business Premises (street address):

4. Mailing Address:

5. Type of Organization: (*sole proprietorship, partnership, corporation, etc.*)

If the applicant is a corporation, complete and attach page 1.A.1 and 1.A.2.
If the applicant is a partnership, complete and attach page 1.B.
If the applicant is an association, complete and attach page 1.C.

Page 1.A.1.
For use by applicants which are corporations

6. If incorporated:
   a. State of Incorporation and Address of Domiciliary Officer (if other than above):

   b. If a foreign corporation, specify date of qualification to do business in state for which this application is completed:

   All non-resident corporations must appoint an agent for the Service of Process. See individual state laws for necessary forms or procedures.

   c. Identify all share holders holding 10% or more of the voting securities:

Full Legal Name	Principal Residence Address	Active Occupation(s)

   d. Identify the Board of Directors:

Full Legal Name	Position/Title	Principal Residence Address	Active Occupation(s)

   e. Identify the Officers of the Corporation

Full Legal Name	Position/Title	Principal Residence Address	Active Occupation(s)

   f. Attach a copy of the Articles of Incorporation and any amendments thereto.
   g. Attach a copy of the Bylaws and any amendments thereto.

Page 1.A.2.
For use by applicants which are corporations

   h. If the applicant is a corporation, identify parent, affiliate and subsidiary corporations, if any, and a clear description of the relationship of each to the viatical settlement company, including percentage of stock owned by applicant and each related corporation. Attach an organizational chart showing the relationships between the parent, affiliate(s) and/or each subsidiary corporation.

Corporation	Relationship to Applicant

Page 1.B.
For use by applicants which are partnerships

6. If a partnership:
   a. Identify all the partners:

Full Legal Name	Principal Residence Address	Active Occupation(s)

   b. Attach a copy of the Partnership Agreement and any amendments thereto.

Page 1.C.
For use by applicants which are associations

6. If an association:
   a. Identify all the members:

Full Legal Name	Principal Residence Address	Active Occupation(s)

   b. Identify the Trustees and/or Board of Directors:

Full Legal Name	Principal Residence Address	Active Occupation(s)

   c. Attach a copy of the Articles of Association and any amendments thereto.

Page 2

7. List the states in which the applicant is, or at any time was, engaged in the business of a viatical settlement provider:

State	From-To	Status

8. List all business licenses held or applied for by the applicant from any governmental agency:

Type of License	Issuing Authority	Date of Issue or Denial *(Explain denials)*	Status

9. Has any license or application of this applicant, or any owner, director, officer, partner, or employee of the applicant been suspended or revoked in any state?

Individual's Name	Type of License	Action	Date of Action	State involved

Page 3

10. Provide a list, and certified copies of all criminal, civil, regulatory and administrative action(s) taken against applicant (including officers, directors, trustee, partners, members and/or applicant's ultimate controlling parent) by any governmental body (including actions taken outside the United States), within the last ten (10) years.

Exact Date of Action:

Reason for Action: (include code sections, if applicable)

Government Body Taking Action: (name and full address)

Case Number or Other Reference:

Results of Action:

11. a) Name, title, and resident address of the manager/officer in charge of the business premises of the applicant:

Full Legal Name	Position/Title	Address	Soc. Sec. No.

b) Employment history of the manager/officer during the last ten (10) years:

From-To	Name of Employer	Employer's Address	Position

Page 4

PART B: CERTIFICATIONS AND SIGNATURES

The undersigned certifies that the proposed applicant and all officers, directors, controlling shareholders or partners of the applicant, and all other individuals employed or affiliated with the applicant:

1. Have not misrepresented any fact in this application for the certificate of registration;
2. Have not been convicted, within 10 years prior to the date of the application, of a felony or other crime involving fraud in any jurisdiction;
3. Are not conducting the applicant's financial affairs in such a manner as to jeopardize a viator's rights under a viatical settlement with the applicant;
4. Are engaging in the business of viatical settlements lawfully in all states in which it is doing business;
5. Understand and agree to abide by all laws and regulations of the state to which this application is made.

Further, the undersigned deposes and says that he/she has duly executed the attached application dated ______________, including such additional materials which are required for licensing/registration in the state of ______________________________, for and on behalf of ________________________, applicant: that he/she is the ___________________________of such company; and that he/she is authorized to execute and file such instrument. Deponent further says that he/she is familiar with such instrument, including all attachments thereto, and the contents thereof, and that the facts therein set forth are true to the best of his/her knowledge, information and belief.

Signed on behalf of ____, in the City of___________________________ and State of ______________________, on the ______ day of __________________, in this year of _____.

By ______________________________________

Typed or Printed Name __________________________

Title ______________________________________

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ATTACHMENT FIVE

Synthetic GIC Working Group
Detroit, Michigan
March 24, 1996

The Synthetic GIC Working Group of the Life Insurance (A) Committee met in the Richard Room of the Westin Hotel in Detroit, Mich., at 10 a.m. on March 24, 1996. Reginald Berry (D.C.) chaired the meeting. The following working group members or their representatives were present: Larry Gorski (Ill.); and Rick Morse (N.Y.).

Reginald Berry (D.C.) read the charge assigned to the working group. The charge is to recommend an appropriate regulatory approach to the product known as the "synthetic GIC" and develop a model law for the Life Insurance (A) Committee consideration by the Winter National Meeting. Mr. Berry referred to the *Proceedings of the NAIC* 1994 Fourth Quarter where the working group report outlined what would be included in a model law. Rick Morse (N.Y.) reported that New York issued advisory letters in fall 1995 that said that the department would view synthetic guaranteed investment contracts (GICs) favorably. He said most of the product designs so far are in a group annuity format. New York's Regulation 128 on reserving will apply and companies will be required to file a plan of operation. Mr. Morse said most of the contracts have implications under the Employee Retirement Income Security Act (ERISA) and regulators are not allowed to regulate them to the extent they might wish. Mr. Morse said there could be significant exposure to companies and that many of these products would stay on the books for decades. He said regulators should be concerned about the exposure to the general account. He said it was important for regulators to stay on top of the issue and estimated that $30 billion had already been written. He predicted that soon this would exceed $60 billion. Because of the magnitude of business, and the fact that the insurer was guaranteeing the performance of the underlying assets, he said there would be an immediate concern if the underlying assets became more volatile.

Mr. Berry said that during 1994, the regulators had a symposium to acquaint the insurance departments with this market. He asked if it was appropriate to do that again, since many in the audience were regulators who had not previously participated. Larry Gorski (Ill.) said he did not see a need, unless the market had changed. Commissioner Dwight Bartlett (Md.) asked what the interaction was between this group and the Life and Health Actuarial (Technical) Task Force. He said, as he understood the product, the investment management function was separated from the insurance function, which might have reserve implications because of the additional risk. Mr. Gorski said there was also a link to the Life Risk-Based Capital Working Group, which was considering the risk-based capital implications. Mr. Gorski said he had volunteered to the Life and Health Actuarial (Technical) Task Force to look at the issue and would serve as a liaison between the three groups. Mr. Berry asked if the Blanks Task Force was also considering this issue. Mr. Gorski responded that interrogatories were already in place to pick up information from the annual statement on synthetic GICs.

Mr. Gorski said he had three questions for the New York Insurance Department: He said synthetic GIC products filed in Illinois has a variable language design, which allowed for modified language in each situation. He asked if New York had seen this type of filing. Mr. Morse responded that most of the contracts reviewed so far in New York had set language, but he did not know yet what others might be filed. Mr. Gorski asked if New York had taken a look at the interest rate risk inherent in the difference in duration of the underlying assets, and Mr. Morse responded that he did not know the answer to that question. Mr. Gorski said in certain situations an insurer could advance funds to the client to meet cash needs so that the underlying assets would not be sold to generate cash. He asked if these were treated as loans. He said this might be a design feature to consider in developing a model law. Mr. Morse said that New York had not arrived at an answer to this question.

Robert Willis (Mitchell Williams Selig) said that concern about the ultimate exposure to the general account was appropriate. He also heard concerns about policy design and asked the working group to be mindful of the need not to put product design constraints in the regulation. Mr. Berry responded that the regulators had no desire to standardize product design, but would focus on protecting the general account and on the reserving requirements.

Mr. Gorski encouraged California to become a member of the working group, since it has a law or regulation on synthetic GICs already in place. He suggested that California would be a valuable addition to the group because of its previous experience.

Having no further business, the Synthetic GIC Working Group adjourned at 10:30 a.m.

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ATTACHMENT SIX

TO: Commissioners, Superintendents and Directors
FROM: Commissioner Dwight Bartlett III (Md.), Chair, Life Insurance (A) Committee
DATE: April 2, 1996
RE: Valuation of Life Insurance Policies Model Regulation - "XXX"

Just a reminder of my plea to those of you who have not started the process for the adoption of the captioned regulation, which has broad consensus support. It is essential that we all act in concert on this. Otherwise, companies doing business in states which have adopted the model will be disadvantaged when doing business in states that have not.

If you have any questions, please call either me, Tom Foley (Chair of the Life and Health Actuarial Task Force) or Mark Peavy (Life Actuary, NAIC). Thank you for your support and cooperation.