

LIFE INSURANCE (A) COMMITTEE

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

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MINUTES

The Life Insurance (A) Committee met in Space 2/11/12 of the Egan Center in Anchorage, Alaska, at 11 a.m. on Oct. 1, 1996. A quorum was present and Dwight K. Bartlett III (Md.) chaired the meeting. The following committee members or their representatives were present: Patrick E. Kelly, Vice Chair (D.C.); Terri Vaughan (Iowa); Chris P. Krahling (N.M.); Edward Muhl (N.Y.); Glenn Pomeroy (N.D.); Kerry Barnett (Ore.); and Robert E. Wilcox (Utah).

1. Report of Synthetic GIC Working Group

Rick Morse (N.Y.) presented the report of the Synthetic GIC Working Group. He said a draft had been distributed of a model regulating synthetic guaranteed interest contracts (GICs). Both he and Larry Gorski (Ill.) agreed that it would be appropriate to expand the working group to include regulators of states where companies writing the product are domiciled. He suggested that at least regulators from California, Connecticut, Massachusetts and New Jersey consider participating. He said regulators from New Jersey had already indicated an interest in participating in the working group. Mr. Morris asked that a formal invitation be extended to the states he had indicated. Upon motion duly made and seconded, the report of the Synthetic GIC Working Group was received. (Attachment One).

Commissioner Dwight Bartlett (Md.) complimented Mr. Morse on the excellent report and asked Mr. Morse to consent to serve as vice chair of the working group. Mr. Morse responded affirmatively. Commissioner Bartlett said the report represented substantial progress for the working group, and he agreed to follow through with sending an invitation to other states to join the group.

2. Report of Viatical Settlements Working Group

Tom Foley (N.D.) reported that the working group met to continue discussion of the Viatical Settlements Model Act and Regulation and the state laws on viatical settlements. He said a considerable amount of time was spent discussing the tax clarification for viatical settlements in the Health Insurance Portability and Accountability Act of 1996 and pointed out several areas where the working group raised questions about the tax treatment. Mr. Foley said the working group also has been working on an actuarial study of pricing, since it has become apparent that the market is expanding beyond the AIDS community to other chronic illnesses. He suggested that it might be useful to consider other pricing strategies than the table in the model. Some states have agreed to provide information that will help the working group make a decision. The working group also decided to put together a disclosure statement to use in 1997 to disclose the tax treatment in the Health Insurance Portability and Accountability Act of 1996.

Commissioner Bartlett asked if the tax provisions of the Health Insurance Portability and Accountability Act of 1996 applied only to accelerated death benefits. Mr. Foley responded that the law covers accelerated death benefits and viatical settlements. Commissioner Robert E. Wilcox (Utah) pointed out that there also are some specific requirements in the law relative to viatical contracts. He said in order to receive the tax-free treatment the contract must include the provisions of Sections 8 and 9 of the NAIC model law or the requirements in state law.

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

3. Report of Life Disclosure Working Group

Commissioner Wilcox reported that the Replacement Issues Subgroup met and prepared a survey, a draft of which is attached to the subgroup's minutes, and requested comments on the draft survey of insurers' replacement practices. He said the Life Disclosure Working Group met in Kansas City for two days in July and held two conference calls. Included in the working group minutes are questions and answers with regard to the Life Insurance Illustrations Model Regulation. Commissioner Wilcox said 81 questions have been identified as ones upon which the working group is in agreement and other issues are being resolved and will be added to that list. He pointed out a paragraph at the beginning of the questions and answers document that sets the questions in their proper context. He said the questions and answers were being offered as assistance to states, to give insight into the intent of the drafters, and to give guidance to those companies implementing the illustrations rules.

The Buyer's Guide Subgroup has completed its task and offers a revised Life Insurance Buyer's Guide for adoption at this meeting. In addition, the working group discussed annuity illustrations and standards for disclosure. Work on this project will continue at the Winter National Meeting.

Commissioner Bartlett asked if the questions and answers document will be made part of the public record. Commissioner Wilcox responded that the questions and answers have already been published to provide guidance, but, as they were attached to the working group minutes, they will become part of the permanent record of the Life Insurance (A) Committee.

Upon motion duly made and seconded, the report of Life Disclosure Working Group was adopted, including the revised Life Insurance Buyer's Guide (Attachment Three and paragraph on page 918 showing the working group's revision).

4. Report of the Annuities Working Group

Jerry Fickes (N.M.) reported that the membership of the working group was expanded at this meeting. He said that at each meeting one or two more states asked to join the working group, and he thought this was an indication of the interest in the issue of annuities. He said the working group provided a forum for discussing annuity issues and the group also could forward issues to appropriate committees for discussion. Mr. Fickes described the attempt of the working group to arrive at a

definition of an annuity. He said currently the group is trying to identify some types of annuities that fall outside the definition put forth at the Summer National Meeting and is working toward a glossary that defines all types of annuities. He anticipated this list would include some annuities that did not have periodic payments, but are under the annuity umbrella because of the tax benefits.

Mr. Fickes pointed out the discussion the working group had on sales of annuities to seniors. He noted that many of the problems described also occur with any other age group and the working group discussed whether age was really an appropriate criterion. Many of the problems will be addressed by the Life Disclosure Working Group project on annuity illustration disclosure and some of the issues are really a question of suitability.

The working group also discussed equity-indexed annuities and requested that the Life Insurance (A) Committee send to the Life and Health Actuarial Task Force a request to consider reserving issues for equity-indexed annuities.

The working group speculated on why more states have not adopted the various model laws on annuities and expressed an intent to survey states to see if the NAIC models need to be changed. An additional charge to the working group is to develop a model law on charitable gift annuities and a draft was distributed for discussion. Mr. Fickes said this will be discussed further at a conference call in November.

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

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

Mr. Foley reported that the Life and Health Actuarial (Technical) Task Force had completed revisions to the NAIC Model Rule (Regulation) for Recognizing Annuity Mortality Table for Use in Determining Reserve Liabilities for Annuities and asked that this be adopted by the Life Insurance (A) Committee. He explained this was an interim solution until the year 2000 and Society of Actuaries had been asked to develop a new table for use after the turn of the century. Mr. Foley reported that a considerable amount of time was spent discussing revisions to the Actuarial Opinion and Memorandum Regulation and some of these were quite controversial. The proposal was to create a central depository of information about state actuarial opinion rules and policy decisions to assist states in knowing the rules of other states. The purpose of this depository is to implement a change in the model regulation requiring use of the rules of the state of domicile rather than having each state use its own rules. In addition, the most controversial part of the change to the model regulation is the elimination of the Section 7 exemption for small companies. The next task will be to work on redefining the companies subject to the Section 7 exemption.

In addition, Mr. Foley reported on the progress of the task force in creating a new nonforfeiture law for life insurance. He said the group expected to hold an interim meeting in Orlando, Fla., on Oct. 28, 1996, in conjunction with a Society of Actuaries meeting to consider key concepts and questions about nonforfeiture. After that, the group expects to write a white paper to bring to the Life Insurance (A) Committee at the Winter National Meeting in Atlanta. It will not be a completed document, but rather a significant step toward a new law on nonforfeiture. Mr. Foley said he believes the task force will be able to develop a model law and regulation in 1997.

Upon motion duly made and seconded, the report of the Life and Health Actuarial (Technical) Task Force was adopted.

6. Consider Accomplishment of 1996 Charges

Commissioner Bartlett asked the chair of each working group to prepare a memorandum to him describing its progress on current charges and its prediction of whether those will be completed at the end of 1996. In addition, he asked that the memorandum include suggestions for 1997 and 1998 charges. He asked chairs to complete the document by the end of October and asked Carolyn Johnson

asked that the next meeting of the Life Insurance (A) Committee be expanded to one and one-half hours to allow time to discuss the 1997 charges. Commissioner Wilcox suggested that it would be helpful to the A Committee if the memoranda included fiscal notes to allow the committee to consider the cost of the proposed charges. Mr. Fickes suggested that interested parties and others who had suggestions for proposed charges provide those to the working group chair or NAIC staff.

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

ATTACHMENT ONE

Synthetic GIC Working Group of the Life Insurance (A) Committee Anchorage, Alaska September 29, 1996

The Synthetic GIC Working Group of the Life Insurance (A) Committee met in Space 4 of the Egan Center in Anchorage, Alaska, at 9 a.m. on Sept. 29, 1996. The following working group members were present: Larry Gorski (Ill.) and Rick Morse (N.Y.).

Rick Morse (N.Y.) said that all three members of the working group felt that it was appropriate to add more states to the membership and asked states with companies writing synthetic guaranteed interest contracts (GICs) to volunteer to participate. Karen Mitchell (N.J.) agreed to become a member of the working group. Mr. Morse also invited those interested in becoming technical resource advisors to provide an indication of their interest. Mr. Morse also said that a coordinator for the technical resource advisors would be selected. He said that he had prepared a discussion draft of a model regulation (Attachment One-A) and asked that comments on the draft be sent to Carolyn Johnson (NAIC/SSO) by Oct. 31, with an interim meeting or conference call to follow in early November. Mr. Morse pointed out Section 12 of the draft regulation on reserves and asked whether it was appropriate to refer that to the Life and Health Actuarial (Technical) Task Force for development. Larry Gorski (Ill.) suggested this group handle all aspects of the regulation including the reserve requirement and then to forward it to the Life and Health Actuarial (Technical) Task Force for review.

Mr. Morse reviewed the draft section by section and said most of the language in this draft was from New York administrative rules that had been developed with input from several major synthetic GIC writers. He said the language reflects a conscientious effort to give regulators control if the companies do not stand behind their contract rights designed to protect general account policyholders. This permits the regulator as a rehabilitator or conservator to cancel the synthetic GIC contract and get it off the books so that the company is not drawn down into liquidation. Mr. Morse said that the insurance laws are to a great extent overridden by the provisions of the Employee Retirement Income Security Act (ERISA) since assets are under the control of the plan sponsor, but that regulators do have the ability to control the language of the contract and the reserve requirements.

Mr. Gorski said one of the problems that he saw was that because of the competitive nature of the product, significant portions of the contract were subject to negotiation. He felt uncomfortable approving this type of filing and asked if the draft deals with this issue. Mr. Morse responded that the draft was written with a requirement that a plan of operation be filed for each contract which would include the investment guidelines and that would allow the regulator to review the description of each contract. Mr. Gorski asked if it was possible to prepare a filing that includes all the alternative acceptable plans of operation. Mr. Morse responded that for larger contracts the plan of operation investment guidelines would vary and noted that New York presently only accepts one-case filings. He pointed out that, as drafted, the regulation was open on this issue.

Mr. Gorski asked if there were any design types that were prohibited by this draft. Mr. Morse responded that in an indirect way it precluded the immediate participating guarantee (IPG) contract.

Having no further business, the Synthetic GIC Working Group adjourned at 9:25 a.m.

ATTACHMENT ONE-A

Synthetic Guaranteed Investment Contracts Model Regulation Draft: 9/29/96

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Section 1. Authority

This rule is issued pursuant to the authority vested in the commissioner of the State of [insert state] under [insert citation for authority].

Section 2. Purpose

The purpose of this regulation is to prescribe:

- A. The terms and conditions under which life insurance companies may issue group annuity contracts and other agreements that establish the insurance company's obligation by reference to a segregated portfolio of assets that is neither owned by nor in the possession of the insurance company;
- B. The essential operational features of the segregated portfolio of assets; and
- C. The reserve requirements for these group annuity contracts and agreements.

Section 3. Scope

This regulation applies to group annuity contracts and other agreements that:

- A. Are used to fund defined contribution plans;
- B. Are benefit responsive; and
- C. Guarantee principal and stated interest rates or rates that are declared in advance.

Section 4. Definitions

As used in this regulation, the following terms shall have these meanings:

- A. "Synthetic guaranteed investment contract (GIC)" or "contract" means a group annuity contract or other agreement that establishes the insurance company's obligations by reference to a portfolio of assets that is neither owned by nor in the possession of the insurance company.
- B. "Contract value record" means an accounting record established by the contract in relation to the portfolio of assets that is credited with a fixed rate of return over regular periods. The contract value record is experience rated relative to the market value record and is used to measure the extent of the insurance company's obligations to the contractholder.
- C. "Experience rating formula" means a mathematical formula used to calculate the fixed rate of return credited to the contract value record during any rate period and based in part upon the differences between the contract value record and the market value record and based on a period of time related to the average duration of the assets held in the segregated portfolio.
- D. "Investment guidelines" means the set of written guidelines established by the contractholder setting forth the quality and duration corridors within which the investment manager may invest and reinvest the assets within the segregated portfolio.
- E. "Investment manager" means the insurance company, if it is registered as an investment adviser under the Investment Advisers Act of 1940, or any third party entity registered as an investment adviser under the Investment Advisers Act of 1940, appointed by the contractholder to manage the segregated portfolio in accordance with the investment guidelines.
- F. "Market value record" means an accounting record established by the contract in relation to the market value of the portfolio of assets and expressed as the sum of:

(1) The aggregate of the prices at which the publicly traded assets held in the segregated portfolio are traded as of any valuation date, or in the case of an asset for which no such price is available, a price that appropriately reflects its fair market value; plus

(2) Any related cash or currency held in the segregated portfolio.

G. "Permitted custodial institution" means a bank, trust company or other duly licensed fiduciary services provider.

H. "Rate period" means the period of time during which the fixed rate of return credited to the contract value record is applicable between experience rating formula adjustments.

I. "Segregated portfolio" means:

(1) A portfolio or sub-portfolio of assets to which the contract pertains that is held in a custody or trust account by the permitted custodial institution and identified on the records of the permitted custodial institution as special custody assets held for the exclusive benefit of the retirement plans or other entities on whose behalf the contractholder holds the contract; and

(2) Any related cash or currency received by the permitted custodial institution for the account of the contractholder and held in a deposit account for the exclusive benefit of the retirement plans or other entities on whose behalf the contractholder holds the contract.

Section 5. Segregated Portfolio Operational Features

A. To become authorized to issue contracts subject to this regulation, the insurance company shall file for approval with the commissioner a plan of operation for each contract, accompanied by the contract or a description of the contract, and an undertaking to file actuarial opinions and memoranda in conformity with the requirements of this regulation.

B. The plan of operation shall include but not limited to:

(1) A statement that the plan of operation will be administered in accordance with the requirements prescribed by the commissioner pursuant to Section [insert citation for authority].

(2) A description of how the contract value record will be determined, and, where applicable, adjusted by experience rate;

(3) A statement of how the guaranteed contract liabilities are to be valued;

(4) A statement of how the procedures required under Section 12 will be followed;

(5) A description of how the contract value record will be determined, and, where applicable, adjusted by experience rating;

(6) A description of how the market value will be established and maintained, including a description of the rules for valuing securities and other assets that are not publicly traded;

(7) A description of how information concerning the assets in the segregated portfolio and related transactions will be reported to and verified by the insurer;

(8) A description of how the investments in the segregated portfolio reflect provision for benefits wrapped by the contract;

(9) A description of any requirement for plans purchasing synthetic GICs to establish a buffer fund or an allocation procedure that limits the allocable share of benefit payments made from the segregated portfolio;

(10) A description of the experience rating formula and how it will operate to take into account differences between the market value and contract value records;

(11) A description of all termination events, discontinuation triggers and options, notice requirements, corrective action procedures and all other contract safeguards, including a list of events that give the insurer the right to terminate the contract immediately, distinguishing between events unique to synthetic GICs and events that apply generally to group annuity contracts providing guaranteed benefits;

(12) A description of the procedures to be followed when a termination event occurs but the company fails to terminate the contract. The commissioner shall require a report from an insurer that fails to terminate a synthetic GIC when a termination event occurs, describing the corrective action to be taken. The commissioner shall require, in a March 1 annual report, an inventory of all material termination events that occurred during the preceding year but where the company decided not to terminate the contract, plus illustrative examples of events that were not deemed to be material. The company also shall provide an analysis of each material event, including any increased risk to the company and whether corrective action was taken by the March 1 date of the report. The commissioner

also shall require a similar report by September 1 of each year, covering events as of July 1 of that year, that includes one of the following statements:

- (a) A statement that no such events have occurred; or
 - (b) A statement that no material events have occurred, with an illustrative example of the most significant event; or
 - (c) An enumeration of all material events together with information as in Paragraph (16)(b).
- (13) A description of the procedures that the insurance company will follow in evaluating the appropriateness of the investment guidelines submitted by the contractholder, including a description of the manner by which the insurance company shall monitor the segregated portfolio and verify that it is being managed in accordance with the investment guidelines;
- (14) The name and qualifications of any investment manager that will be used in managing the segregated portfolio, if other than the insurance company, including a description of the criteria used by the insurance company in approving the investment manager;
- (15) A demonstration as to the adequacy of the consideration charged by the insurance company for the risks it has assumed with respect to synthetic GICs.
- (16) A statement that the Opinion and Memorandum required by Section 12 due each March 1 shall include:
- (a) The amount of risk charges for synthetic GICs net of any losses, and the amount of any losses incurred in the preceding calendar year; and
 - (b) A statement that the applicable investment guidelines were adhered to during the preceding calendar year;
- (17) A description of the procedures to be followed in accounting for any risk charges;
- (18) An illustration of how the contract will perform under at least three (3) diverse hypothetical interest rate withdrawal scenarios;
- (19) Acknowledgment that the "prudent man rule" will be adhered to in all investment procedures;
- (20) Acknowledgment that the insurance company will:
- (a) Maintain adequate risk reserves;
 - (b) Collect adequate consideration for the cost of fixed annuities purchased under contract option by transfer from the segregated fund; and
 - (c) Maintain reserves required by [insert statutory citation] for fixed annuities; and
- (21) A statement as to whether the contract provides that assets in the segregated account shall not be chargeable with liabilities arising from any other source.

C. Review of the plan of operation by the commissioner may necessitate requests for information to supplement that furnished in the replies to the above questions. In any event, replies that comply with these guidelines shall contain sufficient detail that any follow-up correspondence can be held to a minimum.

Section 6. Required Contract Provisions

- A. The contract shall clearly identify all circumstances under which insurance company payments to the contractholder are to be made.
- B. The types of withdrawals made on a market value basis shall be clearly identified in the contract.
- C. Except under the circumstances set forth in Section 10, at termination the contract shall provide a settlement option permitting the contractholder to receive the contract value record over time upon payment to the insurance company of the assets held in the segregated portfolio.
- D. The contract shall state the maximum rate period between experience rating formula recalculations that will be permitted, if any.
- E. The contract shall grant the insurance company the right to perform audits and inspections of assets held in the segregated portfolio from time to time upon reasonable notice to the permitted custodial institution.

F. The contract shall provide the insurance company with prior notice of and the right to approve any change of investment managers.

G. The contract must include a waiver provision stating that no waiver of remedies following the breach of a contractual provision or of the investment guidelines, or failure to enforce the provisions or guidelines, shall be effective against an insurance commissioner with regulatory jurisdiction over this contract, including the domiciliary insurance commissioner, unless approved in writing by the domiciliary insurance commissioner and any other insurance commissioner with regulatory jurisdiction over this contract.

Section 7. Establishment of Segregated Portfolio

A. No contract subject to this regulation may be written unless the assets that it supports and for which a contract value is established are maintained in a segregated portfolio of a permitted custodial institution.

B. The insurance company shall regularly account for the segregated portfolio. Accountings shall be prepared no less frequently than monthly, and shall include the following items:

- (1) A complete statement of segregated portfolio holdings and values; and
- (2) The cash balance within the segregated portfolio.

C. The insurance company shall maintain a market value record at all times for each contract subject to this regulation. No less frequently than monthly, the insurance company shall update the market value record to reflect the market value of the segregated portfolio. In performing the market value calculation, the insurance company shall select a method of valuation designed to reflect the fair market value of the segregated portfolio, which may include the use of a vendor market valuation service.

D. At least annually the contractholder and the insurance company shall agree on the permissible levels and timing of any new deposits to the segregated portfolio, expressed as a percentage of the contractholder's positive cash flow or in gross dollar amounts.

Section 8. Investment Management of the Segregated Portfolio

A. The investment manager must have full responsibility for, and sole control over, the purchase and sale of all segregated portfolio assets within the quality and duration constraints of the investment guidelines submitted by the contractholder to the investment manager and accepted by the insurance company from time to time.

B. The investment guidelines shall be submitted to the insurance company for underwriting review before the contract became effective. Any changes made to the investment guidelines that are not submitted to and accepted by the insurance company prior to the effective date of the change, shall be a reason for the immediate termination of the contract by the insurance company. The investment guidelines may only provide for investments of the segregated portfolio in instruments for which market values are readily ascertainable.

C. Prior to issuing a contract subject to this regulation, the insurance company shall file with the commissioner a copy of the investment guidelines for the contract. The filing shall be accompanied by a statement of an authorized officer of the insurance company that shall include:

- (1) A statement of the identity of the permitted custodial institution;
- (2) A description of the manner by which the insurance company shall monitor the segregated portfolio and verify that the segregated portfolio is being managed in accordance with the investment guidelines; and
- (3) An agreement to file with the commissioner any changes to the investment guidelines upon acceptance of the changes by the insurance company.

Section 9. Purchase of Annuities

For contracts that are group annuity contracts, and that make available to the contractholder the purchase of immediate or deferred annuities for the benefit of individual members of the group, no annuity may be purchased without the delivery of the contractually agreed consideration in cash to the insurance company from the segregated portfolio for allocation to the insurance company's general account or a separate account.

Section 10. Unilateral Contract Terminations

A contract subject to this regulation shall allow the insurance company to unilaterally and immediately terminate, without future liability of the insurance company or obligation to provide further benefits, upon the occurrence of any one of the following events:

- A. The investment guidelines are changed without the advance consent of the insurance company;

- B. The segregated portfolio is invested in a manner that does not comply with the investment guidelines; or
- C. Investment discretion over the segregated portfolio is exercised by or granted to anyone other than the investment manager.

Section 11. Disclosure

An insurance company issuing a contract to which this regulation applies is required to provide a statement summarizing any automatic termination provisions of the contract and the options available to the contractholder at termination to maintain the contract value record.

Section 12. Reserves

[Development of reserve and actuarial reporting standards by the Life and Health (Technical) Task Force probably similar to California's Insurance Code §§ 10506.4 and 10507.5 and Bulletins 95-8 and 95-10 and New York's 11 NYCRR 97 (Regulation 128) for market value separate accounts funding guaranteed benefits.]

Section 13. Severability

If any provision of this regulation or its application to any person or circumstance is adjudged invalid by a court of competent jurisdiction, that judgment shall not affect or impair the validity of other provisions of this regulation.

ATTACHMENT TWO

Viatical Settlements Working Group of the Life Insurance (A) Committee Anchorage, Alaska September 30, 1996

The Viatical Settlements Working Group of the Life Insurance (A) Committee met in Space 7/8 of the Egan Center in Anchorage, Alaska, at 3 p.m. on Sept. 30, 1996. Tom Foley (N.D.) chaired the meeting. The following working group members or their representatives were present: Don Koch (Alaska); Ron Kotowski (Ill.); Tom Wilder (Kan.); Lester Dunlap (La.); Rick Morse (N.Y.); Angela Ford (N.C.); John Crawford (Okla.); Richard McGavock (Ore.); Rhonda Myron (Texas); and Dixon Larkin (Utah).

Tom Foley (N.D.) said the market of viatical settlement companies had originally been to serve people with AIDS, but the working group had received testimony that the market was moving more toward other illnesses and chronic care. He opined that the Health Insurance Portability and Accountability Act of 1996 recently passed in Congress would see a further expansion of that trend.

1. Report on Health Insurance Portability and Accountability Act of 1996

Carolyn Johnson (NAIC/SSO) reported on the provisions of the Health Insurance Portability and Accountability Act of 1996 that apply to viatical settlements. She said that the provisions on the law include a tax-free status for viatical settlements after Jan. 1, 1997, if certain requirements are met. The provisions apply to the proceeds of a life insurance policy viaticated by an individual who is terminally ill or chronically ill. "Terminally ill" is defined as an individual who has an illness or physical condition that can reasonably expect it to result in death in 24 months or less, and "chronically ill" is defined as an individual who is unable to perform the activities of daily living or need substantial supervision.

The law refers the NAIC models on viatical settlement providers. If the state has a law on viatical settlement providers, its provisions are followed; otherwise the viatical settlement must meet the standards of Sections 8 and 9 of the NAIC Viatical Settlements Model Act and payments must be made according to the requirements of Section 4 of the NAIC Viatical Settlements Model Regulation.

The working group and audience raised many questions where it appeared the legislation was unclear. Rhonda Myron (Texas) asked if it is clear that viatical settlements prior to Jan. 1, 1997, are taxable. Holly Roth (Viaticus) said her company has been telling people that viatical settlements prior to that date are probably taxable, but she agreed the answer is not clear. The working group also wondered about the situation where an individual is certified by his doctor to have a life expectancy of 24-months or less, but the individual lives a considerable amount of time past that. Doug Head (Medical Escrow Society) said he thought the Internal Revenue Service (IRS) would be reluctant to tax the estate or an individual who is dying. Angela Ford (N.C.) asked if it was possible to pose the questions being raised by the working group to the IRS. The working group discussed sending a letter to the IRS. Even if the IRS did not respond, it might use the questions as assistance in formulating its regulations, or the working group might use this information to develop a disclosure statement.

Mr. Foley asked if the working group could enhance the provisions of Sections 8 and 9, or whether this bill meant that it was not possible to amend the model. Don Koch (Alaska) opined that the federal law seemed to allow the standards to be a moving target because it did not cite a specific NAIC model. Ms. Johnson agreed that seemed an appropriate interpretation because in the long-term care area, the Health Insurance Portability and Accountability Act of 1996 had been very specific about which

version of the NAIC model to reference and in this case no particular version was specified. Others in attendance wondered whether a Form 1099 would be provided to individuals by the provider that purchased the policy for preparing an income tax return.

The working group expressed concern about the cut-off of 24 months and wondered if a market would develop for doctors willing to certify a 24-month life expectancy in order to allow the favorable tax treatment. Mr. Koch suggested that maybe this question could be submitted to the American Medical Association (AMA) because of the ethical implications to that organization. He speculated that the AMA would be looking at this issue.

Ms. Roth said the doctor's certification of life expectancy is really somewhat divorced from the process of the viatical settlement provider in determining the amount to offer for the life insurance policy. She said the company does its own underwriting to determine the offering price and another company might decide on a different life expectancy and set a different price for the policy. Gary Chartier (Okla.) asked if the viatical settlement companies had a lot of policies with life expectancies exceeding 24 months. Mr. Head and Ms. Roth agreed that approximately one-third of the business their companies do is with individuals who have more than a 24-month life expectancy.

Mr. Foley asked Ms. Johnson to develop an initial draft of a letter to the IRS, to find out whether it would be possible for the working group to talk to a representative from the IRS, and to put together a first draft of a disclosure statement. This disclosure statement would be used in soliciting viatical settlements after Jan. 1, 1997. After distribution of these materials to the working group, a conference call will be scheduled in early November.

2. Actuarial Standards for Viatical Settlements

Mark Peavy (NAIC/SSO) explained a table (Attachment Two-A) he had prepared that analyzed the expected returns using the minimum returns in Section 4 of the NAIC Viatical Settlements Model Regulation. He and Mr. Foley explained that the chart showed for a particular life span what the annualized return on the company's investment would be given expenses of 5, 10, 15 or 20% of the face amount of the policy. Mr. Foley said that the expenses of the company would include marketing, paying premiums on the policy until death, income tax on the profits for the viatical company, broker commission, overhead, cost of verification of coverage, and the cost of getting medical records from the attending physician. In addition, if the viatical settlement company does not have its own funds, there would be the cost of borrowing funds. Mr. Head pointed out that for a small face-value policy, many of the costs will be similar to the costs for a high face-value policy, which would reduce the return significantly. Richard McGavock (Ore.) asked Ms. Roth if the percentages of expenses on the chart were appropriate. Ms. Roth said that the costs to her company were proprietary information, but she would see if some average information could be provided to the working group. Mr. Koch noted that when percentages were included in the model, the working group had very little information on which to base those numbers. He said at that time the industry could not provide much information to the working group and he seemed to hear that the information was still not available. Ron Kotowski (Ill.) asked how much of the time the minimums in the model were actually the maximums being offered. Mr. Head responded that the prices being offered are going up all the time as more players enter the market and competitive bidding becomes commonplace. He opined that when the model was first written those percentages might have been unachievable, but a year from now they might be too low.

Rick Morse (N.Y.) asked if the working group had considered requesting data from the states that collect that information. He said New York did have some data because the New York regulation has been in place for some time. He offered to see if New York's data was in a form that would be helpful to the group. Mr. Foley asked Ms. Johnson to check with other states that have a viatical settlement law to see if they have any data that can be shared with the working group members.

Having no further business, the Viatical Settlements Working Group adjourned at 4:50 p.m.

ATTACHMENT TWO-A

TO: Tom Foley (N.D.), Chair, Viatical Settlements Working Group
 FROM: Mark Peavy, NAIC Life/Health Actuary
 DATE: September 24, 1996
 SUBJECT: Minimum Discounts for Viatical Settlements

Tom, you asked for a brief summary of where the discussions you and I have had since the New York meeting have taken us. This memo will briefly describe some of the observations we have made and some possible directions for future discussions.

Relative to the impact of the discounts permitted by the model regulation, Table 1 shows the annual rates of return to viatical companies assuming the maximum discounts are applied, death can be exactly predicted, and a specified level of expense is incurred. For example, suppose the viaticant was predicted to (and did) die in exactly six months. If expenses equaling 5% of the face amount were incurred in viaticating the policy, the viatical company would receive a 78% annual rate of return on its investment, i.e., $.78 = [1 / (.70 + .05)]^{(1/20)} - 1$. However, if expenses totaled 20% of the face amount, the company would receive a 23% annual rate of return. The last seven rows show annual rates of return where death is expected at 24 months or beyond. At least two observations can be made from this table. First, there are significant discontinuities in the table at the durations where the minimum percentage of face amount changes. Second, the level of expense incurred in viaticating a policy has a significant impact on the rate of return earned by the viatical company.

While Table 1 tells us where we are in terms of the minimum percentages of face value imposed by the regulation, guidance as to how those values might be modified is not so easily forthcoming. At our meeting in New York, it was suggested that existing NAIC models on structured settlements might provide some guidance, since both structured settlements and viatical settlements pertain to individuals in poor health. In looking through the existing NAIC model acts and regulations, it does not appear that there are any models exclusively devoted to structured settlements. There are a few models and Actuarial Guidelines that touch on structured settlements, but these primarily relate to reserving issues. However, there is a model regulation pertaining to accelerated benefits (#620). Section 10A(2) of that regulation requires that, in determining the present value of the portion of the face amount to be accelerated, "the calculation shall be based on any applicable actuarial discount appropriate to the policy design." Obviously, determining what is "appropriate to the policy design" is quite subjective. The only specific constraint imposed is on the maximum interest rate that may be used in the discounting; the interest rate is limited to the greater of the current yield on 90-day treasury bills and the current minimum statutory adjustable policy loan interest rate.

Finally, it should be noted that the Life and Health Actuarial Task Force is finalizing a report on new life nonforfeiture standards. As you are aware, one technique being considered is described as a "future benefits approach," where the nonforfeiture benefit is an estimate of future benefits and expenses forgone under the policy less future premiums. Since this is intended to approximate the market value of the policy, regulations and actuarial standards of practice, which are developed to implement this approach might provide some guidance for viatical settlements. Unfortunately, one area where guidance probably won't be forthcoming pertains to how the mortality assumption should be adjusted to fit the viaticant's circumstances.

I am looking forward to discussing this with you in Anchorage.

TABLE 1

Estimated Months Until Death	Percent of Face Amount	Expenses (Percent of Face Amount)			
		5%	10%	15%	20%
1	80%	603%	254%	85%	0%
2	80%	165%	88%	36%	0%
3	80%	92%	52%	23%	0%
4	80%	63%	37%	17%	0%
5	80%	48%	29%	13%	0%
6	70%	78%	56%	38%	23%
7	70%	64%	47%	32%	20%
8	70%	54%	40%	28%	17%
9	70%	47%	35%	24%	15%
10	70%	41%	31%	22%	13%
11	70%	37%	28%	19%	12%
12	65%	43%	33%	25%	18%
13	65%	39%	30%	23%	16%
14	65%	36%	28%	21%	15%
15	65%	33%	26%	20%	14%
16	65%	31%	24%	18%	13%
17	65%	29%	23%	17%	12%
18	60%	33%	27%	21%	16%
19	60%	31%	25%	20%	15%
20	60%	29%	24%	19%	14%
21	60%	28%	23%	18%	14%
22	60%	26%	21%	17%	13%
23	60%	25%	20%	16%	12%
24	50%	35%	29%	24%	20%
30	50%	27%	23%	19%	15%
36	50%	22%	19%	15%	13%
42	50%	19%	16%	13%	11%
48	50%	16%	14%	11%	9%
54	50%	14%	12%	10%	8%
60	50%	13%	11%	9%	7%

ATTACHMENT THREE

Life Disclosure Working Group
of the Life Insurance (A) Committee
Anchorage, Alaska
September 28, 1996

The Life Disclosure Working Group of the Life Insurance (A) Committee met in Space 11/12 of the Egan Center in Anchorage, Alaska, at 11 a.m. on Sept. 28, 1996. Tom Foley, Vice Chair (N.D.) chaired the meeting. The following working group members

Life Insurance Committee

or their representatives were present: Don Koch (Alaska); Sheldon Summers (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Jerry Fickes (N.M.); Rick Morse (N.Y.); and Robert E. Wilcox (Utah).

1. Report of Replacement Issues Subgroup

Carolyn Johnson (NAIC/SSO) reported that the Replacement Issues Subgroup met by conference call twice and discussed surveying insurers to learn more about their replacement practices. The subgroup requested comments be sent to Ms. Johnson on the survey draft attached to its minutes by Oct. 24, 1996, and will hold a conference call the following week to discuss the comments and prepare any necessary revisions to the survey. Upon motion duly made and seconded, the report of the Replacement Issues Subgroup (Attachment Three-A) was received.

2. Report of Life Disclosure Working Group Interim Activity

Mr. Foley summarized the interim activity of the Life Disclosure Working Group. He said the group met in Kansas City, Mo., in July and held two conference calls. He pointed out that some of the questions and answers on the Life Insurance Illustrations Model Regulation were considered finished and adopting the report would adopt those as a position of the working group. He pointed out that numerous other questions had been considered but conclusions had not been reached on those questions. Upon motion duly made and seconded, the report of the Life Disclosure Working Group interim activity was adopted (Attachment Three-B).

3. Appropriate Use of Cost Indices in Sales of Life Insurance

Mr. Foley said a subgroup had considered whether there was one cost index that would add to a consumer's ability to make an appropriate purchasing decision on life insurance. The subgroup had concluded that there was not one superior cost index, but thought it was appropriate to allow the development of various indices. Roger Strauss (Iowa) opined that it was not appropriate to specify any particular indices in the Life Insurance Buyer's Guide, but to briefly describe the purpose of a cost index. He said that if an individual was interested in that type of information he or she would be aware of the need to ask more questions. Mr. Foley asked Lester Dunlap (La.), chair of the Buyer's Guide Subgroup, if he considered that group's work to be finished. Mr. Dunlap pointed out that the Life Insurance Buyer's Guide attached to the interim report had been revised to take into account the recommendations of the Cost Indices Subgroup and it was ready for adoption. Steve Frankel (Northwestern Mutual Life) suggested a change to the paragraph on cost indices because he did not think the sentences described them accurately. Mr. Dunlap suggested that a group draft language and present it for working group consideration after the break.

Mr. Foley reminded those in attendance that the Life Disclosure Working Group recommends that the policy summary required by some state regulations not be required if an illustration meeting the requirements of the Life Insurance Illustrations Model Regulation is being provided. That would mean that the applicant would not have information about indices. He asked if the Buyer's Guide would still be appropriate in that context and no objections were raised about the use of the proposed Buyer's Guide in that situation.

4. Standards For Annuity Illustrations

William Fisher (Massachusetts Mutual) summarized the work of the technical resource advisors on annuity illustrations. A letter from Linda Lanam (Life of Virginia) attached to the interim report suggests that the problems that have occurred with annuities have not been illustration-related but rather a problem of incomplete disclosure or miscommunication. He said the technical resource advisors felt this best could be addressed through a brief disclosure document rather than a full illustration. He called on Barbara Lautzenheiser (Lautzenheiser & Associates) to describe the disclosure document standard. Ms. Lautzenheiser said the document represented work done by technical resource advisors and the Annuity Disclosure Working Group of the American Academy of Actuaries Committee on Life Insurance. She said the group had developed a standard of principles similar to what the Life Disclosure Working Group did before drafting the Life Insurance Illustrations Model Regulation. She said the intent was to develop flexible general standards and the group had not yet considered the implications for two tier annuities, equity-indexed annuities, or other specialized products. As Ms. Lautzenheiser reviewed the provisions of the standard (Attachment Three-C), the group suggested several additions to this document. Ms. Lautzenheiser said that Section IC could include a Paragraph 7 to talk about annuitization guarantees to address the concerns Daphne Bartlett (Calif.) raised at an interim conference call. The group spent some time discussing Section IIB, which contains exemptions for several types of annuity products. Christian Uhlmann (Alaska) suggested that some of these products are included under the guaranty fund definition and some of the structured settlement annuities in Paragraph 4 are sold as guaranteed investment contracts (GICs) that are not annuities in Alaska.

Members of the working group expressed some reservation about including a list of exemptions. Mr. Foley suggested the working group had not mapped out its plan with enough detail to be able to set such a list at this time. He said some might be uncomfortable with the idea of including a product after developing the model under the assumption that the product would not be included. Bob Brown (CIGNA) asked the group to consider developing the standards with this list of exclusions because the standards document had been drafted with those in mind. Commissioner Robert E. Wilcox (Utah) suggested that the working group leave the draft as presented but make sure that everyone was aware that as the working group moved along the development process there might be reasons to modify that list. He suggested adding a sentence saying there may be some appropriate carveouts from the disclosure requirements such as those listed, but the working group is not ready to make that decision at this point.

In discussion of Section IVC, Rick Morse (N.Y.) questioned the emphasis on the explanation of the crediting rate, rather than stating the rate. He asked if it was safe to assume that the disclosure document would not include the current crediting rate. Ms. Lautzenheiser responded that the technical resource advisors had not arrived at consensus on this issue.

Mr. Uhlmann questioned the drafting of Section IVH, and suggested broadening the language to express an explanation of federal and state income tax treatment.

The Life Disclosure Working Group of the Life Insurance (A) Committee adjourned at 12:30 p.m. and reconvened in Space 2 of the Egan Center in Anchorage, Alaska, at 5 p.m. on Sept. 28, 1996, with Commissioner Wilcox presiding.

5. Life Insurance Buyer's Guide

Mr. Dunlap presented a revised paragraph on cost indices for the Life Insurance Buyer's Guide.

Once you have decided which type of policy to buy, you can use a cost comparison index to help you compare similar policies. Life insurance agents or companies can give you information about several different kinds of indexes that each work a little differently. One type helps you compare the costs between two different policies if you ~~take out the cash value at the end of a period of time~~ give up the policy and take out the cash value. Another helps you compare your costs if you ~~continue to pay premiums until your death~~ don't give up your policy before its coverage ends. Some help you decide what kind of questions to ask the agent about the numbers used in an illustration. Each index is useful in some ways, but they all have shortcomings. Ask your agent which will be most helpful to you. Regardless of which index you use, compare index numbers only for similar policies—those that offer basically the same benefits, with premiums payable for the same length of time.

Mr. Dunlap said, with this last change, the Buyer's Guide Subgroup considers its task to be complete. He said the primary reason for revision of the Buyer's Guide was to make changes required by the illustrations regulation. In addition, the subgroup took the opportunity to improve the wording of the Buyer's Guide to make it more readable.

Upon motion duly made and seconded the Life Insurance Buyer's Guide was adopted (Attachment Three-B1a).

6. Questions and Answers on Life Insurance Illustrations

Commissioner Wilcox asked the working group to first consider for final disposition the questions and answers that had been reviewed on the conference call. He asked if there were any further changes that the working group wished to make to the following questions from the Aug. 28, 1996, draft that is Attachment Three-C to the report of interim activity of the Life Disclosure Working Group: D.1.1, D.3.2, D.4.2, D.4.3, D.5.3, D.5.4, D.5.6, D.5.9, and D.6.5. In addition, the group had recommended deletion of Questions D.7.4 and D.7.5. Without further discussion, the working group agreed to add these to the list of completed questions. Commissioner Wilcox announced that the group would next go through questions in the Aug. 28, 1996, document that have been identified as being relatively easy to dispose of quickly and then move on to the ones that are more difficult. Commissioner Wilcox asked the group to turn first to Question D.7.8 and Mr. Foley suggested deleting the question, because it did not provide any new information. The working group agreed that was an appropriate action. Commissioner Wilcox asked the group to review Question D.7.19 next. Mr. Foley said he would not have a problem if the company wanted to show the premium in a cumulative manner or individually, as long as it was clear. Mr. Fisher said the companies expected to use the individual year's premium rather than an accumulation. Mr. Frankel asked if the working group had a problem if someone wanted to show on the illustration the individual year's premium plus the accumulated premium. The working group decided to revise Question D.7.19 to say "the premium amount must be clearly shown on this page. The cumulative premium is not required." With this change the working group agreed that Question D.7.19 was ready to move to the list of completed questions.

After review of Question D.7.20, the working group agreed this question was also ready to move to the list of completed questions. The group next reviewed Question D.7.21. Mr. Foley said that bolding a line would not be as bad as bolding a column. Commissioner Wilcox agreed that bolding the column containing non-guaranteed elements would clearly mislead the reader. The group agreed to delete the first phrase of the answer and with that change decided the question and answer are ready to move to the list of completed answers.

In reviewing Question D.7.22, Mr. Frankel asked if it was adequate for the narrative summary to describe a marketing term that was not used in the policy. Mr. Strauss said it was important that the narrative describe things in the same way as the policy. Commissioner Wilcox asked if there was a potential to use a term in marketing that would not be included in the policy. He suggested changing the answer to say that the terms used should be *consistent with* those used in the policy so that the same term cannot be used in a different way in the policy or a different term could not be used for the same concept found in the policy language. With that change the working group agreed this question was also complete.

Question D.7.27 was adopted without further change. The group reviewed Questions D.7.29 and decided that it might have a tendency to mislead. The working group decided to delete the question from its work product.

The working group next turned to Question D.8.1, and after some discussion decided the question was unclear. Commissioner Wilcox asked staff to revise the question and then the working group would reconsider the answer. Question D.9.1 was adopted without further change. Question D.9.7 was reviewed next. Mr. Foley asked if this question was needed and suggested

its deletion. Don Koch (Alaska) said that it added clarity and advised leaving the question. The working group decided to include the question in its completed list without change.

The working group next turned to Question D.11.1. The group decided to eliminate the last paragraph and to include it in the list of completed questions. Question D.11.2 was also added to the final list. Commissioner Wilcox suggested deleting one sentence from Question D.11.3 so that the middle of the paragraph read, "For example, some have argued that a company could create a policy form...." With this change, the working group agreed to finalize this question also.

Review of Questions D.11.4, D.11.5, D.11.6, D.11.7 and D.11.9 led the group to recommend deletion of all five questions. It was decided that none of them served the purpose of articulating regulatory compliance positions.

George Coleman (Prudential) said there were several questions in the Question and Answer document upon which it was very critical for companies to have answers quickly. The group identified Questions D.3.3, D.7.6, and D.9.3 as questions to address.

John Helms (Primerica) pointed the group to an illustration prepared by his company that included a supplemental illustration with a mutual fund accumulation. He asked the working group to consider this an appropriate use for a supplemental illustration. Commissioner Wilcox said that the answer to Question D.3.3 provided in the document was appropriate for a basic illustration, and asked if it was also an appropriate answer for the supplemental illustration. He suggested that mutual funds and other types of investment vehicles could be permitted as long as all the requirements of Section 6 of the model were included. Several members of the working group expressed discomfort with this type of illustration. Mr. Foley said the disclosure that the working group had worked so hard to provide in life insurance illustrations was missing from the sample illustration. Mr. Coleman suggested adding to the answer an additional sentence saying that supplemental illustrations may show other assets as long as the requirements for a supplemental illustration are met. He said it would be a state-by-state decision as to whether the supplemental illustration was misleading. With the modifications suggested by Mr. Coleman, the working group agreed to add Question D.3.3 to the list of finalized questions.

Mr. Strauss said he had received several questions regarding the meaning of the phrase "non-guaranteed elements may be shown if described in the contract" as described in Question D.7.6. Gregory Hardy (American Council of Life Insurance—ACLI) suggested that this was really part of the policy approval process that would be decided state-by-state. The working group agreed that it was not appropriate for it to answer this question so decided to delete Questions D.7.6, D.7.7, and D.7.9.

Next, the group turned to Question D.9.3. Mr. Koch expressed discomfort from the viewpoint of a market conduct examiner because there was no proof that the illustration being delivered was actually the one that had been used on the computer. He asked if the purchaser would even be able to remember whether this was the illustration he had seen the first time. Commissioner Wilcox pointed out that some summary information would help check to be sure that it was the same policy. Mr. Foley questioned whether agents would be able to use this as a loophole to create illustrations that could not be checked in a market conduct examination. Mr. Coleman said he saw this suggested solution as an interim solution until technology improved. Mr. Strauss agreed that this was a workable solution. He said at first he had been uncomfortable with the idea, but realized that it was important to address the issue. Members of the working group made two suggestions for compromise positions: first, a requirement that the illustration be delivered in person rather than mailed, so that a signature would be obtained, or an alternative requirement that the illustration be mailed within 48 hours after the call. Commissioner Wilcox said the provisions in question in Answer D.9.3 were definitely a compromise position. The group had started with a requirement to leave a copy of an illustration that was used during the sale. Mr. Morse agreed that this was definitely an interim solution and pointed out that Internet marketing and other types of sales on-line will require the development of a way to do a market conduct examination on electronic sales. It was moved and seconded that the group adopt Question D.9.3 as final. The motion failed. A revised motion that required personal delivery of the illustration by the agent at or before policy delivery was adopted. With the revision, the question will be moved to the list of completed questions.

Having no further business, the Life Disclosure Working Group adjourned at 6:30 p.m.

ATTACHMENT THREE-A

Report of the Replacement Issues Subgroup of the Life Disclosure (A) Working Group

The Replacement Issues Subgroup of the Life Disclosure (A) Working Group met by conference call on Aug. 29, 1996, and on Sept. 20, 1996. The following working group members participated: Paul DeAngelo (N.J.), chair; Paul Hogan and Erin Klug (Ariz.); Mike Hessler (Ill.); Jo Olson (Iowa); Lester Dunlap (La.); Cindy Martin (Mass.); Paul Boucher (N.Y.); Tony Higgins (N.C.); Bill Brooks and Joel Ario (Ore.); Ted Becker (Texas); and Charlie Merriman and Tom Van Cooper (Vt.).

Paul DeAngelo (N.J.) announced the working group would discuss the suggested questions for a survey of insurers on the issue of replacement of life insurance. The issues to be discussed are (1) the appropriateness of the questions both in scope and completeness; (2) how to identify which insurers should be included in the survey; (3) how and from whom to solicit comments prior to sending out the survey; (4) the manner in which to collate the responses to the survey; (5) the time-frame for companies to complete and return the surveys; and (6) whether an interim meeting of the group will be necessary.

1. Scope of Questions

Mr. DeAngelo asked for input from the subgroup members on the first draft of questions he had put together. Erin Klug (Ariz.) suggested putting the questions into groups for ease in answering them and also to make compiling the results simpler. Mr. DeAngelo responded that he had started with broad headings and agreed that it would be advantageous to use those headings to group the questions. Paul Hogan (Ariz.) said that his state did not use appointments and suggested rewording questions to make them easy to apply to non-appointment states. He suggested that other questions could be more broadly worded to increase their applicability. Charlie Merriman (Vt.) asked about applicability of the questions to an instance where an insurance product was replaced with a security or vice versa. He suggested that there were instances where this type of replacement would fall through the cracks and not be subject to review. Mr. DeAngelo responded that the questions he was proposing were geared to replacement of life insurance with life insurance. He said the NAIC model on replacement also is focused in that direction. He asked Mr. Merriman to suggest some questions that could be added to the survey. Bob Plybon (National Association of Life Underwriters—NALU) asked if there would be a differentiation between external and internal replacements. Mr. DeAngelo responded that he had focused on internal replacements because of a recent market conduct study New Jersey had completed but asked Mr. Plybon to suggest revisions to questions as necessary to bring in external replacements. Cindy Martin (Mass.) suggested it would be useful to know if a company had recently changed any procedures that were included in the questions. She suggested prefacing the questions with a request for that information. Mr. DeAngelo said that he recognized instructions would need to be prepared for the list of questions, and suggested that in this instruction a notation be made that, where the procedures had changed over the last number of years, that this information be included in the company response. Mr. DeAngelo agreed to change the questions in response to these suggestions and asked working group members to make any others to him by phone or fax (Attachment Three-A1).

Tony Higgins (N.C.) suggested that Mr. DeAngelo discuss with Mr. Plybon the efforts of NALU and the report that group prepared. He suggested it would avoid duplication of effort and make the NAIC subgroup's job easier.

The group discussed whether to leave room on the survey for responses or to ask companies to put their responses on separate sheets. Joel Ario (Ore.) opined that companies would want to answer the survey on their computers and suggested providing the survey in electronic format.

2. Identify Insurers to Survey

Mr. DeAngelo submitted a list of large insurers to the working group for its consideration. Comments on the list included a suggestion to review the companies to make sure that a large percentage of their premium dollar came from non-term life insurance. A further review of the list pointed out that possibly some insurers wrote most of their business outside of the United States or wrote mostly health business. Mr. DeAngelo said that he would try to narrow the list and asked the assistance of subgroup members in identifying good companies to survey. Ron Panneton (NALU) asked if companies that wrote term insurance should be left out of the survey. Mr. Higgins suggested including them because there were numerous instances of replacement of whole life insurance with a term policy. Mr. DeAngelo agreed to refine the company list to narrow it down to writers of individual life insurance.

3. Solicitation of Comments Prior to the Survey

Mr. DeAngelo asked Carolyn Johnson (NAIC/SSO) for a suggestion on soliciting input and comments prior to sending out the survey. Ms. Johnson suggested including the minutes of the conference calls and the survey as an attachment to the Life Disclosure Working Group minutes at the Fall National Meeting and through that manner sharing the survey questions with those who attend the meetings and get the minutes. In addition, a copy of the survey can be sent to the individuals who have indicated an interest in the replacement issue. Mr. DeAngelo agreed this was a good way to solicit comments. The group agreed to request that all comments be sent to Ms. Johnson by Oct. 24, 1996, so they can be transmitted to the members by Oct. 25. A conference call will be scheduled on Oct. 30 or 31 to consider the comments. The working group will decide at that time whether an interim meeting is necessary.

4. Collating Responses to the Survey

Mr. DeAngelo asked for suggestions on how to collate the responses received from the survey. He suggested that members of the subgroup could each take several responses and collate those. William Fisher (MassMutual) asked the subgroup to consider any Freedom of Information Act request that might be made to the states. He expressed concern that the answers to the questions would contain information that companies would not want to become public information. Mr. DeAngelo agreed that it would be important to protect company information, and opined that the survey would garner better results if companies were assured that their privacy was protected. Two suggestions were considered by the group: (1) the American Council of Life Insurance (ACLI) may be able to receive, collate and summarize the results of the survey for the working group; or (2) staff could assign to each company a number used to mark all documents provided by that company in response to the survey. After the survey results are in, the list of numbers assigned to companies would be destroyed.

5. Timeframe for Completion of Survey

The subgroup discussed an appropriate timeframe for responding to the survey. Mr. DeAngelo suggested that the working group plan to present the survey questions at the Winter National Meeting, with mailing shortly thereafter and asked if it was

reasonable to expect responses in 60 days. Several in attendance agreed that was an appropriate timeframe and so the subgroup agreed to that schedule.

ATTACHMENT THREE-A1

NAIC Replacement Issues Subgroup New Business Practices Company Questionnaire

As mentioned in our correspondence of xx/xx/xx and in the cover letter attached to this questionnaire, the Replacement Issues Subgroup of the NAIC has prepared the following questionnaire. One purpose of this questionnaire is to assist the Subgroup in evaluating company activities in soliciting and processing replacement policies. In addition, the Subgroup expects that the information garnered from this survey will assist the regulatory community in understanding the larger issue of life insurance new business practices in the industry as a whole. To that end, the Subgroup appreciates your cooperation.

The survey has been divided into seven major headings, each with questions related to that category. Included with some of the headings and questions are instructions, which explain and elaborate on any specific details contained in the questions.

Please answer every question as fully and succinctly as possible. Unless otherwise specified, the period of applicability to each question is 1986-1995.

I. AGENT EMPLOYMENT, LICENSING AND TRAINING

In this category, the Subgroup wishes to determine a company's efforts to recruit, properly license and train its sales force for the years 1986-1995. Please provide this information, by year where applicable, for the period requested.

- 1) By year and for the last 10 years, how many new agents (not general agencies) were appointed by your company?

1986 _____	1991 _____
1987 _____	1992 _____
1988 _____	1993 _____
1989 _____	1994 _____
1990 _____	1995 _____

- 2) For the same period, how many agents held appointments at year-end with your company?

1986 _____	1991 _____
1987 _____	1992 _____
1987 _____	1993 _____
1988 _____	1994 _____
1989 _____	1995 _____

- 3) What are the minimum agent candidate qualifications and what background checks are required prior to appointment?

- 4) What percentage of newly appointed agents has never previously sold insurance? If not known specifically, please provide your best estimate.

- 5) What position, authority level and department is required to approve the employment or appointment of a new agent?

- 6) Does your company allow agents to hold appointments with other companies?

- 7) Does your company provide training to satisfy the educational requirements for licensure? If so, who (or what vendor) provides the training and at what location?

- 8) Does your company provide continuing education courses for its agents? _____ If so, where and by whom?

- 9) How are company bulletins and directives communicated and disseminated to the agent staff?

II. AGENT DISCIPLINE AND COMPENSATION

In this area, please provide the Subgroup with details regarding your compensation and discipline systems utilized by your company. Please equate job titles in this survey to those positions that correspond to your organization.

10) What has been your average annual turnover of agents? What does this number represent as a percentage of agent staff?

1986 _____ %	1991 _____ %
1987 _____ %	1992 _____ %
1988 _____ %	1993 _____ %
1989 _____ %	1994 _____ %
1990 _____ %	1995 _____ %

11) How many agents in total were terminated for cause during the period 1986-1995?

1986 _____	1991 _____
1987 _____	1992 _____
1988 _____	1993 _____
1989 _____	1994 _____
1990 _____	1995 _____

12) Does your company set a minimum level of life production for a new agent? ____ If so, what are the standards?

Does your company have a standard for career (experienced) agents? ____ If so, what is that standard?

13) Please provide for the years 1985-1995 a separate listing of the number of agents terminated for the following reasons:

- | | |
|--------------------------------|--------------------------------|
| a) poor sales production | e) underwriting irregularities |
| b) failure to follow co. rules | f) insured complaints |
| c) adverse regulatory activity | g) claimant complaints |
| d) shortages/poor accounting | h) continual discipline |

14) Does the company have established disciplinary guidelines? ____ If so, when enacted? ____

15) What position and authority is required to approve disciplinary action against an agent? ____

16) What position and authority is required to terminate an agent? ____

17) How and to whom are disciplinary actions reported? ____

18) Are these records maintained electronically or manually? ____

19) Exclusive of terminations, how many disciplinary actions were instituted against agents in the last 10 years? Please categorize by type of action by using the letter identifiers indicated in question # 13. (three most common types, e.g., e12, c10, a10)

<u>Year</u>	<u>Types</u>	<u>Year</u>	<u>Types</u>
1986 _____	_____	1991 _____	_____
1987 _____	_____	1992 _____	_____
1988 _____	_____	1993 _____	_____
1989 _____	_____	1994 _____	_____
1990 _____	_____	1995 _____	_____

20) Are any current agents or sales managers compensated solely for new agent recruitment? ____
If so, in what manner and how calculated? ____

21) Please explain your company's method of compensating new agents, i.e., straight commission, draw against commission, salary plus commission? ____

22) Please provide the commission structure for your current portfolio of individual life products. ____

23) If these commission schedules have been modified in the last two years, please provide the prior schedules and their effective dates. _____

24) Are all or part these commission rates the result of a collective bargaining agreement? Please explain _____

25) To what extent are commissions reduced, if any, if a new policy replaces or is funded by values from an existing policy? _____

26) Does the company consider internal replacements as new business sales with respect to commissions payable, awards or recognition programs, etc. _____

If not, how does the company treat these sales? _____

27) Are commissions reduced if an agent who is also licensed to sell securities either a) replaces an existing life insurance policy with a security product or b) replaces an existing security product with an insurance policy? _____

28) If so, under what circumstances and to what extent are the commissions reduced and are paid commissions recaptured when replacements are later identified? _____

29) How does the company determine when less than the full commission should be paid on financed sales and replacement transactions? _____

30) How are first-line sales managers compensated? _____

31) How are agency general managers compensated? _____

32) Are there any other positions that are compensated either partially or fully based on sales production? If so, please identify. _____

33) Please describe how these compensation systems operate and a breakout by percentage of the contributing factors. For example, Regional Marketing Administrator: 60% salary, 25% commissions based on region's sales, 15% conducting training seminars _____

34) Were any bonuses, benefits, conventions or sales recognition methods not previously described used to recognize life new business sales? If so, please describe. _____

35) Please provide the Subgroup the Company's established guidelines for promotion within the marketing area. _____

36) Were any changes made to the agents' or sales management compensation programs that accentuated life new business sales efforts? _____ If so, please describe these changes, the rationale for implementing them and when they occurred. _____

III. GENERAL SALES PRACTICES AND USE OF ILLUSTRATIONS

37) Please describe the company's methodology for reassigning a retired or terminated agent's book of business _____

38) Are agents provided, either periodically or through blanket requests, data on accumulated dividends and/or cash values on an agent's book of business? _____ If so, for what purpose? _____

39) Does (or did) the company offer agents sales illustrations that show premiums abbreviating or vanishing after a certain number of years? If so, what product(s) were identified or suggested as suitable for sale with an abbreviated payment plan? _____

40) Did the company rate manuals indicate the number of years the insured would be required to make premium payments from their own funds? _____ Were the current dividend scales or excess interest rate included in the rate manual data? _____ If so, please provide us with sample rate pages for each year since the introduction of the product. _____

41) Did the company encourage or mandate the use of sales illustrations as part of the sales presentations? _____ If so, were agents required to disclose with the application whether an illustration was used? _____

42) Please provide sample copies of sales illustrations used during the last 15 years. If illustrations practices have changed please provide a copy of each type of illustration, highlighting the differences and the year each illustration was introduced. _____

IV. REPLACEMENT SALES PRACTICES AND DETECTION

43) Does the company have a procedure for systematically identifying replacement sales when a new policy is funded with values from an existing policy? _____ If so, is the system electronic or manual? _____ Please provide the Subgroup with a brief description of your system. _____

44) Please provide the number of life insurance financed sales and replacements for the last fifteen (15) years. Please also provide what those sales represent as a percentage of total new life sales.

Year	% of Sales	Year	% of Sales	Year	% of Sales
1981	_____	1985	_____	1991	_____
1982	_____	1987	_____	1992	_____
1983	_____	1988	_____	1993	_____
1984	_____	1989	_____	1994	_____
1985	_____	1990	_____	1995	_____

45) Does this system generate any periodic report(s)? _____ If so, to whom are the reports disseminated? _____

(Please provide a sample of any report produced by this system(s). Please also include for monitoring both internal and external replacements.)

46) Please describe the company's systems for monitoring new life insurance sales that are funded by values from existing policies _____

47) Please describe what procedures the company initiates to correct any improper replacement activity. Please describe any involvement with the insured. _____

48) Briefly describe the company's procedures for ensuring that regulatory requirements have been fulfilled when a replacement transaction has been identified after the sale has been made. _____

49) Are any additional requirements mandated by the company with respect to replacement transactions? _____ If so, please provide the Subgroup with a copy of those procedures _____

50) Please provide the Subgroup with any company bulletins or directives related to financed sales or replacements. _____

51) Has the company presented or sponsored any agent training seminars, workshops, management conferences, etc., that addressed financed or replacement sales? _____ If so, please list dates of presentations _____

V. PORTFOLIO AND DIVIDEND CHANGES

52) What new products has the company introduced in its portfolio in the last fifteen (15) years and when were these products introduced? _____

53) Circle the following to indicate the method of allocating interest to dividends that was used in calculating the dividend scales for each new participating product. _____

Average Portfolio Investment Generation Method Other

54) Did the company at any point switch from the average portfolio method of allocating dividends to the investment generation method? _____ If so, when did this occur? _____

55) Please attach a Schedule M, submitted to your state of domicile, for the year the change occurred in your dividend allocation method. _____

56) Provide the rate of interest used to develop the dividend scales established for each of the last fifteen (15) years and the rate of interest actually credited.

Year	Assumed Rate	Credited Rate	Year	Assumed Rate	Credited Rate
1981	_____	_____	1988	_____	_____
1982	_____	_____	1989	_____	_____
1983	_____	_____	1990	_____	_____
1984	_____	_____	1991	_____	_____
1985	_____	_____	1992	_____	_____
1986	_____	_____	1993	_____	_____
1987	_____	_____	1994	_____	_____
			1995	_____	_____

57) Please indicate the dividend scale established for the last fifteen (15) years and the actual dividend rate paid.

Year	Scale	Paid	Year	Scale	Paid
1981	_____	_____	1988	_____	_____
1982	_____	_____	1989	_____	_____
1983	_____	_____	1990	_____	_____
1984	_____	_____	1991	_____	_____
1985	_____	_____	1992	_____	_____
1986	_____	_____	1993	_____	_____
1987	_____	_____	1994	_____	_____
			1995	_____	_____

VI. COMPLAINTS

58) Please provide the number of consumer complaints filed with the company for each of the last fifteen (15) years relative to life insurance sales new business. In the second part of this question, please elaborate on how your company has historically monitored complaint volume?

1981	1986	1991
1982	1987	1992
1983	1988	1993
1984	1989	1994
1985	1990	1995

59) Please provide the number of consumer complaints for the same time period specifically concerning replacements, financed sales in which premiums were to abbreviate and complaints alleging agent misrepresentation.

1981	1986	1991
1982	1987	1992
1983	1988	1993
1984	1989	1994
1985	1990	1995

60) What systems are currently in place to monitor agent compliance with company and regulatory requirements? Please provide the date each system was installed (implemented) _____

61) Has the company provided its agents with training and sales literature for these products including any guidelines regarding the suitability of the product (or lack thereof) to specific or targeted individuals?

VII. COMPLIANCE

62) What organizational unit and what level position are responsible for compliance within the company?

63) When was this area created? _____ What area was responsible prior to that date?

64) What management reports are generated to track compliance by either the company or its marketing force? Please indicate when these reports were first generated. _____

65) What information is provided by each report and to whom is it disseminated? Please provide a sample of each report.

66) Please provide any additional information or relevant comments, which you believe bear on the issues of financed sales or replacements. The Subgroup especially welcomes suggestions with respect to regulatory modifications that impact these issues. _____

ATTACHMENT THREE-B

Report of Interim Activity of the Life Disclosure Working Group of the Life Insurance (A) Committee

The Life Disclosure Working Group met on July 23-25, 1996, in Kansas City, Mo., and by conference call on Aug. 28, 1996, and Sept. 18, 1996. The following working group members participated: Robert E. Wilcox, Chair (Utah), Tom Foley, Vice Chair (N.D.); Christian Uhlmann and Don Koch (Alaska); Sheldon Summers and Daphne Bartlett (Calif.); Frank Dino (Fla.); Roger Strauss (Iowa); Lester Dunlap (La.); Paul DeAngelo (N.J.); Jerry Fickes (N.M.); Rick Morse (N.Y.); Tony Higgins (N.C.); Kip May (Ohio); and Ted Becker (Texas).

1. Consider Amendments to Life Insurance Buyer's Guide

Lester Dunlap (La.) reported that the Buyer's Guide Subgroup had nearly completed its task and had a few issues that it wished to refer to the working group for input. He said the subgroup had struggled with the issue of whether to include information on cost comparison indices, and if so to what extent. He said the Buyer's Guide could simply explain that indices were available without describing them or could provide a lengthy description of the different types of indices. In addition, Mr. Dunlap said he had received some suggestions for technical amendments that would remove bias toward one type of coverage over another. Chris Kite (FIPSCO) commented on a method he had devised that is similar to a yield index. He described his method as superior in some ways to the yield index because it allows the consumer to compare the assumptions in the illustrations and to initiate further discussion. Roger Strauss (Iowa) said he had reservations about putting extensive information about cost indices in the Buyer's Guide, which was designed to be a consumer friendly document. Tom Foley (N.D.) suggested putting together a Cost Indices Subgroup to look at what indices should be included and to bring a recommendation to the entire working group. The following states expressed interest in participating in the subgroup: Alaska, Florida, Louisiana, Nebraska, North Carolina, North Dakota, Oklahoma and Texas. A conference call of this subgroup was held Aug. 15, 1996 (Attachment Three-B1).

2. Questions and Answers on Life Insurance Illustration Regulation

Commissioner Robert E. Wilcox (Utah) reminded everyone that the Life Disclosure Working Group had committed to answering questions that arose as states began to implement the Life Insurance Illustrations Model Regulation. The document being considered by the working group contains questions and answers submitted up to the time of the meeting, with answers for the working group to discuss. As a result of working group discussions and comments received from the public, the document was divided into two separate units. The first document (Attachment Three-B2) contains questions and answers on which there was little or no discussion or disagreement. The second document (Attachment Three-B3) includes questions and answers with which some members of the working group disagreed or upon which a great deal of comments and discussion took place. The working group intends to solicit further comments on the issues raised by these questions and answers.

a. Completed Questions

Question 7.1 and its answer were discussed extensively. Some members of the audience noted that the model did not contain a *requirement* that the elements of an illustration be presented in the same order as described in the Section 7 of the regulation. The regulators agreed that throughout the drafting process that had been their intent, but the requirement for the tabular detail to follow the numeric summary is not specified in the model. The regulators agreed to have the answer show that it was their intention to put it in that order and, while companies are not legally required by the model to follow that order, the regulators hope that companies will do so. Reasons for doing so are to be consistent from one company's product to another and the logic of having the summaries come before the details. Keeping the elements in the order listed will avoid a situation where programming changes are necessary if the NAIC model and state regulations are amended.

The working group also discussed Question 7.2 and noted that it would only be necessary to have an illustration signed that matched the policy being applied for. Also, if the illustrations varied by the use of more or less conservative interest assumptions, it would be appropriate to have the one most favorable to the applicant signed for the file, otherwise the statements would not be true.

When discussing Question 7.6 the working group members agreed that it was not necessary to include the graphic illustration within the pagination of the basic illustration, but that it did need its own pagination. It also was pointed out to the working group that as more companies go to a Windows-based computer system, graphics are more likely to be included within the basic illustration.

Several that commented on Section 7.9 expressed discomfort with the answer, suggesting that illustrating something that did not meet the definition of life insurance was not appropriate.

The regulators and interested parties agreed that the answer to Question 9.3 was appropriate because no more representations were made by the agent before the follow-up illustration. All agreed that the drafting of Section 9A was not complete because there should have been a third alternative where the policy was not applied for as illustrated. The working group noted this was one area in which a technical amendment would be very helpful.

One comment on Question 11.6 suggested that the timeframe in which an actuary changes his opinion should be specified. Obviously it would be before the next certification, because otherwise he or she could not certify that the scales used had been appropriate.

The regulators decided to add information to the answer to Question 11.8 to make clear that a single method of determining expenses must be chosen by the insurer for all policy forms.

These and other questions on which there were no specific comments were identified to include on the list of questions considered finished.

b. Questions for Further Discussion

The working group next considered questions from Attachment Three-B3. Question D.1.1 was considered and revised because the working group agreed that information in the policy was not subject to the Life Insurance Illustrations Model Regulation. The revised question was reviewed and the working group agreed that D.1.1 was ready to move to the list of completed questions.

The group spent a considerable amount of time discussing riders and their effect on the illustration. Several questions touched on the illustration of riders, such as D.3.1 and D.4.1. One of the questions raised was whether the illustration of a rider was optional or required. Concern was raised about a \$1 policy with a \$1 million rider, a different illustration for an annuity with a life rider or a life policy with an annuity rider, life insurance with only guaranteed elements with a rider that contained non-guaranteed elements and other variations. The working group agreed that all riders being sold with the policy should be illustrated because the model requires that the illustration signed corresponds with the policy issued. If the policy is issued with a rider, that rider must be included in the illustration.

A comment on Question D.3.2 suggested that benefits of a fraternal provided outside the contract would not be subject to illustration. It would be very difficult to value discount airline tickets or other items provided outside of insurance. A fraternal representative opined that most special fraternal benefits would be outside the contract, and so would not be included in the illustration. The group agreed that the items being illustrated need to be part of the policy and expressed a comfort level with this answer that would allow it to be moved to the completed list.

The group held extensive discussion on Question D.3.3. Interested parties commented that it had been their understanding that other items such as mutual funds could be illustrated to assist in comparing cash value insurance with the philosophy of "buy term and invest the difference." Regulators expressed discomfort with that type of illustration, suggesting that a mutual fund or similar investment would not meet the requirements of a regulation. This was countered with the suggestion that companies needed flexibility to show other professionals how products work together. The working group agreed not to change its answer but to leave the question open so that interested parties could provide sample illustrations that might increase the regulators' comfort level with this concept.

In response to concerns raised about Question D.4.2, the regulators agreed that there was not necessarily one approach that would be appropriate. It would be possible to use a supplemental illustration to show the use of long-term care benefits or to include them in the basic illustration. Because an individual would not know whether he would utilize the long-term care benefits, one approach would not necessarily be better than another. At the follow-up conference call the regulators agreed that Question D.4.2 was complete.

When considering Question D.4.3, regulators expressed concern about the use of the term "guarantee" and the inappropriate use of the term when a *benefit* was guaranteed, but not the *amount* of that benefit. Review of the definition of the term in the model made clear that a value that was indeed guaranteed was guaranteed as to numerical amount. After revising the answer to refer to that definition, the working group decided Question D.4.3 was complete.

One of the interested parties suggested that the answer to Question D.4.4 might require that every sales brochure be accompanied by a signature page. The regulators said that this was not the intent but rather that the numbers in the sales brochure need to be consistent with an accompanying illustration. It would not be possible for the agent to certify that no illustration had been used because of the numbers in the sales brochure. One of the interested parties asked how this applied to a direct marketing situation where no one actually met with the client in person. The working group chair suggested that, if some numbers were used in the brochure or other advertisement, there had been a partial illustration and a full illustration was required. An interested party pointed out that it was important to review the advertisement or brochure to determine whether it was an invitation to contract or an invitation to inquire.

The working group considered Question D.5.1 and the question of whether the model precludes providing an in-force illustration during the first year of a policy. It was agreed that an illustration provided at six months must comply with the requirements for a new illustration and reminded those in attendance that the reason for this was to prevent abuse of the regulation by calling something an in-force illustration. In response to the question of what to do if someone requests an illustration within the first year for a policy that the company had designated to be marketed without illustrations, the response was that if there was a provision in the policy that an insured could ask for a policy illustration, the insurer could not choose to designate the policy form as one not to be used with an illustration. In response to a comment from an interested party that he did not see the harm in producing an in-force illustration during the first year if a basic illustration has been produced originally, the regulators agreed that the rule was clear that any illustration during the first year was not an in-force illustration. In discussing the situation proposed in Question D.5.1, the working group considered whether a reproposal six months later would be an appropriate use for a supplemental illustration because it had been preceded by a basic illustration. It was suggested that it would be prudent to bring along or attach a copy of the basic illustration to make clear that this was accompanied by a basic illustration.

Question D.5.2 was revised to make clear that if an insurer chooses to provide an in-force illustration after the first policy year, it must meet the standards of the model.

The working group agreed to change the answer to Question D.5.3 to make clear that the question was describing a quotation, and in the rule an exception for quotations allows them to be treated as if no illustration had been used. The question was modified to make clear that a signed statement that no illustration was used is needed. When reviewing that revised answer, the working group was asked to remove the modification. Concern was expressed that consumers would be confused because the quotation would look like an illustration to them and they would hesitate to sign a form saying that no illustration had been used. The working group agreed to explore this issue further and to consider also the case where a group meeting was followed by individual sessions.

The extensive answer to Question D.5.4 was reviewed and the working group agreed with the suggestion that the detail is not needed. Simply referring to Sections 5C and 5D and their requirements is adequate. With this change, the working group agreed the question was complete. In response to a question about the \$10,000 amount, the working group agreed that the dollar amount refers to any amount illustrated at the time of sale. For example, if the face value will increase in response to changes in the Consumer Price Index, and that is illustrated, the \$10,000 limit would apply to any increased amount on the illustration.

The working group reviewed Question D.5.6 and agreed it was ready to move to the completed list.

Question D.5.9 was discussed because some of the working group members were concerned that an agent might use an illustration when the company had chosen the policy as one not to be illustrated. The signed statement in the files would give extra assurance this had not happened. The working group members were asked to leave the answer as is because asking for a signed statement would raise questions in the minds of applicants. Some might request an illustration that the company would not be prepared to provide. Working group members agreed it would have been clearer if Section 9 had referred to the provisions of Section 5 and clearly exempted policies from the signature requirements if they had been designated as ones to be sold without an illustration. To address the market conduct concern, the working group agreed a sampling of applicants would give examiners a comfort level that the procedures had been followed. With that in mind, Question D.5.9 was designated as complete.

The working group discussed Question D.6.1 and decided to give further thought to the last sentence of the answer, agreeing that providing benefits on another individual by way of rider created a special set of circumstances that needs to be addressed.

The working group next discussed Questions D.6.3 and D.6.4. A commentator suggested that a quote service is not neutral, but has a choice of products to offer. He saw little difference between the services an insurer could provide

showing various products it sells and a quote service. The working group agreed that, if a quote service is marketing the policies, it would be licensed as an agent and would be required to follow all of the provisions of the model regulation, including providing basic illustrations. They agreed this did provide a level playing field for agents and others providing quotations.

The working group members agreed to revise the second sentence of Question D.6.5 to clarify that the description of the classification must be sufficiently clear to identify the payment schedule and any other elements dependent on classification.

When discussing Question D.7.1, the working group agreed that a sample illustration did not meet the requirements of the model and suggested that an agent had to have access to illustration software to prepare an appropriate illustration or should use no illustration and get a signed statement that none had been used. The working group drafted the model regulation under the assumption that a customized illustration would be prepared for each individual.

The working group and interested parties discussed Question D.7.2 extensively. Some in the audience said the answer reflected a position that they had not previously understood the working group to hold. The course of discussion showed that for a flexible premium contract and a fixed premium contract using policy loans, the illustrations could end up quite different. Some in the audience suggested that the working group had not specifically addressed policy loans, but rather had focused on remedying the danger that a consumer would assume the premiums had stopped when the amount was being paid from the policy value. The working group agreed that it might be necessary during 1997 to prepare technical corrections to the model to address this and other issues, but that such an amendment would not suspend the application of the model in this instance. The working group agreed that adding a column to indicate loans or withdrawals would be a satisfactory solution.

The level of detail required in the policy description required by Section 7E(3) was the subject of Question D.7.4. The working group agreed that the model was not very specific about the level of detail required. The intent was to include enough information in the policy for an individual to decide if a particular action or activity on his part would be appropriate. If unusual credits or unusual patterns of action were included, they should be described more fully. One regulator suggested that the description in the policy of the credit would assist in determining whether to approve the policy.

The working group discussed extensively the situation described in Question D.9.3. Several comments were received from interested parties suggesting that the result required by the answer was harsh and a very narrow reading of the model regulation. Interested parties asked the working group to recognize the difficulty that this interpretation posed for companies and agents. One regulator suggested that the only way to use a computer would be if the illustration on the computer could be printed. Interested parties reminded the working group that many sections of the model had been phrased carefully to avoid undue hardships for agents in rural areas where returning to provide a compliant illustration would require a great deal of expense and time. Regulators expressed concern that incorrect information could be put on the computer screen and there would be no way to confirm later that the numbers matched. One company representative described a procedure used by his company where the material used on the computer screen was locked so that it could not be changed by the agent and suggested similar technology could be used to address this situation. Interested parties offered to draft a revised sample certification that would address the problems and concerns expressed and the working group agreed to review that material.

The working group reviewed the Society of Actuaries (SOA) answer to Question D.11.1 and decided to substitute it for the answer in the earlier draft. Changes to the answer to Question D.11.3 also were suggested by the SOA and the working group agreed to modify its answer correspondingly. Next the working group discussed the generally recognized expense table (GRET) referenced in Question D.11.4 and the questions related to it. The working group decided to refer most of the questions to the SOA for revised responses.

The working group discussed Question D.11.8 and a comment that suggested answers provided by the SOA and the American Council of Life Insurance (ACLI) were superior to the answer as drafted. While members of the working group did not agree with the answers drafted by the SOA and the ACLI, they agreed that it would be appropriate to review a different suggested answer provided by those organizations.

The working group members expressed some discomfort with the type of questions being submitted. While some addressed issues that were ambiguous or where similar state interpretations would be helpful, it seemed others asked questions that were clearly answered in the model if people were willing to take responsibility for review and study. In some cases regulators felt questions were being asked in the hopes that the model would be stretched to allow more than its words said. The working group decided to delete questions like this from the current draft and not to answer them in the future. An explanation of this policy will be added to the beginning of the draft.

Gregory Hardy (ACLI) cautioned the regulators that it was important not to create technical amendments to the model through the questions and answers document. The purpose of this document is to clarify law rather than to create new law. He asked that companies be allowed discretion where there was no clear answer in the model.

3. Standards for Annuity Illustrations

Linda Lanam (Life of Virginia) reported for a group of technical resource advisors that had prepared materials on annuity illustrations. She said the working group had begun drafting a model regulation for annuity illustrations by applying the

model for life insurance illustrations and making minor changes to deal with annuities. This created difficulties in two areas: (1) the overall scope of the regulation, and (2) the marketplace, with its competing financial instruments. She said the technical resource advisors are recommending that the disclosure requirements for annuities be divided into two pieces: (1) what everyone needs to understand (key elements) such as surrender charges, and (2) a full basic illustration for situations where this is appropriate. Ms. Lanam said that most companies do not now provide illustrations for annuity policies. Frank Dino (Florida) asked if companies would be satisfied with a provision like that in the Life Insurance Illustrations Regulation, where they could decide whether to use illustrations. Ms. Lanam responded that this situation would not be as helpful because companies want to be able to use a full illustration in certain situations. She also noted that most complaints about annuities were because of misunderstandings about surrender charges, rather than about the amount of the annuity proceeds. Mr. Foley said that, if insurers want to illustrate annuities, an Actuarial Standard of Practice would be needed. Craig Raymond (Hartford, representing the American Academy of Actuaries) said that a group had been appointed to work with the Actuarial Standards Board to develop an Actuarial Standard of Practice. He said that the group already had started looking at the issue of how to apply the lapse support and self support tests to annuities. He said it would be helpful to know the working group's concerns before getting too far in the work.

The working group decided to draft a document of annuity disclosure standards, similar to the document drafted for life insurance illustrations more than two years ago. Commissioner Wilcox said that he and Tony Higgins (N.C.) had put together a draft for the working group and interested parties to discuss. Those in attendance discussed Section IB extensively. The draft reported significant problems in representations on annuities. The group was informed that the Annuities Working Group had done a survey earlier in the year that reported states had not seen extensive problems in annuity illustrations. Barbara Lautzenheiser (Lautzenheiser & Associates) took exception to a specific mention of two tier annuities, and asked the working group not to include language that would restrict new policy design. Mr. Foley suggested changing this paragraph to mention the three types of annuities and to mention some of the other issues that have created problems. With regard to Section IC Jim Thompson (Central Actuarial Association) reminded the working group that annuity products compete with bank products, so it is important that regulations of these insurance products not be too onerous.

When reviewing Section II, Ms. Lanam asked for more flexibility than for life insurance illustrations, rather than designating a policy form that would be illustrated. Ted Becker (Texas) applauded Section IIC because he said it was important to provide some warning language about what might happen to annuity nonforfeiture laws. Galen Ullstrom (Mutual of Omaha) asked if this annuity disclosure standard was being written to cover variable annuities also. Commissioner Wilcox responded that it was important for all of the working group's efforts to be consistent and the purpose of Section IID was to emphasize the fact that rules for variable annuities will follow soon.

Commissioner Wilcox said Section III and following were limited solely to illustrations of non-variable annuities. Mr. Foley asked if the distinction was being made between the disclosure and full illustrations as Ms. Lanam had suggested. Commissioner Wilcox suggested that all of the disclosure be covered by the term "disclosure" and that sometimes disclosure would include a full illustration. Mr. Strauss asked if any types of non-variable annuities would be excluded from this regulation. Mr. Foley suggested that those who are interested in excluding any category work on a method to clearly define and describe those types.

The working group did not make any changes or hear any comments to Section IV.

Section VA was changed to replace the word "lapse" with the word "termination," which is more appropriate to an annuity. Mr. Kite suggested that it would be more conservative to consider *improved* mortality for an annuity. Ron Nelson (Northwestern Mutual) said that right now his company was crediting many different rates, and he wondered what the term "current credited scale" meant. He said the terminology fit life insurance but not the annuity market. Commissioner Wilcox emphasized the group's goal of promoting consistency between the regulations for life insurance and annuities so that someone would not be motivated to create life insurance that looked like an annuity or vice versa. In reference to Section VC Mr. Raymond said he would like to see the working group move away from that proscription. He thought it was appropriate to make the rules look more like those for the nonforfeiture law. Mr. Foley said that if the nonforfeiture law changes would happen soon, it would be appropriate to consider them, but the changes being discussed by the Life and Health Actuarial (Technical) Task Force may or may not happen.

In regard to Section VIII several interested parties expressed concern over the difficulty of preparing an in-force illustration. William Fisher (MassMutual) opined that many companies did not have the capacity to prepare an in-force illustration. He also noted that there had never been a big demand for in-force illustrations for annuities.

With the changes discussed at the meeting, the working group agreed to use the annuity disclosure standard as a starting point for discussion on what should be included in an illustration regulation for annuities (Attachment Three-B4).

At the Sept. 18 conference call the working group discussed recommendations for annuity disclosure prepared by technical resource advisors (Attachment Three-B5). Ms. Lanam said the advisors intend to flesh out the document if the regulators are comfortable with the concept. Sample disclosure statements will be drafted for working group review. Rick Morse (N.Y.) asked if the disclosures could include information about the current interest rate. He asked at what point the agent crossed the line between a narrative disclosure and a full illustration and suggested that perhaps a middle ground was needed where a generic illustration was used to give the applicant a feel for the effect of differing interest rates. Ms. Lanam said her company would be agreeable to a rule that said if the company wanted to identify current crediting rates, it would have to provide a generic illustration. Mr. Higgins said the generic illustration should match the policy being sold, and Mr. Morse agreed that was important. Commissioner Wilcox asked if it was possible to identify by form the type of disclosure or illustration that would be used. Ms. Lanam said that in some cases it would be necessary to identify on a case-by-case basis.

Daphne Bartlett (Calif.) expressed concern about illustrations showing deposits accumulated at the current interest rate for a long period, but there may be no guarantee in the contract that the company will use the then current annuity purchase rate at the end of the accumulation phase. Mr. Higgins expressed the opinion that the model on annuity illustrations should apply to ERISA plans. Commissioner Wilcox asked the group to give some thought to appropriate exclusions from the model.

The working group and interested parties spent some time discussing the concept of equity indexed annuities, how they worked and what concerns they might raise for illustrations. Commissioner Wilcox emphasized the task before the group is to come up with a disclosure standard that would cover these type of products plus whatever new products came on the market. He said the discussion had focused on what companies do now, but that inventive minds would come up with new products, and the model regulation needs to work as well as it can to cover those new products. Mr. Ullstrom said one way to accomplish this is to use general requirements instead of getting too specific; for example, "be clear and not misleading" rather than "use these columns showing these numbers." Commissioner Wilcox agreed that soundly based general rules are best. Mr. Foley said one of the things that had been most helpful to the working group was sample illustrations that use standards of the Life Insurance Illustrations Model Regulation. He suggested that examples of clear disclosure by use of a narrative such as Ms. Lanam had eluded to earlier would be very helpful to the working group in deciding what was adequate disclosure. Ms. Lanam said technical resource advisors would prepare some samples that show what is currently being used in the marketplace and put together a packet of information for the regulators.

ATTACHMENT THREE-B1

Report of the Cost Indices Subgroup of the Life Disclosure (A) Working Group

The Cost Indices Subgroup of the Life Disclosure Working Group met by conference call on Aug. 15, 1996, to discuss the appropriate use of cost indices in the Life Insurance Buyer's Guide and broader issues regarding the use of cost indices. The following regulators participated: Tom Foley (N.D.), Chair; Christian Uhlmann and Mae Gabor (Alaska); Frank Dino (Fla.); Lester Dunlap (La.); John Rink (Neb.); Tony Higgins (N.C.); Dan Keating (Okla.); and Ted Becker (Texas).

The group first considered a suggestion from Chris Kite (FIPSCO) for a new type of index that would allow consumers to compare the assumptions in the illustration. The group reviewed comments in favor of and opposed to the method described by Mr. Kite. Mr. Kite said his index has the advantage of prompting the prospect to question assumptions used. Delmer Borah (MassMutual) suggested that consumers are more concerned about total cost than assumptions. Brenda Cude (Cooperative Extension Service) opined that the target audience does not care about assumptions. Tony Higgins (N.C.) said he was unconvinced about the need for indices, seeing them as an intellectual exercise that would not benefit the public. The consensus of the group was that none of the indices available are clearly superior at comparing policies in a meaningful way. Some are so technical that consumers and maybe agents cannot grasp the nuances. The subgroup decided to include only a general description in the buyer's guide and not to get into the technical aspects of the different indices. Lester Dunlap (La.) asked that further comments on the guide be limited to the description of the use of cost indices (Attachment Three- B1a).

The group then looked beyond the immediate concern about what to put in the buyer's guide and considered the broader issues in the charge to the Life Insurance (A) Committee. The group decided a good starting point would be to make a list of indices that were useful. Tom Foley (N.D.) asked those who felt a certain index should be considered for a list of recommended indices to forward that information to him. A list of useful indices would serve as a good starting point for discussion at the Fall National Meeting.

ATTACHMENT THREE-B1a

LIFE INSURANCE BUYER'S GUIDE

Draft: 8/15/96

[Editor's Note: This draft was adopted by the Life Disclosure Working Group on Sept. 28, 1996, with further revision to a paragraph on cost indices. See the amendatory language on page 918 of this volume of the NAIC Proceedings.]

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. Companies may purchase personalized brochures from the NAIC or may request permission to reproduce the Buyer's Guide in their own type style and format.

[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~~ discusses how to:

- ~~Buying Life Insurance~~ Find a Policy That Meets Your Needs and Fits Your Budget
- ~~Deciding~~ Decide How Much Insurance You Need
- ~~Finding a Low Cost Policy~~
- Things to Remember Make Informed 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 the premium increases later and you still need insurance, can you still afford it?~~
3. ~~Ask about cost comparison index numbers and check several companies, which offer similar policies. Remember, smaller index number generally represent a better buy.~~
43. ~~Don't sign an insurance application until you review it carefully to be sure all the answers are complete and accurate.~~
64. Don't buy life insurance unless you intend to stick with ~~it~~ your plan. It ~~can~~ may be very costly if you quit during the early years of the policy.
65. ~~Don't drop one policy and buy another without a thorough study of the new policy and the one you have now. Replacing your insurance may be costly.~~
76. Read your policy carefully. Ask your agent or company about anything that is not clear to you.
87. 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 buy life insurance is to cover the financial effects of unexpected or untimely death. Life insurance can also be one of many ways you plan for the future.

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

Then, ~~find out how 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~~ reviewing your insurance needs and ~~in giving~~ give you information about the ~~kinds of available 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. If you are thinking about dropping a life insurance 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. You then have a minimum period to review your new policy and decide if it is what you wanted.

- ~~It can~~ may 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~~ may pay this type of cost again if you buy a new policy.
- Ask your tax advisor if dropping your policy could affect your income taxes.
- If you are older or your health has changed, premiums for the new policy will often be higher. You will 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.
- If the policy you have now no longer meets your needs, you may not have to replace it. You might be able to change your present policy or even add to it to get the coverage or benefits you now want.
- At least in the beginning, a policy may pay no benefits for some causes of death covered in the policy you have now.

In all cases, if you are thinking of buying a new policy, 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 benefits of your policy. Before replacing your policy, ask your agent or company 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 of the family income do I provide? If I were to die early, 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 finish their education in the event of my death?
- How will my family pay final expenses and repay debts 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 after my death?
- How will inflation affect future needs?

~~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 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. Some policies may offer other benefits while you are still living. Your choice should be based on your needs and what you can afford.~~

~~A wide variety of plans is being offered today. 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 in the early years, but does not build up cash values that you can use in the future. You may combine cash value life insurance with term insurance for the period of your greatest need for life insurance to replace income.

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 insurance protection for your premium dollar. It generally does not build up cash value.

You can renew mMost 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 may 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 lose the

right to renew the policy at some age. 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 coverage, and premiums may increase.

You may be able trade mMany term insurance policies can be traded before the end of a conversion period for a whole-life-cash value policy during a conversion period—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 is a type of insurance where the premiums charged are higher at the beginning than they would be for the same amount of term insurance. The part of the premium that is not used for the cost of insurance is invested by the company and builds up a cash value that may be used in a variety of ways. You may borrow against the a policy's cash values 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 take out the remaining cash value. You can also use your cash value to keep insurance protection for a limited time or to buy a reduced amount without having to pay more premiums. You also can use the cash value to increase your income in retirement or to help pay for needs such as a child's tuition without canceling the policy. However, to build up this cash value, you must pay higher premiums in the earlier years of the policy. Cash value life insurance may be one of several types; whole life, universal life and variable life are all types of cash value insurance.

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—yYou 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 made during a shorter period.

Whole life policies develop cash values. If you stop paying premiums, you can take the cash or you can use the cash value to buy continuing insurance protection for a limited time or a reduced amount. (Some term policies that provide coverage for a long period also have cash values.)

One Universal Life Insurance 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. Increases may require proof that you qualify for the new death benefit. The premiums you pay (less expense charges) go into a policy account that earns interest, and eCharges 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 yearly premium payment plus the interest your account earns is less than the charges, your account value will become lower. 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 there is enough in your account to pay the premiums, continuing to pay premiums yourself means 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 Insurance is a special kind of insurance where the death benefits and cash values depend upon the investment performance of one or more separate accounts, which may be invested in mutual funds or other investments allowed under the policy. 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 investments do well. Your benefits and cash value will be lower or may disappear if the investments you chose didn't do as well as you expected. You may pay an extra premium for a guaranteed death benefit.

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 benefits 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 show you what could happen in the future. Remember that nobody knows what will happen in the future. You should be ready

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 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~~ do the benefits build up under in 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?

[Editor's Note: The Life Disclosure Working Group further amended the following paragraph and adopted this draft at its Sept. 28, 1996, meeting. See the amendatory language on page 918 of this volume of the NAIC Proceedings.]

~~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. Once you have decided which type of policy to buy, you can use a cost comparison index to help you compare similar policies. Life insurance agents or companies can give you information about several different kinds of indexes that each work a little differently. One type helps you compare the costs between two different policies if you take out the cash value at the end of a period of time. Another helps you compare costs if you continue to pay premiums until your death. Some help you decide what kind of questions to ask the agent about the numbers used in an illustration. Each index is useful in some ways, but they all have shortcomings. Ask your agent which will be most helpful to you. Regardless of which index you use, compare index numbers only for similar policies—those that offer basically the same benefits, with premiums payable for the same length of time.~~

~~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 than 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 policies 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.~~

~~When you find small differences in the indexes, your choice should be based on something other than cost.~~

~~Finally, keep in mind that index numbers cannot tell you the whole story. Remember that no one company offers the lowest cost at all ages for all kinds and amounts of insurance. 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 ~~whenever~~ issued. In others, the ~~dividends~~ return for policies issued

in a recent year, or a group of years, reflects the interest earnings on these that group of policies; in this case, dividends amounts paid are likely to change more rapidly when interest rates change.

ATTACHMENT THREE-B2

QUESTIONS & ANSWERS
LIFE ILLUSTRATIONS MODEL REGULATION
As of July 24, 1996
(Consensus on These Answers)

Introduction:

In December 1995 the Life Insurance Illustrations Model Regulation was adopted by the NAIC. Since then a number of questions have arisen regarding its application and interpretation. For 1996 the Life Disclosure Working Group was charged to provide guidance in interpreting provisions of the model regulation. This charge is being met through the completion of this Questions and Answers document.

This document is not an official pronouncement of the NAIC but rather an unofficial statement of the working group alone that is offered as assistance to any state that chooses to use it. It is not intended to expand the content of the model regulation but gives some insight into the intent of the original drafters of the model regulation and provides interpretive guidance regarding certain of its provisions.

The working group will provide amended and expanded versions of this document from time to time as additional questions are identified and answered.

Section numbers in the questions and answers refer to the NAIC model regulation.

Section 3. Applicability and Scope

3.1 We sell a policy that is a combination of life insurance with a flexible premium annuity rider. The life policy is modified whole life with all guaranteed values. The annuity rider has a guaranteed interest rate, but also an interest sensitive element. It would appear that neither of these elements would presently come under the illustrations regulation, but since this policy is always sold with both elements present, the complete policy could be construed as an interest sensitive policy. Should we illustrate such a product to comply with the NAIC model? Should the life policy and annuity rider be illustrated separately or as one combined product?

If the insurer wishes to illustrate the non-guaranteed elements of the policy being sold with the annuity rider, the life policy and annuity rider must be illustrated as one combined product.

3.2 If a traditional (nonparticipating) product has an annuity rider (fixed premium) attached and the annuity rider has excess (non-guaranteed) interest credited, is it subject to the regulation?

Yes, if it is illustrated, the product with the rider is combined under the requirements of the regulation.

Section 4. Definitions

4.1 Are there exceptions to the requirement that the disciplined current scale be "reasonably based" on actual recent historical experience?

Yes. To gain an adequate understanding of what the disciplined current scale is, a thorough reading of both the regulation and standard of practice is necessary. One example of where the disciplined current scale may not be based on actual recent historical experience is where a change in practice has occurred. Section 5.4 of the Actuarial Standard of Practice describes the way in which the disciplined current scale may be modified to reflect changes in practice which have not yet had time to result in actual changes in experience.

4.2 Suppose your current credited interest rate is 6.5%. If an agent submits an illustration using 6% (or any lower rate), is a "revised illustration" necessary?

Section 4G defines "illustrated scale" as a scale of non-guaranteed elements that is "not more favorable to the policy owner" than the lesser of the disciplined current scale or the currently payable scale. Assuming all of the requirements of the model regulation are met, use of an interest rate lower than 6.5% is permissible.

4.3 Are cost disclosures "illustrations" or "basic illustrations"? Do state cost disclosure regulations still apply?

The possibility for overlap with existing NAIC models and state regulations was discussed by the working group and the recommendations of the group are contained in a report attached to the March 1996 minutes. A letter was sent to each commissioner from the working group chair recommending that an illustration could take the place of a required policy summary. If a state chooses not to change such a rule, a policy summary and an illustration meeting the requirements of the illustrations regulation could both be required.

4.4 Is a presentation or depiction that shows only guaranteed elements an illustration?

"Illustration" means a presentation or depiction that includes non-guaranteed elements. A presentation or depiction that shows only guaranteed elements is not an illustration, and therefore the model is not applicable in such instances.

4.5 What does the phrase "over a period of years" mean in the context of the definition of an illustration?

The phrase "over a period of years" refers to any presentation or depiction of a non-guaranteed element beyond the later of (a) the first policy anniversary and (b) one year from the end of the report period in the most recent annual report.

4.6 Is a depiction of a single, projected non-guaranteed value an illustration; for example, one number showing what the cash value would be in 15 years assuming the current dividends continue to be paid and are allowed to accumulate at 6% interest.

Yes, in order to arrive at that "one" number, an entire series of non-guaranteed amounts is implicitly included. This scenario would be included in the phrase "over a period of years."

4.7 According to the regulation's definition, which of the following are "illustrations":

- a. A rate book page for an indeterminate-premium term plan, with both guaranteed and current premiums.
- b. A universal life brochure that talks about non-guaranteed elements (interest and mortality), but does not show any numbers.
- c. Company-developed agent training material on a participating whole life plan that discusses dividend options, guaranteed cash values, etc., and shows some hypothetical projections.
- d. An advertisement for a universal plan that shows the current interest rate.
- e. A short print-out of numbers for a universal case that is generated through company-provided software, and is clearly labeled for agent use only, not for use with a client, and is used by an agent in his office to compare and contrast his own company's plans, so he can arrive at the best strategy before seeing the client.
- f. A company announcement on a new dividend scale that discusses the changes to be implemented in the various elements.

The working group's minutes reflect an intent to interpret the term "illustration" broadly. The following answers assume the material might be shown to the prospect.

- a. A rate book page would be considered an illustration if it showed non-guaranteed elements beyond policy year one.
- b. A brochure describing non-guaranteed elements without any actual examples would not be a "ledger or proposal showing non-guaranteed elements."
- c. Agent training materials would be illustrations if the agent used them in the sales process. If they were restricted to the training process, they would not.
- d. An advertisement showing current interest rates would not be an illustration because it does not constitute a display over a period of years. However, the regulation requires the agent to certify that he has made no statements inconsistent with the illustration, so use in the sales process of an advertisement showing numbers in excess of what can be shown in an illustration would not be permitted. The agent would also need to be careful to clearly represent that this was the current rate and not to imply that the current interest rate would apply into the future.
- e. A print-out of numbers used by an agent in his office to compare and contrast his own company's plans that is not shown to the client is not an illustration.
- f. A company announcement to existing policyholders might rise to the level of an in force illustration if it depicted future dividends that are not guaranteed. It would not be an illustration if it dealt only with declared dividends that are guaranteed.

4.8 We have a product book used to educate our sales force. We want to illustrate what happens to the death benefits and paid-up additions, if any, under the various dividend options. We plan to show 20 years worth of data as an example. Is this an illustration falling under the regulation? What if we stamp the word "SAMPLE" across the page?

These are agent training materials and would be illustrations if the agent used them in the sales process. If they were restricted to the training process, they would not.

4.9 If showing a chart or graph in a basic illustration, which values have to be shown: guaranteed, midpoint or current?

Any or all of these may be shown as long as they are in addition to the tabular display and satisfy the requirements of the regulation.

4.10 Section 3 indicates that the model is applicable to group life policies and certificates, however Section 4H indicates that an illustration by definition contains "non-guaranteed elements" over "a period of years." Now if a regular old garden variety group term life plan is sold and an "illustration" (using the term loosely here) is provided to the employer in the course of that sale indicating covered lives, volume and monthly premium, is that an "illustration" in the terms of the regulation? It covers one year (not years), and the rate is the rate—no non-guaranteed elements.

This is not an "illustration" and is not covered by the regulation.

4.11 Is a handwritten worksheet considered an illustration?

Since it is a "depiction" (Section 4H of the model), it is not excluded from the definition of "illustration" merely by being a handwritten worksheet.

4.12 Is marketing on the Internet considered an illustration? We need a clear definition of what an illustration is.

Since marketing on the Internet involves a "presentation or depiction" (Section 4H of the model), information so communicated is not excluded from the definition of "illustration" merely because it is sent via the Internet.

Section 5. Policies to be Illustrated

5.1 Does a policy form that the company discloses is to be marketed without an illustration need to pass the actuarial test?

The model regulation requires no actuarial tests for such policy forms except for in force illustrations.

5.2 Is group term life included in the provisions of Section 5C and 5D?

When discussing the applicability of the model to term life, the drafters went through the entire model and identified provisions that would not apply to term life. No such designation is included in Section 5C and 5D.

5.3 It seems that a typical group term life plan would be defined as "non-term group life" under Section 4L of the regulation. In a typical plan, the employer selects the benefits and levels, pays the premium, and the group is issued on approval of the underwriters (group underwriting?). It seems odd to call this "non-term group life." If that is the case, then Section 5D would indicate that "quotations" should be provided and "illustrations" on request. The wording seems to obviously be directed at more typical examples of "non-term group life," such as group universal—obviously a whole different ball game.

The definition is aimed at non-term types of group plans and was not intended to imply that group term life was included. The minutes of the Nov. 8, 1995, conference call make clear that the drafters changed the language from "universal life" to "non-term group life" so it would include group traditional whole life. However, even if the definition in Section 4L includes what most would regard as group term products, this does not create a problem. As pointed out in Answer 5.1, an insurer may choose never to use an illustration; nothing in Section 5A compels them to do so. Instead, if a policy form uses an illustration, then Section 5D functions as a liberalization of the regulation, permitting deferral of the delivery of the basic illustration until the certificate is delivered.

5.4 In order to be classified as "non-term group life" does a plan of coverage need to meet all 3 of the conditions in Section 4L?

Yes.

5.5 Does a basic illustration need to be provided at delivery to enrollees for non-term group life for all permanent insurance? It would seem that more than the minimum premium necessary to provide pure death benefit protection would be involved for all permanent insurance.

Some of the interested parties commenting on the draft evidently sell products where the insured can choose to contribute only the amount of premium necessary to provide pure death benefit protection on a non-term product. This provision was put in at their suggestion.

5.6 If a traditional (nonparticipating) product has a rider attached with non-guaranteed elements, is it subject to the regulation because of the non-guaranteed premiums of the rider?

If the presentation includes a product with non-guaranteed elements, an illustration is required unless the insurer has chosen to not use illustrations with the product, even if one or more of the products included in the presentation are fully guaranteed and not normally subject to the regulation.

Section 6. General Rules and Prohibitions

6.1 Under the generic name requirement, the regulation refers to "flex premium benefit life." Is "universal life" acceptable as a generic name?

Presumably, states that have permitted use of "universal life" as a short title will continue to permit its use.

6.2 Are new policies that come into existence as a result of term conversions or the exercise of a guaranteed purchase option subject to the regulation? Note that these policies are not marketed in the same way that most policies are.

There is no specific exclusion for term conversions, etc. in the model regulation. Assuming that the new policy is one that has been identified as marketed with illustrations, it would seem evident that an illustration would be expected by a regulator.

6.3 How will agent or broker produced illustrations comparing several companies' premiums side-by-side be impacted by this new model?

Any effort to sell a particular policy would require the agent or broker to provide the illustration required by the model regulation.

Section 7. Standards for Basic Illustrations

7.1 Does the law really define the format (i.e., sequence of text, etc.)? It appears that the numeric summary must follow the narrative summary and that the signature blocks must appear with the summary, but nowhere does it say that the summary must immediately follow the narrative. My feeling is that a summary or a summation is a cursory review of the detail. Therefore can the signature block appear last?

The model says the signatures must appear on the same page as the numeric summary. The model is perhaps not as clear as it should be that the elements listed in Section 7 are to come in that order. The working group report from June 1995 makes it quite clear that was the intent of the drafters. The regulators expressed concern over the idea that a tabular display might end up early in the illustration. The sample illustrations prepared for the working group all used the same order as described in the regulation.

7.2 Can an applicant be given more than one basic illustration pertaining to one policy form during a single sales presentation?

So long as each illustration complies with the requirements of the regulation, there is no provision of the regulation that would prohibit this practice. Other than for guaranteed values there are no floors on illustrated scales, so it is possible to create many illustrated scales that meet the requirements of the regulation. The use of multiple illustrations could be helpful in demonstrating the impact of various interest rate scenarios. Also, in cases where the applicant has characteristics that make unclear the appropriate underwriting classification, multiple illustrations could be helpful in illustrating the impact on policy values of each of the classifications.

7.3 Can a faxed copy of the illustration be presented to the applicant or policy owner?

Yes. Nothing in the regulation requires an originally printed illustration.

7.4 Will other numbering systems suffice for § 7A(2) or is that a standard rather than an example.

The numbering "four of seven" in the model is an example rather than a standard. The intent of the working group was clearly to alert the applicant that he had not received all the pages. Any similar system that achieves that goal is suitable.

7.5 If a company is illustrating the effect of loans on policy values, what do they illustrate in the "guaranteed" column if the contract does not specify a maximum interest rate?

If the contract does not explicitly specify a maximum interest rate, then the maximum rate of interest that could be charged under state and federal law would have to be utilized in illustrating guaranteed values.

7.6 Do graphs, charts and concepts have to be included in the pagination?

Section 7A(2) of the model regulation says that each page, including any explanatory notes or pages, shall be numbered and show its relationship to the total number of pages in the illustration. Graphs, charts and concepts only have to be included in the pagination of the basic illustration if they are part of the basic illustration. In many cases they will be part of a separate, complying supplemental illustration, and thus need not be included in the pagination of the basic illustration.

7.7 Occasionally prospects request the illustration of policy values that are not system supported. May these values be displayed using a spreadsheet application? Is it permissible if the printout of the spreadsheet (without text, definitions, continuous pagination, etc.) is attached to a basic illustration of the same policy form?

Assuming the spreadsheet meets the requirement that it not be inconsistent with a basic illustration, it could be attached to the basic illustration as a supplemental illustration.

7.8 What is the term of the contract referenced in Section 7B(2) for a contract without a maturity date?

The working group has not addressed this issue. It would seem reasonable to use the limiting age underlying the valuation table or to use age 100, consistent with the tabular detail specified in Section 7E(1).

7.9 Sec. 7B(2) requires that the illustrations show the premium outlay that must be paid to guarantee coverage for the term of the contract, subject to the maximum premiums allowable to qualify as life insurance under the Internal Revenue Code. Suppose the guideline level premium under the IRC is \$1,000 per year; the illustration assumes a monthly mode; the premium required to guarantee coverage is \$1,100 paid annually or \$100 paid monthly. Which of these three numbers do we show?

Section 7B(2) does not preclude the illustrating of premiums that exceed the guideline premiums in Section 7702 of the IRC. Rather, it merely compels the insurer to at least show the lesser of a) the premium outlay required to guarantee coverage and b) the maximum premium allowable to qualify as a life insurance policy under the applicable provisions of the IRC. Thus, in the cited example, if the insurer does not want to illustrate premium payments over \$1,000 per year, this is permissible. However, if the insurer wants to illustrate the payment of \$1,200 during each policy year, paid by \$100 monthly premiums, this is permissible also. Assuming that the \$1,200 premium is illustrated in the numeric summary, the insurer would be required to disclose in the narrative summary that \$1,000 is the maximum premium qualifying premium under the IRC. In this circumstance, the insurer would need to clearly disclose that the \$1,200 premium violated the guideline premium test.

7.10 If the guideline level premium will not provide coverage to the end of the term of the contract, does the illustration have to display the annual term charges allowed by § 7702 or can the illustration explain that the coverage will terminate?

See Question 7.9. Either may be illustrated as long as the insurer discloses the effect of what is illustrated.

7.11 Section 3 of the illustration regulation lists the exceptions to the regulation. Riders are not listed as an exception. Section 7B(3) states that a basic illustration shall include a brief description of any policy features, riders or options, guaranteed or non-guaranteed, shown in the basic illustration and the impact they may have on the benefits and values of the policy. Does this mean that riders that pay dividends, such as a 10-year level term rider, are exempt from the disciplined scale requirements and from the self-support and lapse-support tests? What about a product like flexible whole life that has a rider made up of a combination of one-year term and paid-up whole life?

No non-guaranteed element, whether provided through the base policy or rider, is exempt from the self-support and lapse-support tests.

7.12 Can the description of supplementary benefits and riders be in footnotes or must they all be included in the text of the narrative summary?

Section 7B(3) says the narrative summary shall include a brief description of any policy features, riders or options, guaranteed or non-guaranteed, shown in the basic illustration. Section 1 articulates the goal of eliminating footnotes as much as possible.

7.13 If an agent illustrates at issue a change in benefit, such as a face amount decrease after five years, does the company have to automatically honor this change when this change date occurs, or can the company wait for the policyholder to request the change at that future date?

The inclusion of a future benefit reduction in an illustration does not, by itself, obligate or authorize the insurer to implement the benefit reduction. The language contained in the policy itself will control the insurer's practice. Section 7B(3) of the model regulation requires that the insurer include a description of any future benefit reduction (and the policyholder's options with respect to the changes) if it affects any information (e.g., numeric summary, tabular detail) contained in the illustration.

7.14 If the basic illustration includes a depiction of paid-up additions on paid-up additions, settlement options, etc., do they all have to be factored into the illustrated scale at "50%"?

The numeric summary required by Section 7C says that all values shown in the illustration must be calculated on three different bases, one of which is dividends at 50% of those contained in the illustrated scale.

7.15 Are illustrated reductions going to be defined or explained—can a straight average of current and guaranteed be used, or must components (like mortality, interest, rider charges, expenses) be averaged?

In the case of participating policies, the dividends in the reduced scale are to be one half of the corresponding annual dividends in the illustrated scale. In the case of policies with non-guaranteed elements of other types, each experience factor (interest rate, mortality rate, etc.) is to be the average of the corresponding factor underlying the illustrated scale and the guaranteed factor.

7.16 Section 7C(1)(c) refers to numeric summary guaranteed values, illustrated values and 50% basis. The last one's "average" values are not exactly arithmetic mean value, are they? If not, would you please elaborate how these values can be determined? The calculated values may not be exactly average of guaranteed and illustrated values.

Section 7C(1)(c)(ii) and (iii) uses the word "average" but does not give an example of how the calculation is to be performed. The result expected by the working group would be based on a policy credited and charged at rates that lie one-half the way between guaranteed and illustrated charges and credits.

7.17 Can the numeric summary be restricted to annual premium mode only or must it use the same mode as in the tabular detail?

Section 7C(1) says the numeric summary shall include the premium outlay. Section 7E(1)(a) says the tabular detail shall show the premium outlay and mode the applicant plans to pay. The numeric summary and the tabular detail should be consistent with each other.

7.18 For a new policy form relative to which a company argues it sells no similar forms, how does the regulator determine what a realistic currently payable scale is?

There is no precise answer possible for this question. However, if the company's other policies utilize disciplined current scales that are generally greater than the corresponding currently payable scales, the regulator should question the company as to why it is realistic to expect that this policy form will be different.

7.19 With the requirement that all non-guaranteed elements be described in the contract, will policies illustrated with "persistency bonuses" need to be refiled to include a description of these bonuses.

Section 7E(3) says that non-guaranteed elements may be shown (in the illustration) if they have been described in the contract. Therefore, a company wishing to include a persistency bonus in its illustration would need to include a description in the policy.

7.20 Does not Section 7E(2) need some more words to clearly express its intent?

The meaning of Section 7E(2) is clear, even if the wording is somewhat awkward. The guaranteed policy values should be those that will be provided if the contract premium is paid.

7.21 Must the tabular detail be shown at the premium mode that is expected to be paid, or can annualized premium be used? This would obviate having to calculate interpolated net single premiums for some riders.

Section 7E(1)(a) says the illustration shall include the premium outlay and mode the applicant plans to pay.

7.22 If a non-guaranteed element is not shown in the contract, it cannot be illustrated. If it is the company's practice to pay a persistency bonus, may it be illustrated as long as a zero is shown in the guaranteed column?

The phrasing of the question leaves the impression that the company does not plan to include a description of its persistency bonus in the contract. If that is the situation, Section 7E(3) says the persistency bonus cannot be shown in the illustration. Showing a zero in the guaranteed column is not adequate compliance with 7E(3).

7.23 If the expected premium outlay but not the contract premium on a traditional policy is to change at some point after the 10th policy year, does that need to be shown in the tabular display, or will it suffice to just show every fifth year ending at 100, etc.?

Section 7E(1) of the model regulation indicates that the tabular detail will need to be shown (except for term insurance beyond the 20th year) for any year in which the premium outlay is to change. Note that Section 7E(1) refers to when the premium outlay and contract premium change, but it was clearly the working group's intent to show the year when either changes.

7.24 Suppose a prospect asks a sales person to illustrate a universal life policy where the applicant plans to pay an annual premium of \$2,400 until his retirement at age 62, after which he plans to reduce his annual premium to \$100. If a conforming illustration is delivered with the policy at issue must the illustration show the planned premium reduction at age 62? The same situation might arise where a rate change is anticipated, for example a commercial pilot who will retire at age 55. Must the conforming illustration show the planned rate change?

Yes. See Answer 7.23 above.

7.25 Are there any special provisions regarding terminal dividends?

Section 7E(3) of the model regulation contains the following statement: "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."

Section 8. Standards for Supplemental Illustrations

8.1 Assuming most common variations on a policy form (i.e., larger premium payments, different death benefits or riders) may be shown in supplemental illustrations, are there any variations that may be so great or extreme or unusual as to require use of another basic illustration? For example, if a basic illustration is for a non-smoking female, can you illustrate the same policy form for her smoking husband as a supplemental illustration?

The intent of the drafters was that the supplemental illustration would show special features and variations applicable to the basic policy being illustrated. It was never contemplated that it would be used in this fashion. Since the contract premium or the premium outlay is required to be the same as that in the basic illustration, this scenario is unlikely in any event.

8.2 In some cases multiple supplemental illustrations are prepared and shown to a client to help him evaluate different scenarios. Must each of these be accompanied by a basic illustration, and if so, does each need to be signed and submitted with the application?

Generally one basic illustration can accompany several supplemental illustrations. The contract premium or premium outlay underlying the supplemental illustration must be equal to the premium outlay shown in the basic illustration. Other variations may not require another basic illustration as long as other requirements of Section 8 were met. The basic illustration matching the policy applied for would be signed and submitted with the application.

Section 9. Delivery of Illustrations and Record Retention

9.1 If a person desires a flexible premium policy and is shown an illustration with a planned premium of \$600/month, but at application changes to \$500 per month, is the illustration not "as applied for"?

The policy would have been issued "as applied for" and not as illustrated and under Section 9B a new illustration would be required at the time of policy delivery.

9.2 When does a difference in money illustrated and money received become a reason for a revised illustration to be sent?

If the amount of the § 1035 exchange varies from the illustrated amount to the extent that it affects the terms of the contract, then a new illustration should be provided.

9.3 Is an agent's signature required on revised illustrations sent from the home office?

Section 7D(2) of the model regulation says that the statement must be signed and dated "by the insurance producer or other authorized representative of the insurer." Section 9A(2) says the revised illustration shall conform to the requirements of the model regulation, shall be labeled "Revised Illustration," and shall be signed and dated by the applicant and producer or other authorized representative of the insurer. The intent of the provision in 9C allowing illustrations to be mailed to the policyowner from the company was not to require a producer or representative signature because it is not being provided as part of a sales presentation. However, if the mailing results from a sales presentation made by telephone or otherwise by an employee of the company, that person should sign as the producer or representative.

9.4 If an insurer employs no agents or other commission-compensated employees and never makes in-person sales, and delivers all documents, including sale packets with multiple illustrations, by mail, would it follow the provisions of Section 9C?

Section 9C is designed to address direct marketing where the basic illustration is mailed from the insurer. The conforming illustration and request for signature may be included with the policy delivered by mail.

9.5 The signature requirement refers to the producer or other authorized representative of the insurer. Do we have a choice of whom this person should be, e.g., the agent as opposed to the general agent?

Yes, however the person is certifying that he or she has explained that any non-guaranteed elements illustrated are subject to change. That must be done by the person in contact with the applicant and in a position to knowingly certify.

9.6 Must the copies in the company's policy owner file be paper copies or is it satisfactory to have the capability to regenerate an exact duplicate of the illustration used in the sale? Can only the signature page be retained, or the signature be imaged into the computer illustration?

The purpose of the signature page in the file is to assure a market conduct examiner that the standards in the regulation have been followed. In order for the examiner to be assured by a computer-generated duplicate of the illustration used in the sale and/or a computer imaged signature, the company's system must be reliable enough to convince the examiner that the technology used by the company will freeze the illustration at the time of solicitation so that it would not be possible to change it before or after placing it in the applicant's electronic file. The technology used might be hardware that scans in the actual illustration used and the applicant's signature and preserves it, or a program that stores the parameters to allow the recreation of the illustration used.

9.7 If the insurer can show § 9C due diligence, must it still retain the signed illustration page?

The Section 9C due diligence requirement applies only when the illustration is mailed out from the insurer's office rather than provided by the agent. If no signed page is returned, the due diligence standards are sufficient.

9.8 We intend to keep the original signed illustrations on file at the head office. What would happen if we misplace or lose these? Will a photocopy or a carbon copy be sufficient? Do we have to go back to the insured and get original signatures? What if the agent has left the company by this time?

The regulation says the signed basic illustration should be retained in the file. A market conduct examiner would undoubtedly need to hear a good reason why the illustration had been "lost." Even a signature obtained years later will not be very persuasive in showing the individual did not hear any representations not consistent with the illustrations shown. A photocopy or a carbon copy should suffice as would an electronic image of the illustration.

9.9 Does § 9D require an insurer to keep a signed certification from the original sale and a subsequently delivered basic illustration and a revised basic illustration if issued other than as applied for?

Yes, the plain language of the subsection does make that requirement. When discussing this requirement, there was mention made by the working group that this would be useful to point out a pattern of agents illustrating policies not as issued.

Section 10. Annual Report; Notice to Policy Owners

10.1 If a person buys a policy in a state that has not adopted the regulation, then moves to a state that has, which state's regulations govern in force illustrations?

General contract law would require you to use the law of the state where the contract was made. However, the laws of the particular states in question should be researched in order to determine whether this rule applies.

Section 11. Annual Certifications

11.1 Can consultants be hired to perform the "illustration actuary" function?

The model regulation does not require the illustration actuary to be an employee of the insurer.

11.2 Is it acceptable for a holding company to allocate expenses disproportionately among its subsidiaries so as to make the illustrations of certain subsidiaries more favorable?

No. In addition, it would be a violation of Section 5A(1)(c) of the NAIC's Holding Company Act to allocate expenses in this manner.

11.3 Can an insurance company that is the part of the same holding group as a bank negotiate an artificially high interest rate on a deposit with the bank in order to make the illustrations more attractive?

Section 5A(1)(a) of the Model Holding Company Act prohibits transactions within a holding company system, which are not "fair and reasonable."

11.4 Must (a) each illustrated value for the specific demographic/premium paying/benefit combination for each insured who receives an illustration meet the definition of self-supporting and non lapse-supported, or (b) can the insurance company certify that the self-supporting and lapse supported tests are met looking at accumulated cash flows in the aggregate across the assumed distribution of ages, premium-paying patterns, etc.?

Provision (b) is the correct answer. The regulation speaks to certifying of the policy form, and generally certification must be done at the policy form level.

11.5 Does the allocation of assets among policies for purposes of illustration certification have to be the same as the allocation of assets for statutory cash flow testing? Does the allocation of expenses for purposes of illustration certification have to be the same as the allocation of expenses done for statutory financial reporting?

There may be valid reasons for differences between allocations on a statutory and illustration basis. However, as much consistency as possible should be maintained between the two, and the illustration actuary should be prepared to explain any differences.

11.6 If the illustration actuary changes his or her opinion as to what constitutes recent historical experience prior to the deadline for the next annual certification, does the actuary have to change the disciplined current scale?

If recent historical experience has deteriorated (e.g., expenses have increased, investment yields have diminished), then the illustration actuary should conduct studies to determine if the disciplined current scale is still consistent with recent historical experience. Otherwise, an insurer may be in violation of Section 6B(2) (prohibition of using or describing non-guaranteed elements in a manner that is misleading or has the capacity to mislead).

11.7 Is there relief for any unusual expense items when it comes to determining expense assumptions? What if there is a one-time expense in 1996, such as purchases of new administration software? Does that have to be reflected in 1997 illustrations?

Section 5.3.3.e.1. of the Actuarial Standard of Practice states, "Nonrecurring costs, such as systems development costs, may be spread over a reasonable number of years (e.g., system lifetime) in determining the allocable expenses for a particular year."

11.8 Can the method of determining the expense assumption, fully allocated, GRET or marginal, vary by product? Regardless of the method, can the unit expense vary by product?

A single method of determining the minimum assumed expenses (i.e. fully allocated, GRET or marginal) must be chosen by the insurer for all policy forms. Variations in the expense allocation formula by product may occur when using fully allocated or marginal expenses. Two sources of variation, as indicated in Section 5.3.3.e of the Actuarial Standard of Practice may be the average policy size and volume of sales for a particular policy block. When using the GRET, expenses will simply be calculated by applying the specified factors.

11.9 Will the different costs of various levels of underwriting (guaranteed issue, simplified issue, nonmed, paramed, etc.) be recognized within the expense structure?

Presumably, differing costs of various levels of underwriting can be reflected in a company's own fully allocated or marginally allocated expense assumptions.

11.10 In the individual life product line, may you choose only one of the expense methods for that line regardless of the product (term vs. universal life vs. par universal life, etc.)?

Section 4K(1) of the model regulation says "the insurer may choose to designate each year the method of determining assumed expenses for all policy forms . . ." In addition, Section 5.3.3.e. of the Actuarial Standard of Practice indicates that the same expense method—fully allocated, marginally allocated, or generally recognized study—must be used for all policy forms during the certification year.

11.11 Is it appropriate to exclude the cost of complying with the illustration regulation in setting the (allocated) expense levels?

The cost of complying with the illustration regulation should be allocated in a manner consistent with the method of allocating other expenses.

11.12 If the illustration is based on zero-profit (minimum), why must income tax be included?

Section 5.3.3.C. of the Actuarial Standard of Practice says the cash flows used in carrying out the self-supporting test should include cash flows arising from all applicable taxes. All income taxes, except the additional tax associated with the differential earnings rate, should be recognized in accordance with their impact by duration in the self-supporting test. However, to the extent that the underlying assumptions would result in no income tax liability being incurred, then clearly the disciplined current scale would not reflect any expense for income taxes.

11.13 What if no company or industry experience exists for a certain experience factor, i.e. level of antiselection, effectiveness on select and ultimate term products—what does the actuary do?

Section 5.3.3 of the Actuarial Standard of Practice says that when no experience of the given company or under similar classes of business in that company or other companies is available, "other sources" may be used.

11.14 For interest and mortality assumptions for the disciplined current scale, is there any guidance on what is considered credible and what is the definition of recent?

Section 5.3.3.a. and b. of the Actuarial Standard of Practice contains guidance on "recent." For guidance on "credible," Actuarial Standard of Practice No. 23, "Data Quality," might be consulted.

11.15 How does an illustration actuary demonstrate that the required tests have been met?

Section 6.3. of the Actuarial Standard of Practice gives sufficient guidance.

11.16 Suppose a block of business is sold from one company to another. Would the company purchasing the business immediately have to apply its own standards to the illustrations, or would there be a transition period during which they could continue to rely on the prior company's certification, disciplined current scale, and illustrated scale?

Before the company purchasing the business can issue illustrations, it will have to file a certification with the commissioner. This is necessary because there is no assurance that the recent historical experience for the prior company will be applicable to the new company.

11.17 When an actuary certifies that an illustrated scale is in compliance with the regulation, is that actuary certifying as to all illustrated scales since the last certification, illustrated scales currently being used, or something else?

The actuary is certifying to all illustrated scales in use at the time of the certification as well as all illustrated scales used since the previous certification.

11.18 Must an insurer file Section 11 certifications both before the effective date of the regulation and later on the date the insurer elects under Subsection G?

Perhaps the language of Section 11D is not as clear as it should be. The intent of the Life Disclosure Working group was clear. All policy forms, whether existing on the effective date of the regulation or developed later, should not be illustrated until after a certification has been filed with the commissioner. The answer to the question being asked is "yes" and a technical amendment will be proposed to the model to delete the word "new" in Section 11D(1)(b). Then there will be no question that an insurer will file a certification when the regulation becomes effective, and again on the date it chooses, which might be a week or a month or a year later.

11.19 Will the actuarial certification be subject to review as part of the regular state examination process?

Yes, probably as part of the market conduct examination.

11.20 The Actuarial Standard of Practice is directed at compliance with the NAIC model. What kind of standard would be applied if some state adopts a regulation significantly different from the model?

Actuarial Standard of Practice Section 1.2, "Scope," says: "Actuaries involved in the preparation of illustrations subject to a regulation that differs materially from the model may consider the guidance in this standard to the extent that it is applicable and appropriate." There is no actuarial guidance for any provisions contained in a particular state's law or regulation that are not also part of the model.

ATTACHMENT THREE-B3

Questions on Life Illustrations Model Regulation Discussion Draft 8/28/96 (Under Discussion; Further Public Comment Requested) Underlining and overstrikes indicate changes and additions to the 5/23/96 draft. (Numbering system has been changed)

Section 1. Purpose

✓D.1.1 How does the life illustration model regulation affect the inclusion of the table of values in the individual's policy?

~~The model regulation applies to any information that could affect the decision of a consumer to purchase or renew a policy. Therefore it does apply to any information included in the policy that relates to non-guaranteed elements. The model regulation does not apply to the information contained in the actual policy.~~

Section 3. Applicability and Scope

D.3.1 Is it required that the illustration system be able to illustrate all available riders? If the application requests a rider that was not shown on the illustration, is a revised illustration required?

The model says that if the benefits of a rider are included, the premium must be also. The illustration must match the policy issued, so if it is issued with a rider, it must be so illustrated.

✓D.3.2 Will benefits provided by membership in a fraternal have to be included in the illustration?

~~The model regulation applies to life insurance policies without specifying types of organizations. Neither the purpose section of the regulation (Section 1) or the excepted policies (Section 3) given any indication that fraternal are excluded. The fraternal insurer may refer to benefits of fraternal membership in the illustration as long as they meet the requirements of Section 6B and are part of the policy. There is no provision saying an insurer must illustrate particular benefits.~~

D.3.3 If a life policy is sold in conjunction with a mutual fund (rather than an annuity) which is not part of the policy but is billed on the same statement can these two elements be combined in a single illustration?

No. The working group was asked this question during model development and all agreed that the mutual fund is not insurance and has no place on a life insurance illustration. According to Section 6B, the policy being illustrated can not be represented as anything other than a life insurance policy. (Note: the working group has asked for sample illustrations that combine other financial products with life insurance in order to determine whether a change to this answer is appropriate.)

D.3.4 Does the regulation apply to group term policies sold in conjunction with a group annuity contract for the purpose of converting the term to a permanent plan at retirement? Can values under the permanent plan be illustrated to the group policyholder and the insured at the time of application for the term insurance?

The group term policy is subject to the regulation, so any illustration of non-guaranteed elements under that policy must comply with the requirements of the regulation.

The group annuity contract, not being life insurance, is not subject to the regulation. Therefore, a (separate) illustration of such a contract may be provided without regard to the requirements of this regulation.

The permanent plan is subject to this regulation. Any illustration of non-guaranteed elements under that plan must comply with the requirements of the regulation. If the permanent plan is purchased with funds accumulated in the group annuity contract, that accumulation may not be shown as part of the insurance illustration, but the illustration may show the amount of premium assumed to be paid into the contract, without specifying its source.

Section 4. Definitions

D.4.1 Are premiums on products such as paid-up additions riders contract premiums?

Section 4B of the model regulation says that if the rider requires payment of a premium, and benefits from the rider are shown in the illustration, the rider premiums are "contract premiums." If the guaranteed death benefits and cash values illustrated

reflect the payment of a stream of rider premiums, fixed or otherwise, the stream of premiums for these benefits should be considered part of the total contract premium in a policy that has a contract premium. Illustrations matching the policy issued will include premium for all riders that are a part of the policy issued.

✓D.4.2 Suppose a life insurance policy provides long-term care benefits in the following manner: a) long-term care payments are 2% of the death benefit for each month the insured is institutionalized; b) the death benefit is reduced in an amount equal to the long-term care benefit paid; and c) the nonforfeiture benefits are reduced proportionately to the reduction in the death benefit. Does the disciplined current scale underlying the illustration have to incorporate long-term care experience that is "recent, determinable, and credible" if it affects non-guaranteed elements? Do the guaranteed values that are shown have to be adjusted to reflect the amount of long-term care benefits that may be paid?

In the above example, utilization of the long-term care benefit represents one experience component that will affect the accumulated cash flows. Therefore, long-term care morbidity should be one assumption underlying the disciplined current scale. One reasonable approach in the construction of the numeric summary and tabular detail in the basic illustration would be to assume that the policyholder for whom the illustration is being prepared will not utilize the long-term care benefit. If that approach is taken, a supplemental illustration could show how policy values will be reduced if long-term care benefits are utilized.

✓D.4.3 Can agents write down guaranteed values only for a customer on an illustrated policy as long as they get a compliant illustration before or at the time of policy delivery? Can an illustration show guaranteed values only for a policy that has non-guaranteed elements described in the policy form?

Showing guaranteed elements only, as that term is defined in the model, does not constitute an "illustration." Providing a compliant illustration at the time of policy delivery would be required if the policy form is one designated to be used with an illustration.

D.4.4 Would a sales brochure showing values in a chart or graph be considered an illustration? For instance, if a chart shows only the current values for a \$100,000 universal life on a male age 35 for years 10, 20, and attained age 65?

The brochure would have to be accompanied by a basic illustration including these numbers as well as the other elements included in the requirements for a basic illustration. A statement that no illustration was used would not be appropriate.

D.4.5 Are we allowed to use an in force illustration before the first year anniversary? For example, if the interest rate or benefits change in the middle of the first year for a universal life plan, the sales illustration cannot reflect actual policy information.

According to the definitions, any illustration furnished before the policy has been in force for one year is not an in force illustration, and therefore would have to meet the requirements for a sales illustration.

D.4.6 In the definition of non-term group life, does the reference to "plan of coverage selected by the employer" refer to a policy form or to the premium or face amount as well as the policy form?

The term "plan of coverage" was intended to describe situations where the employer or other permitted group specifies the general benefit design of the coverage. It was not intended to preclude situations where the employees or other group members have some flexibility regarding the face amount or mode of premium payment.

D.4.7 What is the "simplified underwriting" referenced in Section 4L(3)? Does this mean any modification to the normal rules that would apply for a particular age or amount?

There is no exact definition for the term "simplified underwriting." Together with the phrase "group underwriting," its use was meant to restrict application of the term "non-term group life" to legitimate group arrangements. Use of more than a short questionnaire pertaining to medical history and current physical condition for any age or amount would be inconsistent with the intent of this section.

D.4.8 Suppose an insurer sells a non-term group life policy (whole life) via work site marketing. For most of the group, group or simplified underwriting will be used. However, for a handful of individuals with high face amounts, full underwriting will be done. In either case, the policy's underlying values and premiums do not differ based on the degree of underwriting done. Would such a policy still be considered "non-term group life" as described in Section 4L?

Assuming that every plan of coverage is selected by the employer or group representative and some portion of the premium is paid either by the employer or through payroll deduction, the only question remaining is whether the policy form uses "group or simplified underwriting." Following the answer to Question D.4.7, full underwriting for some individuals would not be consistent with the concept of simplified underwriting.

D.4.9 Is the definition of "non-term group life" under Section 4L met in a work site marketing situation where the employer has agreed to allow the employees a choice of either of two policies, e.g., universal life insurance or term life insurance, and the requirements of Paragraph (2) and (3) of Section 4L are met?

The fact that an individual employee may select a particular policy does not take the situation out of the definition of "non-term group life," provided the employer has selected the plans of coverage to be made available to its employees.

Section 5. Policies to be Illustrated

D.5.1 How do you show a re-proposal on a policy that is six months old? Does it need to comply as a new issue or in force?

Section 5B of the model regulation implies that use of an illustration prior to the first policy anniversary constitutes "marketing" with the illustration. Accordingly, use of an illustration with a 6-month-old policy constitutes use "in the sale" of the policy. Section 4H(3) says an in force illustration ~~must be is one that is~~ furnished at any time after the policy it depicts has been in force for one year or more, ~~so clearly the re-proposal should not be accompanied by an in force illustration. A new basic illustration could be prepared, or a supplemental illustration attached to or accompanied by the original proposal of six months earlier.~~

D.5.2. If a policy form has been designated as marketed without illustrations, can an in force illustration be required after the first policy year?

Section 5B of the model regulation says that if an insurer identifies a policy form as one to be marketed without an illustration, any use of an illustration for any policy using that form prior to the first policy anniversary is prohibited. Section 4H(3) defines an in force illustration as one furnished at any time after the policy has been in force for one year or more. ~~Section 10C says an in force illustration shall be furnished upon the request of the policy owner. A policy form designated as one to be sold without an illustration is not subject to the requirement to offer an in force illustration, but if an insurer does choose to provide an in force illustration, it must meet the requirements of Section 10C.~~

D.5.3 In a payroll deduction case in which the coverage is marketed to the individual employees, can a generic set of rate illustrations for sample ages and weekly premium amounts be used for illustrative sales purposes at the point of sale, followed up with a personalized illustration complying with the regulation at policy delivery?

~~Section 5D allows use of quotations in group marketing, followed by a personalized illustration at policy delivery if the non-term group life policy meets the three criteria of Section 4L. Since a basic illustration will be provided to those who enroll for more than the minimum premium necessary to provide pure death benefit protection, the quotation should contain information that a personalized illustration will be provided to those who enroll. If meetings are held with individuals after a group presentation, a personalized illustration will be presented at that time, or a signed statement obtained that no illustration was used, in compliance with Section 9B.~~

D.5.4 Are payroll deduction sales of small (but over \$10,000) universal life policies, sold via employer sponsored meetings, considered sales to individual group members (because they sign an individual application) or are they considered group sales and therefore exempt from this regulation?

~~Section 5C of the model regulation indicates that a basic illustration need not be provided to individual members of a group or to individuals insured under multiple lives coverage issued to a single applicant unless the coverage is marketed to these individuals. An individual application being signed is not necessarily indicative of marketing to an individual. In a payroll deduction sales context, however, signed individual applications may be additional evidence of marketing to individuals, in which case an illustration is required. Further, Section 5D indicates that a basic illustration shall be provided at delivery of the certificate to enrollees for non-term group life, i.e., payroll deduction, who enroll for more than the minimum premium necessary to provide pure death benefit protection. Group sales are not exempt from the regulation, but rather follow the requirements of Sections 5C and 5D.~~

D.5.5 Does Section 5B cover only corporate owned life insurance (COLI) business where an entirely new group is sold, or when a group policyowner covers a new employee? In the same light, if no new groups are expected to be sold and the policy form is stated to be a non-illustrated form, can any illustration go to the group policyowner on a new employee within the first year of in force coverage on the employee?

~~Section 5B refers to any use of the policy form whether for employer groups or not, during the first year the policy is in effect. If the policy is certified to be a non-illustrated form no illustration may be used the first year the policy is in effect. See also Question D.14.2.~~

✓D.5.6 What are the illustration requirements when a policy is purchased by the trustees of a qualified pension or profit sharing plan where the trustees are the owner and premium payer and the insured selected the insurance coverage?

~~If the policy is not being marketed to the individual, the provisions of Section 5C apply. The illustration may be either an individual or composite illustration representative of the coverage on the lives of group members. If illustrations are presented to the individual insureds in order to select the insurable coverage, the illustrations must comply with the model.~~

D.5.7 Section 5C appears to give some latitude in multi-life cases. If a composite illustration is used, is a composite basic illustration required? If the composite includes more than one type of product, must the product narrative section describe all products included in the composite? In the numeric summary, what should be provided as the projected coverage cease year required by Section 7C(2)? Are signatures required on such composites?

No.

D.5.8 If a company sells an illustrated policy through its agency distribution channel and wants to use the same policy in its direct distribution channel, will illustrations be required for the direct channel even if no non-guaranteed values will be

shown to the prospect? In other words, will it be possible to file a policy as an illustrated product in one distribution channel and a non-illustrated product in another distribution channel? If not, what would the illustration regulation require in this situation to allow the simplicity needed in the direct market channel?

A policy form is designated for illustration. If it is desired to illustrate in one distribution channel and not another, different policy form designations should be used. To prepare an illustration for the direct market, some basic information about the applicant and his needs must be obtained first.

✓D.5.9 Section 9B(1) states that, if no illustration is used in the sale or if the policy is applied for other than as illustrated, the producer shall certify to that effect on a form. On the same form, the applicant must acknowledge that no illustration was used. Does this apply to forms for which no illustration is used, as certified by the company?

If the company has chosen not to market the policy form with illustrations, the certification will have already been filed and additional certification by the agent or applicant would be redundant.

Section 6. General Rules and Prohibitions

D.6.1 If a policy form is designated to be marketed with an illustration, can you not show an illustration if there are riders added to the policy you do not wish to illustrate?

One is not allowed to provide an incomplete illustration (Section 6B(6)). Moreover, one should not be able to avoid an illustration simply by adding one or more riders. If a policy form is designated to be marketed with an illustration, then a basic illustration of that policy form must be provided. The benefits provided on the life of the basic insured by the riders should be included in the basic illustration. Riders providing benefits to other persons, such as family term and children's term, should be described in the narrative. The illustrated premium and outlay should include the rider premium. However, it would not be appropriate to include the benefits from these riders with the death benefits on the life of the insured. Companies may provide a supplemental illustration showing these rider benefits, and would include a description in the narrative.

D.6.2 How are requested changes to an active policy made after the first year to be illustrated (e.g., an increase or decrease in death benefit, addition of an optional rider, or change in dividend option)? Are such changes considered a new policy with an entirely new basic illustration or does this require an in force illustration?

The model regulation makes reference to "marketing policies" (Section 5) and "sale of a life insurance policy" (Section 9) but does not specifically refer to policy changes. It would appear that the "spirit" of the model regulation would require the use of an appropriate illustration when such a change is being proposed by the insurer or its agent. A determination of what is appropriate will be made on a case-by-case basis, but a company will often choose to offer a basic illustration.

D.6.3 Assume that a company has decided to illustrate a term product. This product is then quoted by a term quote service. Is an illustration required with the quote or only on the select product you deliver?

The obligation to provide an appropriate illustration is an obligation of an insurer, its producers or other authorized representatives. If the quote service does not fall into one of those categories, presumably is involved in the sales process, it would not be required to provide an illustration meeting the requirements of the model regulation, just as an agent or company selling the product would be required to produce an illustration.

D.6.4 Please consider an insurer that has developed the capacity to quote term insurance rates to interested individuals, similar to a quote service. If the insurer is operating in the same manner as a quote service, is it fair to assume that they do not need to comply with the illustration model? We feel certain that you intend to treat business consistently, so we assume companies would be allowed to quote their own products in a manner similar to a quote service.

A person or entity soliciting a sale of a policy must follow the illustration rules.

D.6.5 Section 6A(4) requires that the illustration contain the underwriting or rating classification upon which the illustration is based. Does this refer to smoker, nonsmoker, standard, preferred? Or is other information required if the insured is rated? For example, does the amount of the rating have to be shown or would it be sufficient to use a statement to the effect that an additional rating charge is included?

The designation required by Section 6A(4) must be in sufficient detail to identify the payment schedule and any other elements dependent on classification.

D.6.6 The basic illustration should describe the riders available on a policy form. How should the following types of riders be included:

- (a) riders that don't provide death benefits, such as premium waiver?
- (b) riders that don't provide death benefits for all causes of death, such as accidental death benefit?
- (c) riders that don't provide death benefits on the primary insured, such as family term and child's term?

All riders should be described in the narrative summary. If the rider falls into one of the above categories and has only guaranteed elements, it need not be displayed in the tabular detail or numeric summary. If the rider has non-guaranteed

elements, it must be displayed in the tabular detail. Benefits on these riders, if illustrated, must be displayed in a manner that is not misleading. For example, non-insured death benefits should never be included in a column with insured death benefits.

D.6.7 For a universal life policy with an automatic increase rider, must the changes in the death benefit and resulting increases in the premium outlay in the future be illustrated? If the increased amount is based on future salary increases, how would we illustrate that since it would involve a projection of a non-guaranteed salary increase?

Section 7E contains a requirement that the tabular detail include the premium outlay the applicant plans to pay and the corresponding death benefit. If both are based on non-guaranteed salary increases, this figure should be provided by the applicant and the narrative summary disclose the assumptions made. Depending on the applicant's comfort level with his or her estimates, supplemental illustrations might be prepared with alternative salaries and premiums.

Section 7. Standards for Basic Illustrations

D.7.1 An agent may not have access to illustrations software. Is it acceptable for that agent to use a sample basic illustration that would be age and gender specific in a presentation?

A "sample" illustration would not meet the requirements of Section 6A. Either a customized illustration must be prepared or none is used and the agent gets a signed statement that no illustration was used.

D.7.2 Since "premium outlay" is "net out of pocket," should loans and withdrawals payments used to pay premium be netted from this column?

"Out-of-pocket" presumably refers to the total amount remitted to the insurer by the premium payer. Loan repayments are part of the total amount remitted, and therefore should be included in "premium outlay." Withdrawals are not part of the remitted amount, and should not be included. If a flexible premium is being paid by borrowing or surrendering value, the out-of-pocket premium should be less than the full premium or zero. For fixed premium contracts, the full premium will be shown, but an additional column could be added to indicate loans or withdrawals.

D.7.3 Companies have some flexibility as to what constitutes a basic illustration. I assume it was meant to range anywhere from only a full pay illustration to much more complex patterns. However, I believe that the regulation states that the premiums shown in the basic illustration must be those anticipated by the policyholder. How does this reconcile with the concept of having basic illustrations be full pay only? Furthermore, how useful would it be to have signed full pay illustrations in the file if the policy was sold anticipating some other payment pattern?

Section 7E(1)(a) of the model regulation requires that the illustration be based on the premium and mode of payment that the applicant plans to pay.

Section 7A(5) requires that the assumed payments on which the illustrated benefits and values are based shall be identified as premium outlay or contract premium, as applicable. For fixed premium policies, the contract premium must be shown and full disclosure is required under 7A(13) if non-guaranteed credits are used to reduce the premium outlay below the contract premium or to zero so that it does not appear the policy is paid up. For flexible premium policies there is no specified contract premium and the basic illustration must be based on the premium outlay anticipated to be paid by the policyholder. Section 7A(14) provides that the company may reflect, in the basic illustration, the use of guaranteed and non-guaranteed values to pay all or a portion of the premium or charges. "Full pay" can be assumed to mean premium sufficient to keep the policy in force on a guaranteed basis until the end of the table. A company can provide one illustration based on full pay and one based on the expected payment mode.

D.7.4 Minimum premium payable to keep policy in force: level annual? n-pay premium? single? any desired pattern?

Section 7B(2) of the model regulation requires that the illustration "show the premium outlay that must be paid to guarantee coverage for the term of the contract..." The illustration may show any pattern of premium payments that are exactly sufficient to guarantee the coverage and is what the applicant plans to pay. However the insurer is not required to illustrate a premium that would exceed the guideline level premium of I.R.C. Section 7702.

D.7.5 Do the same disciplined current scale, illustrated scale, and experience factors underlying the disciplined current scale apply equally to new business illustrations and in-force illustrations of the same policy form?

It depends on whether the same conditions pertain to new business and in-force policies. For example, a company that credits interest on the basis of new money rates would have different "recent experience" applicable to new issues and in-force business. However, expense assumptions might apply equally to all business. If different disciplined current scales, illustrated scales, and experience factors did exist, this should be prominently disclosed in the annual certification. The illustration actuary should carefully read Section 5.3.6 of Actuarial Standard of Practice No. 24 for guidance on in-force illustrations.

D.7.6 Section 7E(3) states "non-guaranteed elements may be shown if described in the contract." What does "if-described" mean? What level of detail is required in the description of these elements?

The model regulation provides no specific guidance. Failure to make any reference in the policy to any particular non-guaranteed element means that it cannot be illustrated. The policy review process strongly encourages companies to be explicit in their language. For example, "The interest rate will be determined at 50 basis points below Moody's Index. The mortality

charge guarantee will be determined at 90% of [a specific company mortality table]. For a participating policy, language such as "dividends approved by the board from surplus" could adequately describe the process. Unusual crediting patterns that could influence policyholder actions should be described fully enough for the policyholder to determine the most advantageous course of action.

D.7.7 The model regulation does not say that terminal dividends have to be described in the contract. It would seem inconsistent and unfair for the model to require a very detailed description of a non-guaranteed element for a universal life policy when it doesn't require any description at all for a similar non-guaranteed element of a traditional policy. Would it be sufficient to say the current rate will not be less than the guaranteed rate?

See D.7.6 above.

D.7.8 Where do you see the information being disclosed that ties the various insureds with their risk classes, face amounts, riders associated with the specific insureds? It does not appear that this information can easily fit into a "brief" narrative or policy description.

Section 7B of the model regulation uses the phrase "brief description" without definition. Each company must provide its own interpretation.

D.7.9 Can an illustration reflect an increase in the credited rate (i.e., decrease the spread) for certain policies that have met minimum cash value and duration requirements?

Section 7E(3) states that "non-guaranteed elements may be shown if described in the contract." The clear implication is that non-guaranteed elements may not be shown if not described in the contract. What constitutes an adequate description is not equally clear. However, a general statement in the contract that the company reserves the right to adjust the spread in relation to the duration of the contract or the level of the cash value would probably not be a sufficiently detailed description to ensure consumer understanding.

D.7.10 What is expected in the illustrations for term insurance with non-guaranteed features that also have reentry features? Is the reentry feature a part of the original contract for illustration? Are reentry rates to be illustrated for the coverage beyond the original term of the product? Is another illustration required at reentry as if this is a new sale on an illustrated form?

If the sales material provided to the applicant only shows the maximum premium that can be charged (i.e., the premiums which the insureds would pay assuming they could not qualify for more favorable rates at reentry), then there would be no non-guaranteed elements displayed that would subject the sales material to the model regulation. However, if the illustration shows the premiums that would be charged assuming the insured is eligible for the lower reentry rates, then it would be subject to the model regulation. In that case, the guaranteed death benefits shown after reentry would be zero. No in force illustration is required at reentry unless requested by the policyowner.

D.7.11 If a policy form's reentry provision states the client has the option to apply for reentry into a term policy available at the time of reentry, can this be illustrated with the current term premiums? There is a good chance that the term product available at the time of reentry will be different than the current illustrated product.

It would seem reasonable to illustrate the current term premiums subsequent to the point of reentry, provided those premiums are consistent with the requirements of the Actuarial Standard of Practice. However, since there is no guarantee that the policyholder will be able to qualify for these rates, the guaranteed death benefit subsequent to reentry would be zero.

D.7.12 Where premiums are paid in advance on a policy subject to illustration requirements and the prepayment is accomplished through a separate agreement that cannot stand alone, do prepaid premium amounts have to be illustrated?

More clarification would be helpful regarding the nature of "a separate agreement that cannot stand alone." As a general rule, contracts other than life insurance contracts should not be part of the illustration.

D.7.13 Is the numeric summary intended to contain just three columns for each basis: contract premium (or outlay) death benefit, and cash value? Or is it intended to show additional columns such as cash value of additions, face value of additions, cash value of additions surrendered, etc. If so, must it show the same columns as on the tabular report?

The intent is that the numeric summary should be a brief view of key elements. The language of Section 7C does not specifically prohibit more than the three columns, but it was intended to provide an overview which could easily be lost by the use of many columns.

D.7.14 On the tabular detail, is it sufficient to label columns of non-guaranteed elements as such, or must the illustration contain comparable columns labeled "guaranteed" and containing zeros? For instance, must an illustration contain guaranteed columns filled with zeros for dividends, cash value of dividend additions, etc.

For columns representing items that are not guaranteed, a column showing zeros is not necessary. However, in order to avoid a misleading illustration, it must be clearly disclosed that none of the dividends, etc., are guaranteed.

D.7.15 Do you have to provide for illustration of all dividend options? If the applicant requests a different dividend option than that illustrated, is a revised illustration required?

The dividend option the applicant expects to use should be illustrated. If a different plan is selected at policy issue, a revised illustration is required.

D.7.16 If the policy is illustrated with policy loans on the non-guaranteed values report, do you illustrate the policy loans on the guaranteed values report? If so, what do you do if the cash value is insufficient?

If the applicant intends to use policy loans, they should be shown on both the guaranteed and non-guaranteed sections. If cash value is insufficient with policy guaranteed values, zeros should be shown or a notation made that the policy would terminate.

D.7.17 For adjustable products there are many future changes beyond just loans, withdrawals and premium suspension that will impact the planned premium schedule. Must all these be included in the basic illustration? The problem is that we frequently see revisions at issue. Please define "revision" (change in issue information only versus future changes illustrated). If only issue information is included in the revised illustration, this process could be more easily automated in the home office. However, by not including future changes, would the revised ledger be out of compliance? What goes on file for record retention?

While the question is somewhat ambiguous, it is apparently questioning the meaning of Section 9A(2) (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). "Future changes beyond just loans, withdrawals and premium suspension that will impact the planned premium schedule" would seem to be referring to events that occur subsequent to the policy being issued, and therefore no revised basic illustration would be required. Clearly, an in force illustration provided subsequent to the "future changes" should reflect those changes.

D.7.18 For adjustable products, when a future premium increase occurs should we consider this a new sale and get a new signed basic illustration, or an in force contractual adjustment (since it is not a new product/policy form)? This is a frequent occurrence and will add a lot to the cost of administration if it is defined as a new sale. If so, do we replace the basic illustration on file or retain all of them to date?

Since it is not a new product/policy form, this would be considered an in force illustration. It would seem prudent to maintain all basic, supplemental, and in force illustrations until at least three years after the policy is no longer in force. (Note: Do additional comments need to be added regarding how differing future premium scenarios should be illustrated?)

D.7.19 Does Subsection 7C(1) say that we have to illustrate premiums in the numeric summary for policy years 5, 10, 20 and at age 70? Are these cumulative premiums or can we just state the annualized premium in the top right-hand corner labeled as such?

The cumulative premium is not required. One statement of the premium amount is adequate.

D.7.20 In the tabular detail, if an applicant selects monthly mode, do we have to illustrate 12 months of data for each policy year or would illustrating the annualized (i.e. monthly rate times 12) premium suffice?

The annual amount can be illustrated, however the accumulation values must be calculated on the basis of payments received monthly.

D.7.21 Can we bold print the current assumption values and not the guaranteed values on a compliant illustration? Can we bold print a line (i.e., age 70 values)?

The model does not specifically prohibit bold printing the current assumption values, but Section 6B(2) prohibits using the non-guaranteed elements in a manner that could mislead. Printing a line for one year would not raise the same concern.

D.7.22 Can we refer to the non-guaranteed values as "projected values" or similar term, or must we use the term "non-guaranteed values"? Are there any specific limitations on the terms we can use?

The terms used should be the same as those used in the policy and should be defined in the narrative summary.

D.7.23 May the contract premium for a term/paid up additions blend rider vary between the illustrated, guaranteed and midpoint calculations? According to the contract, the premium that will be billed for this type of rider will vary depending on whether or not there are funds available within the contract to pay for the rider's premium. This may cause the contract premiums to vary.

By definition, the contract premium is that "required to be paid under a fixed premium policy." Accordingly, the contract premium will not vary. (Note: The nature of the policy being described needs to be clarified before a more precise answer can be provided.)

D.7.24 For indeterminate premium yearly renewable term products, what should the contract premiums be under the guaranteed assumptions? Indeterminate yearly renewable term, by its nature, has different contract premium under illustrated, guaranteed and midpoint bases. This would dictate that the premium shown in the different bases must differ even

though our interpretation of the regulation is that we should show the same premium under all three bases. Is it acceptable to show three different contract premiums?

First, as pointed out above, the suggestion that the contract premium (which is an amount fixed by the contract) can vary at all, much less vary over three categories, seems unlikely. Second, "indeterminate premium yearly renewable term products" is a category that does not neatly fit into the requirements of Section 7C(1)(c). However, a literal reading of that section, in conjunction with the rest of the regulation, would seem to require that (a) only one premium outlay be displayed in the numeric summary and (b) the death benefit for the guaranteed and midpoint bases be zero (since the premium outlay would be less than required under either the guaranteed or midpoint bases).

D.7.25 For indeterminate yearly renewable term riders with universal life policies, what premiums should be shown under guaranteed assumptions? The model regulation states that the numeric summary should show the premium outlay that the policyholder plans to pay. Assume that the premium outlay that the policyholder plans to pay is the current premium. What should be shown under the guaranteed assumptions? The death benefit decreasing or the premium outlay based on guaranteed yearly renewable term premiums?

See the answers to Questions D.7.11 and D.7.12.

D.7.26 For yearly renewable term riders that are illustrated as dropping off at some point, but issued as if they continue until maturity, must the basic illustration match the policy as issued? For example a yearly renewable term rider would contractually be issued to age 100, but the policy owner only needs this coverage for 15 years and plans to drop it at that time. Should the basic illustration be prepared and signed twice, i.e. yearly renewable term premiums and death benefits payable to age 100 and again for only 15 years?

If it is assumed that the policyowner will only pay for the term coverage for 15 years, then a basic illustration should be prepared using a premium outlay which reflects that.

D.7.27 If the policy expires at death, even if that occurs beyond age 100, may the tabular detail be illustrated only to age 100?

The tabular detail is only required to age 100.

D.7.28 On a universal life policy is it allowable to vary the current interest crediting rate by policy duration, resulting from different interest rate spreads?

There is no prohibition on the crediting of different interest credits by duration, subject to the conditions imposed by the Actuarial Standard of Practice.

D.7.29 For a simple illustration, can you combine the tabular detail with the numeric summary and signatures? I do not think they have to be on separate pages.

There is no requirement to put them on separate pages. The tabular detail can follow on the same page.

D.7.30 Is it permissible to illustrate an "account" or "accumulation" value?

Yes. However, Section 7A(9) states that the account or accumulation value of a policy, if shown, shall be identified by the name this value is given in the policy being illustrated and shown in close proximity to the corresponding value available upon surrender. It is also critical that the limitations regarding how the account or accumulation value can be utilized (e.g., only as a life annuity) be clearly stated in the illustration.

D.7.31 If the account or accumulation value is only available as a life annuity, what illustrated policyowner value is tested against the accumulated value of the policy cash flows to determine if the self-support and lapse-support tests are met?

(Note: In formulating the answer, the implications of Section 6B(2) ("use or describe non-guaranteed elements in a manner that is misleading or has the capacity to mislead") should be considered.

Section 8. Standards for Supplemental Illustrations

D.8.1 If running an illustration that combines values for multiple policies, each policy illustration would include a basic illustration. Is the composite illustration that totals all premiums, values and benefits for all policies considered a supplemental illustration?

It could be either a basic illustration or a supplemental illustration.

Section 9. Delivery of Illustrations and Record Retention

D.9.1 "Other than applied for" may mean that the beneficiary or address changes. It may mean in a § 1035 exchange that the exact amount of the proceeds to be applied from another policy is not known until weeks or even months after the policy is issued. Do these situations require a revised illustration?

There is no requirement that the illustration show the intended beneficiary. This type of change would not necessitate a revised illustration. A change of address could be a significant change, for example if the applicant moved across a state line, and, regardless, could indicate a lack of due diligence if future communications were mailed to the wrong address. If the amount of the \$ 1035 exchange was not known, a revised illustration would be required when that amount became known. Changes that do not affect plan values or benefits do not require a revised illustration, although they may necessitate changes in the administrative records of the insurance company. "Other than as applied for" would come into play when the insurance company will not issue the policy on the basis applied for, such as when it is determined that a worse rating class is necessary. If the policy is issued on a basis different than illustrated and that difference would affect the premiums, benefits or values, a revised illustration would be required. Since the final amount of a \$ 1035 exchange will almost never be known until after the policy is actually issued and will not generally affect the premiums, benefits and values of the policy, a revised illustration will generally not be necessary.

D.9.2 If we have received signed illustrations at 6.5% credited rate at application and then we decide to lower the rate to 6.25% prior to issue, do we need to produce a revised illustration? What about the case of the rate being lowered between issue and delivery of the policy?

It would be prudent business practice to provide a revised illustration.

D.9.3 For Section 9B(1), is it permissible to show an illustration conforming to the model requirements on a computer screen, and obtain the signature at policy delivery?

Section 9A(1) requires a signature at application if a basic illustration is used by the producer. It does not limit that requirement to printed format. If the agent is unable to print out the illustration, he or she should return with a print-out and obtain the necessary signature before submitting the application. Section 9B(1) only applies if no illustration has been used. Where a computer screen illustration conforming to the regulation is used and no hard copy is furnished at the time of application, an acknowledgment, signed by the applicant and agent, should be obtained and submitted with the application, conforming to the following requirements:

1. The personal and policy information on which the computer screen illustration was based shall be itemized in accordance with Section 6A, and

2. An acknowledgment consistent with the provisions of Section 9B(1) shall be obtained so that the applicant is aware that a copy of an illustration conforming to the policy as issued will be provided to him or her no later than at the time of policy delivery. One copy of the signed acknowledgment will be left with the applicant and one copy will be submitted with the application. Following is a sample acknowledgment:

Sample Certification

All new material in box:

I certify that I displayed a computer screen illustration for _____ that complies with state requirements and for which no hard copy was furnished. The illustration was based on the following personal and policy information:

- | | |
|---------------------------------|-------------------------|
| 1. Gender | Male _____ Female _____ |
| 2. Age | _____ |
| 3. Underwriting or Rating Class | _____ |
| 4. Type of Policy | _____ |
| 5. Initial Death Benefit | \$ _____ |
| 6. Dividend Option | _____ |

AGENT

DATE: _____

I acknowledge that I viewed a computer screen illustration based on the information as stated above. No hard copy of the illustration was furnished. I understand that an illustration conforming to the policy as issued will be provided to me no later than at the time the policy is delivered.

APPLICANT

DATE: _____

D.9.4 Can agents who do not use computers provide customers with a preprinted document that describes the policy under consideration and shows generic illustrations with guaranteed and non-guaranteed elements in graphic form when the application is taken and then provide a customized illustration that meets regulatory requirements when the policy is delivered?

An illustration meeting the requirements of the model must be used at the time of solicitation or else no illustration may be used. Any preprinted document showing non-guaranteed elements over a period of years would be an "illustration." The agent should obtain basic age, gender, etc. information before visiting the client and bring an illustration that meets the requirements of the model.

D.9.5 Now looking at Sections 5A and 9B, if in fact the situation described above is not an "illustration," the regulation seems to indicate that notification to that effect needs to be given to the commissioner, and furthermore that signatures need to be obtained from the agent and potential insured that no illustration was provided. Am I reading this right?

The insurer may choose never to use illustrations for this policy form, and then the certification to the commissioner provided for in Section 5A is required. If the policy form is typically sold with an illustration, but isn't in this instance, Section 9B applies, and signatures are required that no illustration was provided at time of application, and an illustration will be required at time of policy delivery.

D.9.6 If a policy owner decided to cancel the policy during the free-look period, are we required to keep the signed illustrations and certifications on file for three years?

The requirement in the model is to keep the illustration on file for three years after issued.

D.9.7 Usually it is not known if a proposed insured is in a preferred class until after the application is submitted and the underwriting process is complete. If the initial illustration was done at the standard class, but the final determination is preferred, must the policy be re-illustrated? Keep in mind that the preferred illustration will always show values that are more beneficial to the insured.

Yes, the illustration must conform to the policy issued.

Section 10. Annual Report; Notice to Policy Owners

D.10.1 If a policyholder requests an in force illustration of a policy form not sold with an illustration and the company agrees to provide one on request of the policyholder, must the illustration comply with the regulation?

Companies are encouraged to provide in force illustrations even for policies not sold with illustrations. Any in force illustration used should comply with the model requirements.

D.10.2 Is an annual report that includes a projection of when coverage terminates based on the currently payable scale (but does not include any projection of values) an "in force illustration" as defined in Section 4H?

The annual report is intended to give the insured the current status of the policy and the model requires inclusion of at least the information specified in Section 10A(1) for universal life policies or Section 10A(2) for other policies. There is no limitation in Section 10 limiting what can be included. If it rises to the level of an in force illustration, the requirements of Section 6A, 6B, 7A and 7E must be met. That determination would be made on a case-by-case basis based on whether it includes non-guaranteed elements over a period of years. While calculation of termination date includes non-guaranteed elements, it is the "bad news" so isn't the kind of information that has raised regulatory concern. This information would often encourage the insured to request an in force illustration and would often be required by Section 10D.

Section 11. Annual Certifications

D.11.1 When one policy form is sold through two different distribution channels, does the illustration actuary need to prepare two illustrations and certifications to reflect the differing distribution channels, or can one illustration and certification be prepared that reflects an average of the two?

Unless there is a compelling reason to do otherwise, the clear intent of the regulation and standard of practice is to test for compliance on a policy form basis, assuming a mix of policies consistent with actual experience. However, an unyielding adherence to this approach could lead to undesirable results. In fact, an insurer is prohibited from using or describing "non-guaranteed elements in a manner that is misleading or has the capacity to mislead" (Section 76B(2)). Combining policies which are anticipated to credit significantly different non-guaranteed elements would clearly have "the capacity to mislead." Therefore, in the new or annual certification, the actuary should clearly disclose that, in order to comply with the prohibition against misleading illustrations, he/she has separated policies within the forms into homogeneous blocks. If the customer will receive the same treatment regardless of the distribution channel, i.e. same non-guaranteed elements, then only one illustration is necessary (other than the obvious changes to the identification of the producer of the illustration, etc.) In conducting the self support test and lapse support test, the illustration actuary would develop assumptions taking both distribution systems into account and could test the single scale separately for each system or could test using assumptions that combined the experience of the distribution channels.

If the non-guaranteed elements will be different depending on the distribution channel used, the situation is different. Even though the regulation and standard of practice require testing for compliance on a policy form basis, assuming a mix of policies consistent with actual experience, the regulation prohibits an insurer from using or describing "non-guaranteed elements in a manner that is misleading or has the capacity to mislead" (Section 6B(2)). Combining policies that are anticipated to credit significantly different non-guaranteed elements would clearly have "the capacity to mislead." Therefore,

the illustrations should be distinct for each distribution channel and they should be considered separately in the self support and lapse support tests.

In neither case would separate certifications necessarily be required since one certification could cover several policy forms.

D.11.2 If one group universal life policy form is utilized to write business where some of the non-guaranteed elements reflect group-specific experience, does the illustration actuary have to tailor-make the illustration and certification for each group, or can the illustration reflect some sort of averaging of all the groups insured under the policy form?

See answer D.11.1 above.

D.11.3 Under fully allocated expenses, does each policy form have to receive some allocation of general overhead expenses, such as rent, furniture and equipment expense, and the president's compensation?

Yes, each policy form must receive a proportion of the general overhead expenses which is reasonable related to the actual incidence of costs for that form. According to the Actuarial Standard of Practice, overhead expenses must be fully allocated using a sound method of expense allocation. There are many sound methods for allocating overhead, but professional judgment needs to be used to ensure that the method used is not merely a subterfuge to effectively avoid the full expense allocation requirement. For example, The standard of practice states that "indirect costs should be fully allocated using a sound basis of expense allocation." Some have argued that the company could create a policy form for which it does not intend to use illustrations, and allocate all indirect expenses to that form. This would effectively allow the company to use marginal expenses while stating in its certifications that it is using fully allocated expenses, or a company could argue that it is allocating all of its indirect expenses to non-life lines, and accomplish the same thing. The illustration actuary should have sound business reasons for the allocation methods used so that the expense allocations that result do not generate sales illustrations that will mislead purchasers.

D.11.4 What is the basis for the generally recognized expense table (GRET)?

As indicated in Section 4K(1)(c) of the model, the generally recognized expense table ~~will be~~ is based on the experience of a number of companies, using fully allocated expenses. The Society of Actuaries is currently developing tables appropriate for this purpose which have been adopted by the Life Insurance (A) Committee and will be considered in September for consideration and adoption by the NAIC plenary.

D.11.5 Why is there an industry expense table allowed for economic viability testing, but mortality, lapse and interest are based on recent historical experience?

Industry representatives expressed concern that the requirement in the model that fully allocated expenses always be shown would be detrimental to new companies or products. The GRET was suggested as a way to ameliorate this concern.

D.11.6 Why does the company notify the agent of the allocation method used for expenses?

Originally the model regulation was drafted with a requirement to disclose the allocation method to the prospect. The working group was persuaded that it would be difficult to disclose this clearly, so the requirement was instead made that the agent be made aware of the allocation method, and he or she can explain it to the prospect as appropriate.

D.11.7 What is a "similar" in force policy under Section 11C(5)?

The question of what policies, if any, are "similar" would seem to be a matter of professional judgment.

D.11.8 How narrowly is disciplined current scale to be defined, i.e., can it say interest rate margin is between 1.25% and 1.75%, if 1.25% margin passes tests?

The interest assumption underlying the disciplined current scale is an interest rate (e.g., 7.00%), not a "margin."

D.11.9 Can a disciplined current scale be changed more often than annually? Must a changed scale be refiled?

The disciplined current scale is to be reasonably based on recent historical experience. If the illustration actuary's judgment regarding recent historical experience changes more frequently than annually, then good actuarial practice would suggest changing the disciplined current scale more frequently than annually. Specifically, Section 5.3.4 of the Actuarial Standard of Practice says "changes in experience should be reflected promptly once they have been determined to be significant and continuing."

The question of whether to refile the scale was answered by the working group in its report at the June 1995 meeting. An earlier draft had contained a requirement for a new filing each time the scale changed. The working group agreed it was not necessary to certify each time a change was made. Instead the actuary was allowed to wait until the annual certification date. Section 11D(1) requires an annual certification that the scales used during the past year must meet the standards of the regulation and the Actuarial Standard of Practice.

D.11.10 When a company has multiple distributions selling the same product, how do they apply the table?

- (1) Product must comply with all applicable tables, or
- (2) Product must comply using a weighted average of the appropriate distribution tables.

See the answer to Question 11.16.

D.11.11 I was thinking about how to calculate company expenses under the GRET and the more I think about it the more confused I get:

(1) As of what point in time do I calculate my fully allocated expenses, marginal expenses and GRET expenses in order to compare them? I assume that I would use the expenses I plan to use for the certification period (e.g., 1997).

(2) If I need GRET expenses for the certification period, that means I will need to project sales (i.e., policies sold, premium received, units issued), right? This seems like a very subjective projection and as best I can tell, the ASOP provides no guidance (e.g., is a 10% increase in sales an assumed improvement?). Am I missing something or are we on our own (within reason) when setting this assumption?

(3) If I plan on continuing to sell (and illustrate) a policy form I've been using for the last 5 years in 1997, do I include in force business in calculating expenses for 1997 or would I include only 1997 and later data to the extent that the regulation does not apply to pre-1997 business?

This is an extremely difficult and broad question relating to the appropriate basis for estimating expenses, whether or not the GRET is used. As pointed out in Question D.11.17, the illustration actuary "is certifying to all illustrated scales in use at the time of the certification as well as all illustrated scales used since the previous certification." Clearly, in order to render that certification, the actuary needs to determine reasonable expense levels at the time of the certification for policies currently being illustrated. For most existing policies, actual "recent historical experience" (i.e., expenses which are "current, determinable, and credible") is required. For relatively new policies or other policies for which there is no recent historical experience, expense levels from "similar" blocks of business or industry data should be used. (Note: Some discussion needs to be added regarding how future sales projections enter the expense analysis.)

D.11.12 It appears there is some flexibility in who or how many responsible officers there can be. While it is clear that the illustration actuary cannot serve as the responsible officer, what qualifications must the responsible officer have and can there be more than one?

No specific requirements are included for the qualifications of the responsible officer. The commissioner would need to be satisfied that the individual signing was in a responsible position.

D.11.13 The GRET report indicates that "premiums for single premium products should be multiplied by 6% prior to the application of the percent of premium factor." It also states that in the development of the expense factors "single premiums were weighted using 6% after reduction for any dividends applied." In using the GRET table to estimate expenses, should premiums for single premium products be reduced by an estimate of "dividends applied" prior to multiplying by 6%?

The use of the 6% adjustment for single premiums was taken from LOMA's expense study methods and is intended to represent the reduced sales overhead as a percent of premium inherent in single premium business. The reduction of the data from the single premium line of the annual statement for dividends applied was done to arrive at a premium number that represented the volume of single premium business which was produced by the distribution system and to which the percent of premium factor should be applied.

D.11.14 Are there other non-level premium products whose first-year premium should be reduced prior to applying the GRET?

The percent of premium expense factor of the GRET is an acquisition expense factor applied only in the first year and is intended to represent the sales overhead associated with a product which is not paid in the form of a commission. The factors that have been developed for the GRET have used unadjusted statutory data which would include only those premiums allocated to the first years of products.

The only leeway a company has in the application of the percent of premium factor to non-level premium products e.g., a universal life product with a pour-in premium, would be to make certain that the GRET percent of premium factor was used on an aggregate basis even though different products forms used different percent of premium factors. The different percent of premium factors and their multipliers should then result in a weighted product equal to the GRET percent of premium factor multiplied by total anticipated first year premiums (adjusted as necessary for single premium products).

D.11.15 The Actuarial Standard of Practice states that investment expenses may be reflected by either reducing investment income or incorporating investment expenses into all other expenses. Does the GRET reflect investment expenses?

No investment expenses were incorporated into the factors developed for the GRET. Therefore, investment expenses should be added to the expenses computed by applying the GRET.

D.11.16 Suppose a policy form is sold through multiple distribution channels. How is the GRET applied in such cases? For example, should one pick the predominant distribution system and apply those factors, or should some sort of proration be done?

The GRET report states: "A company may use one set of GRET factors for a specific distribution system and another set of GRET factors for a separate distribution system." This statement makes no distinction as to whether or not the separate distribution systems are applicable to a single policy form, so it would seem to be permissible to prorate the premium within the policy form to the applicable distribution systems. Whether or not it would also be appropriate to exclusively use the factors applicable to the predominant distribution system depends upon the actual mix of policies. The actuary should apply reasonable professional judgment as to whether the resulting level of refinement in the expense estimate necessitates a proration.

D.11.17 Are we able to use the interest on our surplus to offset some or all of the overhead expenses and still be able to certify that we are using fully allocated expenses in our calculation of the disciplined current scale?

(Donna Claire will draft suggested response.)

D.11.18 Can the responsible officer's certification required under Section 11F be based on "information and belief"?

Yes. The responsible officer shall certify annually that the illustration formats meet the requirements of the regulation and that the scales used in the insurer-authorized illustrations are those scales certified by the illustration actuary; and that the company has provided its agents with information about the expense method used by the company in its illustrations and disclosed as required in the regulation. This certification requires knowledge across multiple disciplines, and therefore it is appropriate for the responsible officer to rely on the knowledge of others as reflected by the unique organizational structure of the given insurer. Thus, for example, the responsible officer might rely on a sales officer that agents have been properly informed of the expense allocation method used and on an administrative officer or attorney that the narrative and numeric summary in the illustration conform with the requirements of the regulation.

D.11.19 If benefits under riders with only guaranteed elements are illustrated, should those benefits be incorporated into the self-support and lapse-support tests applied to the underlying policy?

Yes. To argue otherwise would promote "gaming" in the division of policy benefits between the underlying policy and the rider.

D.11.20 Do the phrases in Section 11C(5) "similar in force policies" and "similar forms" include policies that are not subject to the regulation, e.g., policies issued before the effective date of the regulation?

Yes. There is no language in this section which would suggest those phrases do not include all illustrated policies, regardless of whether those policies are subject to the current model regulation or previous models.

Section 14. Effective Date

D.14.1 It is very likely that many companies will not be able to have all of the changes in place by 1/1/97 for actively marketed products they plan to illustrate. Can they just not allow illustrations until each policy form has been certified and all format changes have been incorporated? When are in force illustrations required, one year from the effective date of the regulation or one year from when illustrations comply with the regulation? What about policies sold under these forms before illustrations are ready?

Until a company is ready to provide complying illustrations, it can designate the forms as not to be sold with an illustration. Once illustration software is in place, a new certification can be filed. In force illustrations are required to be offered on the one year anniversary of a policy sold with an illustration.

D.14.2 Will permanent group life plans in force before the effective date of the regulation be subject to the regulation?

The regulation only applies to policies sold on or after the effective date. However the minutes do not indicate any intention by the regulators to exempt policy forms sold to a group from the requirement to provide an illustration as described in Section 5C and 5D for employees covered after the effective date of the regulation. This may require a technical amendment to the regulation.

ATTACHMENT THREE-B4

Annuity Disclosure Standard
Prepared by the NAIC Life Disclosure Working Group
Draft: 07/24/96

I. Background Statement.

A. A model regulation has been developed for life insurance policies that as of July, 1996, has been adopted in several states to become effective 1/1/97.

B. Annuities are becoming increasingly complex and difficult for consumers to understand the nature of the products and the illustrations of values. Currently the options for purchase include fixed annuities, variable annuities and equity-indexed annuities. Each of these types has several variations in products being offered.

C. It is likely that the future will bring increased marketing of annuity products, often by persons who may have limited training and experience, increasing the need for guidance on appropriate illustrations.

II. Scope.

A. Some products may be appropriate candidates for an abbreviated illustration.

B. Illustrations for annuity products will not be required for a plan, but if they are used they will always be used and must meet the requirements of the model regulation. Except for specified products, if no illustration is used, the company file for the policy must contain a statement signed by the agent and the applicant that no illustration was used in the sales presentation and evidence that an illustration was provided at the time of delivery.

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

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

Note: The working group intends to focus next on a regulation for non-variable annuity products, so much of the balance of this document is specific to non-variable annuities.

III. Understandability.

A. The goal is that illustrations should be understandable with minimal assistance from an insurance agent.

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

IV. Standardization of Presentation.

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

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

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

C. Use a glossary of terms with definitions;

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

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

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

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

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

I. Be clearly labeled as an "Annuity Illustration";

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

K. Contain appropriate personal information including:

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

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

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

V. Assumptions.

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

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

B. Mortality and lapse rates will not reflect future improvement (deterioration).

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

D. Anticipated, but not yet realized, reductions in aggregate or unit expenses may not be reflected.

E. Lapse-supported pricing may not be illustrated. Lapse supported pricing means that minimum profit objectives cannot be met with zero lapse assumptions.

F. Persistency bonuses should not be illustrated.

G. Minimum profit objectives must be established by the regulation or the actuarial practice standard.

H. Amounts in excess of cash surrender values may not be illustrated.

VI. Actuarial Standards.

A. It is preferable to have the Actuarial Standards Board develop the necessary standards.

B. The Actuarial Standards Board must work in close cooperation with the NAIC to assure that the standards drafted in response to the model meet the expectations of the NAIC with regard to specific requirements and minimal actuarial creativity.

C. In the event that the Actuarial Standards Board fails to meet the expectations of the NAIC, a regulatory standard prepared by the NAIC will be utilized.

VII. Responsibility.

A. The company shall be responsible for the accuracy and propriety of the illustration as evidenced by the signed and dated certification by a company officer provided to the insurance department. The insurer is responsible for any representation of material omission of a representation in the sale of an annuity contract.

B. The company's illustration actuary shall be responsible for the accuracy of both guaranteed and non-guaranteed portions of the illustration and shall certify that the illustration is accurate and prepared in accordance with the appropriate actuarial standards as evidenced by the signed and dated certification by the illustration actuary.

C. The producer shall be responsible to provide the appropriate illustration and to assure that he or she has provided no inappropriate illustration to the applicant.

VIII. Annual Reports.

A. The insurer shall annually on the policy anniversary provide a report to each policyowner.

B. The report that is provided shall:

1. Be in a prescribed format;
2. Illustrate actual values as of the date of the report;
3. Illustrate future non-guaranteed values using values no more favorable than the current assumptions; and
4. Explain changes in assumptions since the last report.

ATTACHMENT THREE-B5

To: Robert E. Wilcox, Commissioner, Utah Department of Insurance
 From: Linda L. Lanam, Vice President, General Counsel and Secretary, Life of Virginia
 Date: Aug. 27, 1996
 Re: NAIC Annuity Disclosure Model Regulation; Recommendations From Technical Resource Advisors

On Aug. 15, 1996, the technical resource advisors on annuity disclosure requirements met in Washington, D.C. From the Life Disclosure Working Group meeting in Kansas City on July 24-25, 1996, we took away several substantive questions to be answered relating to our proposal that annuity disclosure requirements be approached somewhat differently from those for life

insurance. We realized that we would not be able to respond to all of the requests of the Working Group prior to the upcoming NAIC meeting in Anchorage. Therefore, the primary goal of our August meeting was to identify for you and the other members of the Life Disclosure Working Group the information we believe needs to be disclosed to purchasers of annuities and to describe how such disclosure would be effected for those annuities to which the proposed model regulation would apply. The results of that effort are set out in this letter.

In addition, a subgroup of the advisors is specifically looking at how our proposal would apply to equity-indexed and two-tier annuities. Another group is working on how to include our proposal in the draft Disclosure Standards which would serve as the "blueprint" for the model regulation. Both of those groups intend to have their initial work concluded and reported on prior to the Anchorage meeting, but we were not able to include them in this submission.

As we have stated previously, we believe that an annuity disclosure regulation should not apply to variable annuities or other registered contracts, fully guaranteed annuities, structured settlement annuities or annuities purchased to fund pension plans. Further, it is the sense of the Technical Resource Advisors that what problems we have identified as being connected with a lack of disclosure in annuity sales are not related to sales illustrations, since illustrations comparable to those for life insurance policies are not commonly used with annuities. We recognize that some individual purchasers of annuities have complained of a lack of understanding of how surrender charges operate and how interest rates may change after the initial guarantee period. In fact, much, if not all, of the information we believe necessary is made available to many customers already, but perhaps is not sufficiently emphasized to assure recognition. We believe that these are issues which can be better dealt with by providing a brief, tightly focused disclosure document than by producing a full basic illustration.

It is the recommendation of the Technical Resource Advisors that every individual purchaser of an annuity to which the model regulation would apply should receive materials containing the following:

- proper identification (1) of the product as an annuity and (2) of the issuing insurer (NOTE: An emphasis on the intended long-term nature of the product and a description of the annuitization phase and available pay-out options could be included.);
- a description of the application of surrender charges (NOTE: A statement such as "surrender charges may apply" alone would not be sufficient.);
- an explanation of current interest rate crediting (and the initial rate guarantee period) and the guaranteed interest rate and an explanation of how future interest rates will apply;
- statement of whether a death benefit is available;
- a description of the effect of current tax-law on the annuity's accumulation values and on withdrawals from those values;
- a statement of other policy charges and fees.

We believe that the purchaser of the annuity should acknowledge the receipt of the disclosure document in a sale involving an agent. However, we do not believe it is necessary that the document be personalized.

As per Tom Foley's request, some sample materials are enclosed. The first group is of annuity sales materials currently in use. These materials contain most if not all of the recommended disclosure information and in some cases provide for a signed acknowledgment by the purchaser. However, the disclosures are not always specifically highlighted. These materials are used in various distribution systems and, particularly in the case of bank sales, include statements required by non-insurance regulators. Also included is a sample of a disclosure statement which contains all the information required under our proposal and would be produced separately from any other marketing materials.

One point that I want to emphasize is that the technical resource advisors are not proposing that the Working Group leave annuity illustrations unregulated. We agree that when an illustration is used, for example, to demonstrate growth in future policy values or to show potential annuitization payouts, it should meet certain basic requirements to be set out in the model regulation. However, we do not believe that an illustration should be required in all sales. This is our purpose in proposing the disclosure document described above.

As you know, I will be unable to attend the NAIC meeting in Anchorage. However, I have asked Bill Fisher and Charlotte Liptak to be available to respond, on behalf of the technical resource advisors, to any questions or concerns on the part of the Working Group. In addition, if there is anything further that you believe is necessary prior to the meeting, please do not hesitate to contact me.

ATTACHMENT THREE-C

Annuity Disclosure Document Standard
Draft: 9/9/96

The following represents work done by technical resource advisors and the Annuity Disclosure Working Group of the American Academy of Actuaries' Committee on Life Insurance.

I. Background Statement

A. For life insurance policies, a model regulation has recently been developed. This model regulation was developed because in recent years the "illustration" has become a standard part of the life insurance agent's sales presentation and over those years some problems have evolved in these illustrations.

B. Annuities, though becoming more varied to satisfy a broader range of consumer needs, have generally not been sold with an illustration. Many also are sold in markets in which they compete with other financial instruments with a variety of disclosure requirements.

C. The differences between these products and markets have led to a different set of issues for annuity sales than for life sales. The issues with annuities have been identified as lack of understanding that:

1. The product is an annuity.
2. There may be different renewal interest rates after the initial guarantees.
3. There may be restrictions on access to benefits.
4. There may be surrender and other charges applicable for a period of time after issue.
5. There may be federal income tax impacts.
6. There may be death benefits as well as annuitization benefits.

D. To solve these problems, a disclosure document needs to be available. If an illustration is provided in addition to a disclosure document, any values must be consistent with the disclosure document.

II. Scope

A. A disclosure document should be required for all annuity sales except those exempted in Section B below. In addition, the company must be able to demonstrate delivery of the disclosure document to the prospective contract owner.

B. The disclosure document should be mandatory for all group and individual annuity policies except the following:

1. Variable annuities or other registered contracts.
2. Fully guaranteed annuities.
3. Annuities purchased to fund an employee pension plan covered by the fiduciary standards of ERISA or under a governmental, church, excess benefit, or "top-hat" plan (as described in ERISA) or a plan described in Sections 401(a), 401(k) or 457 of the Internal Revenue Code.
4. Structured settlement annuities.

III. Understandability

A. The goal is that the disclosure document should be understandable with minimal assistance from an insurance agent.

B. The focus of the disclosure document must be consumer education.

IV. Contents of Presentation

The disclosure document must include the following items:

A. Description of the product as:

1. An annuity.
2. A long-term contract.

3. A product which has periodic income available.
 - B. The company's name and address.
 - C. The guaranteed interest rates and their durations, an explanation of the current crediting rates and an explanation of how future interest rates will apply.
 - D. Surrender charges, their durations and how they work.
 - E. Any other fees or charges, their durations and how they work.
 - F. How benefits can be accessed.
 - G. Description of death benefit features, if any.
 - H. Explanation of federal income tax treatment.
- V. Annual Reports
- A. The insurer shall, at least annually, provide a report to each contract owner.
 - B. At a minimum, the report shall provide actual values as of the date of the report.

ATTACHMENT FOUR

Annuities Working Group
of the Life Insurance (A) Committee
Anchorage, Alaska
September 30, 1996

The Annuities Working Group of the Life Insurance (A) Committee met in Space 4 of the Egan Center in Anchorage, Alaska, at 9 a.m. on Sept. 30, 1996. Jerry Fickes (N.M.) chaired the meeting. The following working group members or their representatives were present: Woody Gridon (Calif.); Roger Strauss (Iowa); Randi Reichel (Md.); Angela Ford (N.C.); Rick Morse (N.Y.); Tom Foley (N.D.); Robert Katz (Ohio); Richard McGavock (Ore.); and Dixon Larkin (Utah).

1. Consider Definition of an Annuity

Barbara Lautzenheiser (Lautzenheiser & Associates) reported on a project that she was assigned at the Summer National Meeting. Ms. Lautzenheiser referred the working group members to a letter that she wrote as a representative from the Annuity Definition Working Group of the American Academy of Actuaries (AAA) Committee on Life Insurance (Attachment Four-A). She said the AAA's group is attempting to identify annuities that fall outside the parameters of the annuities definition included in the minutes of the Summer National Meeting, and the list prepared by the Annuity Disclosure Working Group, but that should be included in the list. She said the next project of her group will be to work on a glossary describing different types of annuities. Jerry Fickes (N.M.) asked the working group members what they thought of the idea of development of a glossary. Woody Gridon (Calif.) said he thought it would be helpful also to list some things that are clearly *not* an annuity. He said that the Senior Issues Task Force had looked at some of these issues and suggested Ms. Lautzenheiser review that work before proceeding. Tom Foley (N.D.) asked if the glossary would be a collection of annuity terms or types of annuities. He asked if there were some products that did not have periodic payments that could be called annuities. Richard Minck (American Council of Life Insurance—ACLI) said that, for purposes of federal income tax, some things are clearly considered annuities, but might not meet a definition including periodic payments. Ms. Lautzenheiser agreed to report to the working group at the Winter National Meeting. Mr. Fickes suggested that the ACLI and the AAA also send letters to their membership asking for suggestions. Christine Cassidy (AAA) suggested that all comments be funneled through or copied to the AAA.

2. Discuss Annuities and the Senior Population

Robert Katz (Ohio) said he had agreed to prepare a report for the Fall National Meeting on some of the issues that presented problems in his insurance department (Attachment Four-B). Mr. Katz said that issues regarding the sale of annuities to seniors mirror in many ways the problems in sales to other citizens, and are not specifically problems of seniors. He suggested that some of the problems are misrepresentation of terms, surrender charges and withdrawal conditions; overselling a product to produce commissions; replacements without full disclosure; misrepresentation to side step company underwriting controls; and misrepresentation of tax features. He drew the attention of the working group to an outline attached to his letter and suggested it as a beginning point for discussion. Mr. Katz asked if age was a legitimate reason for special regulatory treatment and Mr. Gridon responded that, when you look at the overall population, the senior population contains a larger proportion of people who are not in the best position to make these decisions. Some persons reach a point when they are unable to make these decisions and there needs to be some arbitrary line drawn simply because more people in that group fit the description of those who need special treatment. Richard McGavock (Ore.) pointed out that some characteristics do apply to the senior group as a whole, regardless of their special disabilities. He said that perhaps persons in the seniors group might be more trusting

because of the era during which they grew up. Mr. Gridon suggested that it might not be appropriate to *prevent* the sale of annuities at a certain age, but perhaps regulators should build in additional safeguards. Mr. Foley pointed out that, when people discuss annuities, they often assume that the individual will annuitize the policy, and at some age that alternative does not make sense, but because of the tax laws, some people are using annuities as tax-deferred accumulation vehicles. From that viewpoint there may not be a time when regulators can say the sale of an annuity is not appropriate. Mr. Fickes suggested consideration of protections such as setting a dollar amount limit, changing the number of years of surrender charges, or limiting commissions after a certain age. Mr. Katz said one of the important keys is disclosure. He said this had been discussed in the Life Disclosure Working Group and in a two tier annuity discussion several years ago. Roger Strauss (Iowa) pointed out that, just because an individual reaches a certain age, he is not senile and cautioned against going too far with a "big brother" approach. Rick Morse (N.Y.) said he had serious concerns about suitability. At the end of the surrender charge period, agents tend to suggest individuals roll over the annuity into another product, and he found that trend disturbing. Randi Reichel (Md.) questioned if it is possible to discuss suitability issues without identifying the product. Mr. Fickes agreed that it would be appropriate to review each of the types of annuities in the glossary being developed for senior suitability problems. Christian Uhlmann (Alaska) said that the suitability issue is to a great extent an issue of disclosure. Mr. Gridon suggested that states look at the suitability requirements under the Securities and Exchange Commission and state securities laws as a starting point. Bob Glowacki (Aegon USA) said these same issues had come up in the context of long-term care insurance and a working group had developed guidelines for suitability that were very workable. That group talked about issues to be considered, rather than determining that a particular policy was not suitable and prohibiting the sale of that product to a senior citizen. Mike Velotta (Allstate Insurance Company) cautioned against the use of the term "suitable" in annuities because of liability concerns. He suggested it is more appropriate to talk about sales that are in the "best interest of the consumer" so that baggage from securities laws do not come into the annuity sales arena.

Mr. Fickes asked the group's opinion as to why states have not widely adopted the NAIC models on annuities. He wondered if they were inadequate in some way and needed revision. Mr. Foley opined that states have not adopted very many laws on annuities because in the past it had been just a sleepy little market, but, because of the aging of the baby boomers, the annuity market is receiving a great deal of attention and he suggested it would continue to explode as long as tax laws do not change, and that the sales of annuities will pass those of life insurance.

Mr. Fickes asked the members of the working group to list situations that raise suitability concerns for them, such as a long surrender period. He asked the working group members to provide that list to Carolyn Johnson (NAIC/SSO) by Nov. 15 for distribution to the working group and subsequent discussion at the Winter National Meeting. Mr. Fickes also asked Ms. Johnson to prepare an outline of questions for a survey of states as to reasons that the annuity models had not been adopted. He asked that survey outline to be circulated to the members of the working group by the end of October and for a conference call to be scheduled for subsequent discussion. Mr. Gridon suggested putting in a list of key responses to simplify the task of compiling responses, such as for political reasons, because it is a bad model, etc. Angela Ford (N.C.) suggested at the same time asking states to provide any suitability requirements that are contained in their laws.

3. Discussion of Equity-Indexed Annuities

Charlotte Liptak (Transamerica) provided the working group with basic information about equity-indexed annuities. She said the product is a deferred annuity allowing an individual an opportunity to participate in the equity market with a limited downside risk. She said the product has been offered in Europe for a longer period of time, but it is relatively new in the United States. She said it allows for a higher return without all the risk inherent in a variable annuity product. She described several variations possible in the contract, including the participation rate (the amount of the payment that is included in the investment aspect), the floor (the guaranteed cash value), the cap (the maximum return) and the term period (the amount of time that the company may limit or forbid withdrawals). Ms. Liptak also pointed out that there were several ways to calculate the amount of the equity-indexed benefit. Some contracts provide for a point-to-point comparison: compare the starting figure with the ending figure and credit that increase. Some have a high watermark provision in the contract: compare the starting figure with the anniversary figures and use the highest of those as the crediting amount. Some contracts use an average: look at a series of points and average those and compare that to the starting point. She said some plans prohibit withdrawals and others allow them with some type of penalty or for a limited amount. Ms. Liptak noted that this is an annuity product and subject to the disclosure requirements being prepared by the Life Disclosure Working Group.

Mr. Foley said that he had some concerns about this product. He expressed concern that non-NASD (National Association of Securities Dealers) licensed people were selling equity-indexed annuities, and he wondered if consumers would really understand the disclosures. He predicted that at some time in the future the same problems would surface as had surfaced in vanishing premiums and replacement. He said the unanswered questions about reserves also concerned him. Mr. McGavock reminded the group that in some states approval of policy forms or even filing of them is not required, so some states may not even be aware that equity-indexed annuities are being sold. Ms. Liptak said she thought the product raises two major concerns: 1) how to disclose to the consumer and 2) the reserving and accounting issues, and how the company is supporting its obligation with its investments. Mr. Fickes said the Life Disclosure Working Group will consider the disclosure issues and suggested asking the Life Insurance (A) Committee to send a request to the Life & Health Actuarial (Technical) Task Force to have its Annuity Working Group look at the nonforfeiture and reserve issues. Sheldon Summers (Calif.) said the Annuity Working Group he chaired had already discussed this issue and had decided to put it on the agenda for the NAIC Winter National Meeting.

4. Standards for a Model Law on Charitable Gift Annuities

Mr. Fickes drew the attention of the working group members to a preliminary draft of a model regulation put together by his department (Attachment Four-C). He said a copy had been sent to the Council for Planned Giving, and that group had

indicated an intent to provide comment at the NAIC Winter National Meeting. He said the group voiced support for the concept because it would keep bad players out of the market. He asked the working group to review this document so that it could be discussed at the conference call to be scheduled later.

Having no further business, the Annuities Working Group adjourned at 10:50 a.m.

ATTACHMENT FOUR-A

To: Jerry Fickes, Chair, New Mexico, Annuities Working Group Life Insurance (A) Committee
 From: Barbara L. Lautzenheiser, FSA, MAAA, FCA, Annuity Definition Working Group of the American Academy of Actuaries' Committee on Life Insurance
 Date: September 19, 1996
 Re: Definition of Annuities

At the June 1, 1996, Annuities Working Group session of the summer NAIC meeting in New York City, there was a lengthy discussion regarding a definition of annuities. The following definition was suggested: "a financial product that provides a series of payments and contains a mortality risk" and was published in the minutes from that meeting. At the meeting, you requested that a subgroup determine how many of the annuities from a list previously prepared by the Annuity Disclosure Working Group of the American Academy of Actuaries' (Academy) Committee on Life Insurance (see *NAIC Proceedings 1996 Second Quarter*, pages 707-713) fall within this definition. This task has been accomplished and it was found that all of the annuities listed appear to fall within the above definition with the following exceptions and conditions:

- If structure settlements involve life contingencies, they are covered by the definition, If not, they are not covered.
- Products with lump sum only, fixed amount only or period certain only payout options would not be covered by the definition.
- Pre-need annuities are not covered by the definition.

Although all of the annuities in the Academy list are covered by this definition (with the above exceptions), this does not mean that the definition is all inclusive, covering all annuities written by life insurance companies. In addition, because of the broad nature of the definition, it includes things other than annuities, e.g., disability income, long-term care, life insurance (through dividends and settlement option benefits), workers' compensation, etc. These difficulties in finding a definition broad enough to encompass all "true" annuities while narrow enough to exclude all non-annuities plague any single definition of annuities.

It is the hope of the Annuity Definition Working Group of the Academy Committee on Life Insurance that the above analysis is helpful. Please call if you have any questions.

ATTACHMENT FOUR-B

To: Jerry Fickes, Chair, New Mexico, Annuities Working Group Life Insurance (A) Committee
 From: Robert H. Katz, Ohio Department of Insurance
 Date: September 18, 1996
 Re: Senior Issues - Sale of Annuities

At the June meeting of the working group the topic of annuity sales to seniors was discussed briefly. Ohio agreed to look into the issues of this topic and prepare a discussion draft. That draft is attached.

Issues regarding the sale of annuities to seniors mirrors in many ways the issues of life sales and other senior targeted products. The anecdotes contain:

- Misrepresentation of terms, i.e., surrender charges, withdrawal conditions, crediting rates;
- Oversell of product to produce commissions;
- Replacement of existing contracts to chase interest rates without full disclosure of financial consequences;
- Misrepresentation in the application process to sidestep company underwriting controls;
- Theft of deposits;
- Misrepresentation of tax features.

It should be recognized that a significant portion of the annuity market is sold as alternative investments for a short to medium term accumulation of funds as opposed to long-term accumulations for securing lifetime incomes. The short term investment uses many encourage turnover and replacement and other problems associated with aggressive marketing tactics. The problems that flow from this activity are unique to seniors because the buyer does not have the time to recover from unsound decisions.

One common theme appears in the problems associated with annuity sales, which is whether or not the product is suitable for the purchaser. While certain types of annuities use a prospectus as part of the sale process there are significant sales of these products without use of such disclosures. The volume of annuity sales and the increase of non-insurance distributors such as

banks, finance organizations, stock brokers, etc. point to a need for some uniformity of presentation to allow the buyer to make comparison shopping decisions.

The development of any regulation should consider there is a need to encourage individuals to save and accumulate funds for their long term use. There should be protections for the solvency of the providers to assure the long term health of the industry. There should be consumer disclosure adequate to allow the buyer to make a knowing decision.

Life Insurance (A) Committee
Annuities Working Group

Annuities Sales to Seniors
Discussion Outline

- A. Who are "seniors"?
 - 1. Is age a legitimate reason for special regulatory treatment?
 - 2. If age is appropriate, what age?
 - 3. Is there an age when no annuity sale is appropriate?
- B. When is an annuity suitable for sale to a senior?
 - 1. What are the circumstances when an annuity is not a suitable purchase?
 - 2. What are the circumstances when an annuity is a suitable purchase?
 - 3. What documentation should be maintained to demonstrate the suitability of the sale?
 - a. Maintain in company files.
 - b. Make part of contract.
 - c. Duties to review and update for changed circumstances.
 - 4. Development of uniform standards of suitability.
 - a. Development of a uniform checklist or form.
 - b. Development of record retention standards.
- C. Does product design adversely affect sales to seniors?
 - 1. Are there terms or provisions that should not be permitted in a contract sold to seniors?
 - 2. Are special disclosures needed for sales to seniors, by product type?
 - 3. What product types should be excluded from any senior regulation?

ATTACHMENT FOUR-B

Charitable Gift Annuities Act
Preliminary Draft

Section 1	Scope
Section 2	Definitions
Section 3	Certificate of Authority
Section 4	Surplus and Reserves
Section 5	Investments
Section 6	Annual Reports
Section 7	Examination
Section 8	Filing of Contracts
Section 9	Disclosure
Section 10	Severability
Section 11	Other Applicable Code Provisions

Section 1 Scope

Section identifies subject of this act.

Section 2 Definitions

Section defines charitable gift annuities, charitable organization and other terms.

Section 3 Certificate of Authority

Section requires certificate of authority and describes process for procuring of C of A.

Section 4 Surplus and Reserves

Section requires segregated asset equal to Reserves plus surplus. Defines acceptable reserve basis.

Section 5 Investments

Section describes asset & investment restrictions.

Section 6 Annual Reports

Section requires that Annual Financial Statement be filed and requires Actuarial Statement of Opinion.

Section 7 Examination

Section provides for an examination.

Section 8 Filing of Contracts

Section requires that contracts be filed with department, certain provisions required.

Section 9 Disclosure

Point of sale requirements.

Section 10 Severability

Section states severability.

Section 11 Other Applicable Code Provisions

Section identifies other applicable statutes, which may apply if they are not inconsistent with the provisions herein.

Section 1 Scope

This act applies to charitable gift annuities issued by charitable organizations as herein define and shall be known as the Charitable Gift Annuity Act.

Section 2 Definitions

- 1) "Charitable Gift Annuity" means a transfer of cash or other property by a donor to a charitable organization in return for an annuity payable over one or two lives, under which the actuarial value of the cash or other property transferred and the difference in value constitutes a charitable deduction for federal tax purposes.
- 2) "Charitable Organization" means an entity described by:
 - a) Section 501(C)(3) Internal Revenue Code of 1986 (26 U.S.C. Section 501(C)(3)); or
 - b) Section 170(C), Internal Revenue Code of 1986 (26 U.S.D. Section 170(C)).

Section 3 Certificate of Authority

- 1) No charitable organization shall receive transfer of property, conditioned upon their agreement to pay an annuity to the transferor or the transferor's nominee unless and until it has obtained from the commissioner a certificate of authority to issue charitable gift annuities.
- 2) A charitable organization shall file with the commissioner its application for a certificate of authority. The application shall be in form prescribed and furnished by the commissioner and shall be verified by two of applicant's officers. The application shall include or be accompanied by such proof as the commissioner may reasonable require that the applicant is qualified under this act. At filing of the application the applicant shall pay to the commissioner the application filing fees as specified in ____.
- 3) If after such investigation as the commissioner deems advisable, the commissioner finds that the applicant is in sound financial condition and is otherwise qualified therefore, the commissioner shall issue to the applicant a certificate of authority. If the commissioner does not so find, the commissioner shall deny issuance of the certificate of authority and notify the applicant thereof in writing stating the reasons for such denial.
- 4) The certificate of authority of a charitable organization issued under this act shall continue until suspended or revoked by the commission or terminated by the organization, subject to continuance each year by payment on or before March 1 of the continuance fee of _____ and due filing of the annual report.
- 5) Persons acting on behalf of charitable organizations to solicit the transfers of property in exchange for annuity payments shall not be required to be licensed; however, such persons must be authorized in writing by the charitable organization to act on their behalf. The charitable organization shall keep a file of such current written authorizations.

Section 4 Surplus and Reserves

1) Every charitable organization authorized by this act shall maintain a segregated account for its charitable gift annuities. The assets of the account are not liable for any debts of the charitable organization other than those incurred pursuant to the issuance of charitable gift annuities. The assets of the account shall at least equal in amount the sum of the reserves on its outstanding annuities plus a surplus of _____ % of the reserves or \$ _____, whichever is greater.

2) Reserves on the outstanding annuities shall be calculated either: i) in accordance with the Standard Valuation Law; or ii) to equal or exceed reserves calculated on the basis of the assumptions underlying the rates adopted by the American Council of Gift Annuities which are in effect at the time of issuance of the charitable gift annuity or such other assumptions as may be prescribed by the commissioner. In determining the reserves, a deduction shall be made for all or any portion of the annuity risk which is reinsured by an authorized insurer or reinsurer.

3) The general assets of the charitable organization shall be liable for annuity agreements to the extent that the segregated fund is inadequate.

Section 5 Investments

The segregated assets shall be invested in the same manner and subject to the same investment laws applicable to Domestic Life Insurers. (Endowments under Estate and Trust Law).

Section 6 Annual Reports

1) Every charitable organization authorized under this act shall annually, on or before the first day of March, file a report verified by at least two principle officers with the commissioner covering the preceding calendar year.

2) The report shall be on forms prescribed by the commissioner and shall include:

- a) a financial statement of the organization, including its balance sheet and receipts and disbursements for the preceding year,
- b) any material changes in the information,
- c) the number of gift annuity contracts issued during the year, the number of gift annuity contracts as of the end of the year and the number of gift annuity contracts, which terminated during the year,
- d) the amount of annuity payments made during the year and the amounts transferred for the segregated accounts to the general accounts during the year, and
- e) such other information relating to the performance of the charitable gift annuity segment of the charitable organization as is necessary to enable the commissioner to: i) issue certificates of authority, ii) ascertain maintenance of records, iii) assure solvency, iv) respond to consumer complaints and v) to conduct hearings to determine compliance with this act.

3) Each authorized charitable organization shall submit, as part of the annual report, a statement by a qualified actuary setting forth his or her opinion as to the adequacy of reserves. For purposes of this act, "qualified actuary" means a member in a good standing of the American Academy of Actuaries and except in cases of fraud or willful misconduct, the qualified actuary shall not be liable for damages to any person other than the organization or the commissioner, for any act, error, or omission or conduct with respect to the actuary's opinion.

Section 7 Examination

The commissioner, whenever the commissioner determines it to be expedient, may make or cause to be made an examination of the assets and liabilities and other affairs of the corporation as the same pertains to annuity agreements entered into pursuant to this act. The commissioner will keep information obtained in the course of examinations confidential until such examination is completed. The reasonable expenses incurred for any such examination shall be paid by the charitable organization.

Section 8 Filing of Contracts

1) Every authorized charitable organization shall file for information with the commissioner a copy of each form at agreement, which it proposes to issue to donors in exchange for property transferred to the organization. (Within _____ days the commissioner shall approve or disapprove the proposed agreement forms and shall notify the charitable organization as soon as practicable.)

2) Each annuity agreement form shall include the following information:

- a) the value of the property to be transferred,
- b) the amount of the annuity to be paid to the transferor or the transferor's nominee,

- c) the manner in which and the intervals at which payment is to be made,
- d) the age and sex of the person during whose life payment is to be made,
- e) the reasonable value as of the date of the agreement of the benefits thereby created, and
- f) the date that payments are to begin.

Section 9 Disclosure

1) Before accepting the property transferred in exchange for the annuity agreement, the organization shall obtain signed statements from a prospective donor acknowledging the following terms of the agreement:

- a) the value of the property to be transferred,
- b) the amount of the periodic annuity benefits to be paid,
- c) the manner in which and the intervals at which payment is to be made,
- d) the age and sex of the person during whose life payment is to be made,
- e) the reasonable value as of the date of the agreement of the benefits thereby created, and
- f) the date that payments are to begin.

2) The requirements under paragraph (1) of this section may be satisfied by having the acknowledgment be a part of the annuity agreement, which is signed by the donor.

Section 10 Severability

If any provision of this act or the application of such provision to any circumstances is held invalid, the remainder of the act or the application of the provision to other circumstances shall not be affected thereby.

Section 11 Other Applicable Code Provisions

Receivership Law
Hazardous Financial Condition
Unfair Trade Practices
Investments