

LIFE INSURANCE (A) COMMITTEE

Reference:

1996 Proc. 2nd Qtr. 646
1996 Proc. 3rd Qtr. 906

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 the Marquis II Room of the Marriott Marquis in Atlanta, Ga., at 8 a.m. on Dec. 18, 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.); Jim Long (N.C.); Glenn Pomeroy (N.D.); Kerry Barnett (Ore.); and Robert E. Wilcox (Utah).

1. Plan Strategy for Charge from Executive Committee to Consider *Harris Trust* Issue

The members of the Life Insurance (A) Committee reviewed the charge from the Executive Committee to respond to the Department of Labor Request for Information that would affect insurance company general accounts. Commissioner Dwight K. Bartlett (Md.) asked Rick Morse (N.Y.) if he would draft an initial response for A Committee consideration. Mr. Morse responded that he would be willing to do that, as he had worked on the U.S. Supreme Court brief for the *Harris Trust* case for the State of New York. Commissioner Bartlett suggested a conference call of the Life Insurance (A) Committee shortly before the Commissioners Conference in mid-January, and then taking the draft to the Commissioners Conference. Roy Woodall (American Council of Life Insurance—ACLI) said the ACLI is also working on a response to the Department of Labor Request for Information and would be happy to share its thoughts with the Life Insurance (A) Committee.

2. Report of Life Disclosure Working Group

Commissioner Robert E. Wilcox (Utah) reported that the Life Disclosure Working Group met by conference call and in Atlanta. The working group discussed implementation of the Life Insurance Illustrations Model Regulation in states and company implementation even where the state law did not require it. He noted that the working group had spent a significant amount of time developing questions and answers on the regulation. He emphasized these were not intended to be binding on states or on the NAIC, but rather to be thought of as a document to help everyone understand the intent of the working group. He also noted that the working group agreed it would be premature to consider amendments to the model until some states had implemented it and tested the model. Included is a report from the Replacement Issues Subgroup which is working on a survey of life insurers replacement practices.

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

Commissioner Bartlett expressed appreciation for the work that Commissioner Wilcox had done on this project. He suggested that, if the name of Robert E. Wilcox goes down in the history of the NAIC, it will be most importantly for his work on life insurance illustrations.

3. Report of Annuities Working Group

Jerry Fickes (N.M.) reported that the Annuities Working Group met by conference call and in Atlanta. The Charitable Gift Annuities Model Act that is being drafted was discussed and work on this will continue by conference call. Mr. Fickes expects that the draft will be ready for a hearing by the Summer National Meeting. He said the Annuities Working Group is planning a survey to ask how the NAIC can assist states by development of models on annuities. The American Academy of Actuaries (AAA) presented a draft glossary of annuities, which is expected to be completed this year. Mr. Fickes said the group discussed equity-indexed annuities and heard a presentation from the National Securities Exchange Corporation. He said that organization has started a program that will establish the account value of annuities daily.

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

Tom Foley (N.D.) said there was a lot of discussion of equity-indexed annuities in this working group meeting, the Life and Health Actuarial Task Force and other forums. He suggested that insurance department staff need more information before approval of forms. He expressed concern that staff might not understand the nuances of this product and said it would be useful to bring department personnel together at an interim meeting to increase awareness of equity-indexed products. Mr. Morse supported Mr. Foley's suggestion, but suggested that the product really goes beyond annuities. He reported receiving a filing in New York recently for an equity-indexed universal life product. He suggested formation of a separate working group to discuss equity-indexed products. Mr. Foley said the Life and Health Actuarial Task Force is asking for a charge to look at nonforfeiture and reserve issues and the Life Disclosure Working Group will be reviewing disclosure issues, so he wondered if there is a need for a separate working group. Commissioner Bartlett agreed that it might not be necessary to appoint a separate working group as long as the Life Disclosure Working Group is clear that it should include disclosure in its work. Mr. Foley responded that this has been discussed by the Life Disclosure Working Group and examples of industry disclosures are expected in early 1997 to continue that discussion. Mr. Fickes suggested there is some reason for a working group dedicated to this issue. He said that the Securities and Exchange Commission (SEC) had expressed interest in the product and it would be helpful for an NAIC group to be devoting resources to this specific area.

Mr. Fickes moved to appoint a working group to specifically look at the elements of equity-indexed funding mechanisms for insurance products. Mr. Foley clarified that this would be a request to the officers now to receive a charge to do this. This motion was adopted by the Life Insurance (A) Committee.

4. Report of Viatical Settlements Working Group

Mr. Foley reported that the Viatical Settlements Working Group is discussing a disclosure statement on the tax implications of viatical settlements. The group also discussed actuarial experience from New York encompassing 600 individuals that had died in 1995 after viaticating a policy. This information will be helpful to the working group in deciding whether the pricing included in the Viatical Settlements Model Regulation is appropriate. Mr. Foley said the working group also discussed state implementation of the Viatical Settlements Model Act and Model Regulation.

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

5. Report of Synthetic GIC Working Group

Reginald Berry (D.C.) reported that technical resource advisors had suggested eight items to the working group for discussion in the development of a model regulation on synthetic guaranteed investment contracts (GICs). Mr. Berry reported that the AAA was looking at the reserving issue for the working group and asked for a charge to complete drafting of a Synthetic Guaranteed Investment Contract Model Regulation by the end of 1997. Upon motion duly made and seconded, the Synthetic GIC Working Group report was received (Attachment Four).

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

Mr. Foley said the Life and Health Actuarial (Technical) Task Force spent a great deal of time developing a report to the Life Insurance (A) Committee on nonforfeiture. He said the model that would be developed is intended to apply to life, health and annuity products and would be an alternative to the existing nonforfeiture provisions. During early 1997, the group plans to draft model language so that discussion can proceed and the task force can see if it is really possible to get consensus on this concept. The task force also discussed equity-indexed annuities and has two actuarial guidelines to expose: one for comment and one for adoption. Mr. Foley said it appears that it will be 1998 before the task force can deal with reserve issues, so the American Academy of Actuaries was asked to begin work on this issue.

Mr. Morse drew the A Committee's attention to number seven of the appendix of the nonforfeiture report. He said he understood the only guarantee included would be the policy face value. The operational plan would be outside the contract. He suggested including in this list of considerations ramifications for ERISA and possible registration requirements under SEC Rule 151. Mr. Foley responded that those were excellent observations and the working group would include those in its considerations.

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

Commissioner Bartlett observed that if the effort to develop nonforfeiture rules is perceived as internally driven, the project will be viewed with skepticism. He said it must be seen as something that the industry needs or the commissioners will not be in favor of new nonforfeiture standards. He made an appeal to those in attendance that, if they were interested in this nonforfeiture standard, they need to make their needs known to commissioners.

7. Consider Charges for 1997 and 1998

Commissioner Bartlett asked the Life Insurance (A) Committee members to review the suggested charges. Commissioner Bartlett noted that a new Charge 11 should be added based on the earlier discussion.

The A Committee agreed to add that additional charge and moved to recommend this list of charges for 1997 and 1998.

1997 Suggested Charges for Life Insurance (A) Committee

1. Establish model requirements for policy illustrations or ledger information disclosed or made available to consumers of variable life insurance and nonvariable annuities. Recommend adoption of model regulation on non-variable annuities by Fall National Meeting. Adopt illustrations regulation on variable life insurance by Winter National Meeting, subject to coordination with regulatory initiatives of the Securities and Exchange Commission and the National Association of Securities Dealers.
2. Consider changes that may be needed to NAIC models impacting sales of life insurance to address sales on the Internet.

3. Make recommendations for new models or changes to existing NAIC model laws or regulations to address issues related to problems of churning.
4. Adopt amendments to the Viatical Settlements Model Act and Regulation. Complete an actuarial study to determine appropriate minimum payouts, and include the results in amendments.
5. Review various types of annuities and suggest to the parent committee where resolution, if necessary, should be sought. This work should be on-going.
6. Develop a model law on charitable gift annuities by the Fall National Meeting.
7. Develop a glossary of annuities by the Fall National Meeting.
8. Study and make recommendations relating to annuities and the senior population, including suitability and marketing. Make report by Winter National Meeting.
9. Develop a model law and/or model regulation for the product known as a "synthetic GIC" by the Winter National Meeting.
10. Monitor federal and state legislation that relates to genetic testing and provide input as necessary.
11. Monitor emergence of equity-indexed products and make appropriate recommendations.

1998 Suggested Charges for Life Insurance (A) Committee

1. Review Life Insurance Illustrations Model Regulation for possible changes necessitated by revision of the Life Insurance Nonforfeiture Law and state experience in implementing the model.
2. Establish model requirements for policy illustrations or ledger information disclosed or made available to consumers of variable annuities by the Winter National Meeting, subject to coordination with regulatory initiatives of the Securities and Exchange Commission and the National Association of Securities Dealers.
3. Review various types of annuities and suggest to the parent committee where resolution if necessary should be sought.

Having no further business, the Life Insurance (A) Committee adjourned at 9 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

Life Disclosure Working Group of the Life Insurance (A) Committee November 15 and December 16, 1996

The Life Disclosure Working Group of the Life Insurance (A) Committee met by conference call on Nov. 15, 1996, and in the Marquis IV Room of the Marriott Marquis in Atlanta, Ga., at 3 p.m. on Dec. 16, 1996. Robert E. Wilcox (Utah) chaired the meetings. The following working group members participated: Tom Foley, Vice Chair (N.D.); Don Koch (Alaska); Sheldon Summers (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. Implementation of Life Insurance Illustrations Model Regulation in the States

Commissioner Robert E. Wilcox (Utah) said he understood some requests had been received from companies hoping for a delayed effective date rather than implementation on Jan. 1, 1997. He said that he was not sympathetic to that because companies had known for more than a year that this date was coming. Roger Strauss (Iowa) said that Iowa is moving its effective date to Feb. 1, 1997, because the state had gone back and created an exemption for policies with an initial face value of less than \$10,000, rather than the model exemption for any \$10,000 or less illustrated amount. Utah, North Dakota and North Carolina indicated that they still intend to go forward with the Jan. 1 effective date. Commissioner Wilcox noted that companies have the option to continue to market even if their illustrations software is not ready, because they can market without an illustration or use guarantees only.

2. Exemption for Illustrations of \$10,000 or Less Value

Commissioner Wilcox asked if the working group would like to discuss further the move taken by Iowa to change the \$10,000 exemption amount. He said the issue had been discussed previously and that he thought everyone agreed that the exemption

was for policies without any illustrated amount greater than \$10,000. He said he had seen policies where the initial death benefit in early years was less than \$10,000 but could rise to \$100,000 or more later. He opined this would be a very big loophole and asked if Iowa had taken precautions to close that loophole. Mr. Strauss responded that Iowa had not, but would be monitoring activity and, if regulators saw companies abusing the exemption, Iowa would go back and change its rule to follow more closely the NAIC model. Commissioner Wilcox noted that the Iowa experiment would serve as a test case for other states. He said he believed that the \$10,000 exemption for policies with no amount illustrated greater than \$10,000 was the appropriate way to interpret the model, even though he was sympathetic to the concerns of the funeral plan industry. Rick Campbell (Mitchell Law Firm) said, as a representative of the preneed industry, he had begun by seeking an exemption for preneed funeral plans. His companies had accepted the \$10,000 instead as accomplishing the same thing, and noted that he would be asking other states to consider the same provision Iowa had adopted.

3. Questions and Answers on the Life Insurance Illustrations Model Regulation

Commissioner Wilcox said that a few questions remained that had not been resolved by the working group previously. He said some of the questions on the earlier list had been eliminated because they duplicated answers that were already there or asked questions where the answer was obvious from a thorough reading of the model. He asked the working group to consider the remaining questions for inclusion on the document being distributed to assist companies and regulators in interpreting the NAIC model regulation.

The regulators agreed to delete one question from the list and to finalize the remaining questions with the exception of one question on indeterminate premium yearly renewable term products. The regulators had received a number of comments on that question and recognized that this is a difficult question to resolve. The draft of the answer suggested that only one premium outlay could be displayed in the numeric summary and if that resulted in a death benefit of zero for the guaranteed midpoint basis, then that is what would have to be illustrated. John Mathews (Allstate Life Insurance Company) said that contract language in his company's indeterminate premium policies would not allow for a reduction of the face amount. Instead a higher premium would be collected, and he thought it was more appropriate to show that on the illustration. Ted Becker (Texas) said that it is important that the answer harmonize with the requirements of the regulation. Tom Foley (N.D.) suggested that, if an exception were to be made in the numeric summary, there would be no way to keep companies from using that same exception for universal life and other types of policies. Commissioner Wilcox pointed out that the model regulation allows a great deal of latitude in the narrative summary to describe how an indeterminate premium policy works, but sets standards for the numeric summary that would require showing the same premium for all three bases. He said an illustration that showed the policy lapsing if the current premiums were paid would alert the applicant that premiums would have to be higher. Mr. Foley suggested that anyone who had an idea of an appropriate response that would allow an indeterminate premium policy to show different premiums and create, a bright line test between indeterminate premium and other types of policies should provide that information to the working group. He indicated that the working group would consider this question after receiving comments.

At the next meeting of the working group, Mr. Foley said that he had reviewed all the comments that had been submitted and did not see a clear bright line test represented in any of them. He said all who had followed the process of development of a model law recognized that the working group had talked about one premium shown in all basic and supplemental illustrations. He opined that everyone was aware of past abuses where policyholders had been misled in this area. He suggested that it was completely inconsistent with what the model says to allow different premiums to be shown. John Booth (American Council of Life Insurance—ACLI) said the distinguishing feature is that the specified contract premium can only be changed by the company, up to the maximum listed in the contract. He said this type of policy has a fixed face amount, but a premium that can vary. He submitted a revised paragraph for working group consideration. Commissioner Wilcox agreed that the first paragraph of the ACLI response might be correct, but the second paragraph caused him concern. Chris Kite (FIPSCO) suggested that an answer showing the same premium in all three situations would require computer programming changes in the companies. The working group always had focused on disclosure, and he thought showing three different premiums was within the spirit of the regulation. He opined that to not show differing premiums would conflict with the purpose of the model. Judy Faucett (Equitable) suggested that the non-guaranteed element in an indeterminate premium term life policy is the premium discount. She suggested that the effect of that discount should be displayed. She said a lower death benefit should not be shown because it is not contemplated in the contract. Mr. Foley agreed with the interpretation given by Ms. Faucett and suggested he meet with Ms. Faucett, Mr. Kite and Mr. Booth to write a revised answer before the Life Insurance (A) Committee meeting. Commissioner Wilcox suggested that to complete the process, the group described by Mr. Foley write a revised question and answer, distribute it to the working group members, and if no member of the working group objects, it will be considered the final working group answer and incorporated in the document prepared by the working group (appearing as question 7.32).

George Coleman (Prudential) asked the working group to reconsider question 14.1 of the completed document. He said he was surprised that the answer contradicts an earlier draft. He suggested that answer did not match what the model said and that many companies would not be ready on Jan. 1, 1997, to illustrate group policies currently in force. Commissioner Wilcox clarified that the regulation is to apply to sales of life insurance. He said the intent was not to look at the effective date of the policy, but rather to look at the date of the sale to decide whether it is governed by the regulation. Mr. Foley reminded the group that there is another option if the illustrations software is not ready; companies can choose not to illustrate that type of policy until it is ready to comply. Commissioner Wilcox said that he admitted that the working group had gotten a little sloppy on its terminology, but it had been clear all along that the working group was focusing on sales. Otherwise, a company could keep on using an old illustration that was not in compliance for many years after the effective date of the regulation. Tony Higgins (N.C.) said that the North Carolina version of the regulation adds a sentence at the end to clarify that North Carolina does not intend to apply its regulation to certificates issued under group policies in force prior to 1997. Commissioner Wilcox responded that in Utah the expectation is that any sales that take place after Jan. 1, 1997, are covered. Commissioner Wilcox

asked if any other members of the working group wished to address Mr. Coleman's suggestion and none of the other members of the working group responded.

Mr. Becker asked the group to consider question 4.9 from the list of completed answers. He suggested that the answer was incomplete and asked the working group to enhance the answer to clarify it. The working group agreed to make a change to question 4.9 in the group of completed questions and answers (Attachment One-A).

4. Discussion on Actuarial Practice Notes

Mark Peavy (NAIC/SSO) expressed concern about some of the practice notes being prepared on the Life Insurance Illustrations Model Regulation. Commissioner Wilcox pointed out that the practice notes are intended to be helpful guidance to actuaries in interpreting the actuarial standard of practice, similar to the questions and answers the Life Disclosure Working Group has used to address questions about the illustrations regulation. He noted the practice notes were not binding on actuaries, but were helpful advice and invited Mr. Peavy to express his concerns to those drafting the practice notes. At the next meeting of the working group, Donna Claire (Claire Thinking) reported that Mr. Peavy's suggestions had been considered and the comments had resulted in some revisions to the practice notes. She said the practice notes are currently awaiting board approval and would become effective as soon as that occurs. She said that Mr. Peavy had indicated one of the practice notes conflicted with question 11.8 on the NAIC's questions and answers document. Ms. Claire said that, in her opinion, question 11.8 was not consistent with the regulation. Commissioner Wilcox said he did not agree that question 11.8 was inconsistent with the model, so he suggested that there could be a problem with the practice note.

5. Request to Consider Additional Generally Recognized Expense Table (GRET)

Milliman & Robertson actuaries suggested an additional GRET to the working group as an alternative to the one adopted by the Life Insurance (A) Committee in September 1996. Since no one was present from Milliman & Robertson, Commissioner Wilcox asked Ms. Claire to comment on the suggested GRET. Ms. Claire agreed that the GRET already adopted probably was not as accurate as it could have been. She said the Society of Actuaries anticipates improving its GRET during 1997 when complete 1996 data becomes available. Commissioner Wilcox suggested to the working group members that an additional GRET as proposed by Milliman & Robertson be considered at the same time as a revised Society of Actuaries GRET is discussed. Ms. Claire said the Society of Actuaries GRET should be available in June 1997.

6. Technical Amendments to the Life Disclosure Model Regulation

Commissioner Wilcox noted that there had been some discussion of whether it would be appropriate to prepare technical amendments to the illustrations regulation. He said that, in his opinion, it would be counterproductive to do so at this time. He noted that other projects need to be completed first and felt strongly that it was important to finish the illustrations regulation for annuities and variable life before thinking about technical amendments. Mr. Strauss agreed that it would be premature to consider changes before any of the states had had an opportunity to implement the regulation.

7. Report of the Replacement Issues Subgroup

Paul DeAngelo (N.J.) reported that the Replacement Issues Subgroup began its work at the Summer National Meeting and met several times by conference call and at the Winter National Meeting in Atlanta to further discuss a survey of insurance companies' replacement practices. In responding to comments from the public, the working group revised the survey to address concerns for the potential of increased litigation. The working group is soliciting comments from the life insurance industry on this revised survey and also considering a list of suggested topics to be included in a revised NAIC model. Upon motion duly made and seconded, the report of the Replacement Issues Subgroup (Attachment One-B) was received.

8. Discuss Charges for 1997 and 1998

The working group agreed to ask for the following charges for 1997:

1. Establish model requirements for policy illustrations or ledger information disclosed or made available to consumers of variable life insurance and non-variable annuities. Recommend adoption of model regulation on non-variable annuities by Fall National Meeting. Adopt illustrations regulation on variable life insurance by Winter National Meeting, subject to coordination with regulatory initiatives of the Securities and Exchange Commission and the National Association of Securities Dealers.
2. Consider changes that may be needed to NAIC models impacting sales of life insurance to address sales on the Internet.
3. Make recommendations for new models or changes to existing NAIC model laws or regulations to address issues related to problems of churning.

Suggested Charges for 1998:

1. Review Life Insurance Illustrations Model Regulation for possible changes necessitated by revision of the Life Insurance Nonforfeiture Law and state experience in implementing the model.

2. Establish model requirements for policy illustrations or ledger information disclosed or made available to consumers of variable annuities by the Winter National Meeting, subject to coordination with regulatory initiatives of the Securities and Exchange Commission and the National Association of Securities Dealers.

9. Any Other Matters Brought Before the Working Group

Mr. Foley expressed appreciation for the work that Commissioner Wilcox has done with the Life Disclosure Working Group over the past two and one-half years that he has served as chair of this working group. Mr. Foley said that the working group had accomplished a great deal under the leadership of Commissioner Wilcox and he and the other members of the working group were very appreciative of the time commitment and the leadership of Commissioner Wilcox.

ATTACHMENT ONE-A

Questions & Answers Life Illustrations Model Regulation as of Dec. 17, 1996

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 1. Purpose

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 does not apply to the information contained in the actual policy.

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 nonguaranteed 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.

3.3 Will benefits provided by membership in a fraternal have to be included in the illustration?

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.

3.4 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?

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 basic life insurance illustration. According to Section 6B, the policy being illustrated cannot be

represented as anything other than a life insurance policy. A supplemental illustration may show other assets as long as the requirements for a supplemental illustration are met.

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?

If any nonguaranteed elements are shown, the guarantees must also be shown.

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.

4.13 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.

4.14 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.

4.15 Would a sales brochure showing values in a chart or graph be considered an illustration?

Yes, if it contains nonguaranteed elements over a period of years, it would be an illustration and all of the model requirements would have to be met.

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.

5.7 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.

5.8 Are payroll deduction sales of small (but more than \$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?

Group sales are not exempt from the regulation, but rather follow the requirements of Sections 5C and 5D.

5.9 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.

5.10 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?

No.

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.

6.4 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.

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."

7.26 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 premium amount must be shown clearly on this page. The cumulative premium is not required.

7.27 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.

7.28 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)?

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 as bolding non-guaranteed values.

7.29 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 consistent with those used in the policy and should be defined in the narrative summary.

7.30 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.

7.31 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.

7.32 For indeterminate premium term products, what should the contract premiums be under the guaranteed assumptions? Indeterminate premium term, by its nature, has different contract premiums 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?

The basic illustration should follow the terms of the policy or rider. An indeterminate premium term contract has a scale of maximum premiums that are guaranteed at issue and contained in the policy or rider form. The non-guaranteed element is a premium discount that results in a scale of current premiums that are lower than the guaranteed maximum premiums.

The premiums shown in the numeric summary and the tabular detail should follow the terms of the policy or rider. Some indeterminate premium term products provide that, whenever the scale of current premiums increases, the automatic option is that the death benefit will decrease and the premium paid will remain level. In that instance, the premium illustrated is constant for all three bases (guaranteed, non-guaranteed and midpoint) and the death benefit will vary to match the premium. Other indeterminate premium term products require that, whenever the scale of current premiums increases, the automatic option is that the premium must be increased to maintain the death benefit. In this situation, the premiums will vary for each of the three bases (guaranteed, non-guaranteed and midpoint) while the death benefit is held constant.

An indeterminate premium term contract can be differentiated from a flexible premium contract through the presence of an explicit scale of guaranteed maximum premiums contained in the indeterminate policy or rider, payment of which will assure that the indeterminate policy remains in force and maintains the level of death benefit. It is the insurance company, not the policyholder, that determines the premium that must be paid to maintain the benefit in force under the indeterminate premium contract. If the policyholder has the contractual right to pay a policy or rider premium that is greater, or lesser than the premium determined by the insurance company, it is only appropriate to illustrate one premium pattern for all three bases in the numeric summary and tabular detail. It should be remembered that Section 7B(2) requires that "for a policy that does not require payment of a specific contract premium, the illustration shall show the premium outlay that must be paid to guarantee coverage for the term of the contract" in the narrative summary.

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.

9.10 "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?

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.

9.11 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.

9.12 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?

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

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
2. Age
3. Underwriting or Rating Class
4. Type of Policy
5. Initial Death Benefit
6. Dividend Option

Male _____ Female _____

\$ _____

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: _____

An illustration conforming to the requirements of the model must be prepared and personally delivered by the agent at or prior to delivery of the policy.

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.

10.2 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?

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.

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 Model Holding Company System Regulatory 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 System Regulatory 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, generally recognized expense table (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.

11.21 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?

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.

11.22 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 11.21 above.

11.23 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. 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, 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.

11.24 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.

Section 14. Effective Date

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

The regulation applies to any sale that occurs on or after the effective date. If a group plan includes sales to new employees, those sales would be covered by the regulation.

ATTACHMENT ONE-B

Report of the Replacement Issues Subgroup
of the Life Disclosure (A) Working Group
October 30 and December 17, 1996

The Replacement Issues Subgroup of the Life Disclosure (A) Working Group met by conference call on Oct. 30, 1996, and at the Winter National Meeting in Atlanta, Ga., on Dec. 17, 1996. The following working group members participated: Paul DeAngelo (N.J.), chair; Paul Hogan and Gregory Harris (Ariz.); Robert Heisler (Ill.); Jo Oldson (Iowa); Lester Dunlap (La.); Cindy Martin (Mass.); Frederick Schumpe and Cynthia Amann (Mo.); Jeff Angelo and Rich Morse (N.Y.); Tony Higgins (N.C.); Kip May (Ohio); Joel Ario (Ore.); Ted Becker (Texas); and Charlie Merriman (Vt.).

1. Survey of Insurers

Paul DeAngelo (N.J.) thanked those who had prepared comments for working group consideration on the survey of insurers' replacement practices and said the subgroup would respond to the comments. The American Council of Life Insurance (ACLI) provided extensive comments on its concerns, and Mr. DeAngelo said the comments would not be set aside without an attempt to address the issues raised by the ACLI. Mr. DeAngelo said the ACLI questioned whether it was necessary to do a survey. He said it was useful for the NAIC's group to conduct its own survey to increase the validity of the resulting recommendations. He also noted that it was important to document where companies have changed their procedures voluntarily to implement the recommendations of the ACLI or the National Association of Life Underwriters (NALU).

When the working group reconvened at the Winter National Meeting Mr. DeAngelo presented a second edition of the replacement issues questionnaire that had been revised to address many of the concerns articulated by the ACLI (Attachment One-B1). Mr. DeAngelo said he recognized that the ACLI had presented legitimate concerns of the industry that some of the information could make the insurance industry susceptible to suit. Mr. DeAngelo said he had removed most, if not all, of the historical data request. He said the purpose of the survey and of the subgroup was to make sure that replacement problems did not occur again. He said with this revised survey the subgroup would start with the assumption that the problems uncovered in a recent multistate market conduct examination had occurred in much of the industry. He said the survey is still needed to determine whether the industry had been able to fix its own problems or whether there are some areas where the NAIC needs to draft a model. Mr. DeAngelo opined that a major long-term solution would be to remove the financial incentive for the agent to replace a policy, and to have instead a financial incentive to keep the policy in force. Mr. DeAngelo said there would be an opportunity for further comment on the revised survey before the subgroup finalized it for distribution. Robert Heisler (Ill.) questioned whether the information would be compiled in the aggregate or left as individual company information. Mr. DeAngelo responded that it would not be necessary for the subgroup to know from which company the information came. The subgroup had looked at procedures to keep confidential the identity of individual companies.

Tony Higgins (N.C.) said he found a lot of merit in the recommendations of the NALU and would like to see the group combine its efforts with those of the ACLI and NALU before making recommendations. Marybeth Stevens (ACLI) suggested starting out with the NAIC's model on life insurance replacements and determining what protections are lacking. She suggested this would help get company input on narrow issues. Jeff Angelo (N.Y.) asked if some information is needed before the subgroup could proceed. He suggested that the group look at the survey question by question to see where information exists elsewhere. Joel Ario (Ore.) agreed this was a useful approach and suggested asking associations that had already provided information that would answer a question to give that information to the subgroup.

Mr. Higgins said the ACLI comments led him to anticipate a low response to the questionnaire. Charlie Merriman (Vt.) asked if the ACLI members were more likely to respond if the subgroup worked through the concerns expressed in their comments. Ms. Stevens said the conclusion of the ACLI legal department was that companies would not be able to keep the information confidential simply because the company had collected the data, so she anticipated that few companies would be willing to collect the information. Phillip Stano (ACLI) said that asking questions when they knew that companies would not be able to respond was simply a way to make the industry look bad. He said the survey created problems for the insurance industry that would be very harmful, particularly in the area of liability exposure and use of time and resources that could better be spent in other ways. Mr. DeAngelo asked if Mr. Stano's opinion had changed with the revision of the survey. Mr. Stano responded that it was certainly better than it had been before but there were still remaining questions about company liability. Ms. Stevens added that the currently legal environment was not conducive to this type of survey. She said if the NAIC had asked for the information five years prior, it probably would not have caused companies any concern.

Mr. Higgins cautioned the group not to waste too much time before getting rules in place because they are needed now. He expressed concern that waiting to see if companies would respond to a survey and then taking action if they did not would be a waste of time. Mr. Higgins suggested that the working group follow two tracks: start reviewing the NAIC model for possible changes, and, as more information comes in from survey results or otherwise, more changes can be made in response to new information. Mr. DeAngelo agreed that was a good approach. Mr. DeAngelo reiterated his position that it was important to know whether companies had implemented the ACLI's recommendations in its Industry Market Standards Association specifications or perhaps had even gone further. Ms. Stano responded that this program was just getting started so companies would not yet have had a chance to implement any of the recommendations.

Mr. Stano said that any question could be the subject of a discovery request. He said related questions to those on the survey would also be asked. Mr. Merriman cautioned the group to be careful it did not over-extend the bounds of its authority. He suggested that this subgroup meeting was the wrong forum to discuss the alleged shortcomings of the judicial system. He asked

the audience why it expected insurance regulators to solve the legal problems of frivolous law suits, "ignorant" jurors, and others that had been alleged during the discussion.

Mr. DeAngelo asked for the submission of written comments about the revised survey by Jan. 17, 1997, and asked that those comments be sent to him in New Jersey and also to Carolyn Johnson (NAIC/SSO) for distribution to the other subgroup members. Ms. Stevens said that her organization had identified sources of information that would answer many of the questions and agreed to provide that material to the subgroup also.

2. Issues to Include in a Replacement Regulation

Mr. DeAngelo said he had put together a series of questions and suggestions on key elements that would begin a discussion that was requested by Mr. Higgins to look at what types of issues might be included in a revised life insurance replacements regulation. He began the discussion by posing a series of threshold questions and asked for input on these issues. The threshold questions he identified were:

1. Should replacement transactions be treated differently than other new sales?
2. How can unreported replacements be identified and minimized?
3. How can external replacements be detected?
4. Are we confusing replacements with premium financing?
5. What kind of disclosure is meaningful to policyholders?
6. Are the interests of all three parties—policyholder, company and agent—aligned?

Mr. DeAngelo said that in the recent multistate market conduct examination one of the problems discovered was that some replacements had not been so identified. Many companies have a policy of only providing a first-year commission on the difference between the original and new face amount or if it is replacement of a policy from another company. That discouraged agents from reporting the sale as a replacement. He asked the regulators and audience to comment on suggestions for ways to identify and detect unreported replacements. Mr. DeAngelo asked the group to consider whether using the cash value or borrowing from one policy to fund a new policy fit into the category of a replacement or whether a regulation on the use of existing policy values to fund new policies should be considered. Ms. Stevens said the 12 areas targeted by the ACLI for discussion matched many of the concerns raised by Mr. DeAngelo and the issue of meaningful disclosure had been discussed extensively by the ACLI group. The group had been discussing this problem for a year but had not yet formulated conclusions.

Mr. DeAngelo asked if the subgroup members could see any reason why a model regulation on life insurance replacements should exempt internal replacements from coverage. The members of the subgroup agreed that this was not an appropriate exemption. Bob Plybon (NALU) said that his organization's task force had addressed these same questions. He said a small survey had been conducted to determine whether companies could detect the internal replacements. All of the companies surveyed had in place systems to track cancellations of policies and compare them with sales to the same individuals. He said the NALU suggested a credit for suicide and incontestability periods for replacement policies and opined that this would eliminate or reduce significantly the unreported replacements. If a death should occur during the incontestability period, the agent would be personally liable for not reporting this as a replacement.

Mr. DeAngelo drew the attention of the group to a list of suggestions for addressing replacement issues that he had prepared for working group consideration. He said many of these suggestions had come from the NALU report and from other documents provided to him. The suggestions included the following:

- credit for suicide and incontestability periods (NALU)
- original issue age rating
- 60-day free look/automatic reinstatement period (NALU)
- 60-day freeze on compensation (NALU)
- replaced policy in-force illustrations within 20 days
- compensation restructuring
- defining replacement
- orphan policyholders servicing
- requirements for training, supervision and monitoring of agents on replacement
- suitability standards for sales
- redefining replacements
- require replacing company to send reasons why replacements may not be in the best interest of policyholders (NALU)
- defining twisting or churning
- eliminate internal replacement exemption in NAIC model (NALU)
- comparison forms
- orphan policyholders should receive good service and agents who perform such services should be adequately compensated
- compensation disclosure
- require all "sales material" used by a replacing agent to be sent to the replaced company (NALU)
- compensation generally payable on new sales should be permitted to be paid to the replacing agent on replacement sales (NALU)

Mr. Plybon said that the NALU suggested a 60-day free look period and he believed this would address many of the problems. He said that during that 60-day period the commission would not be paid, the company doing the replacing would be required to provide information to the replaced company, and the company that had been replaced would have an opportunity to provide an

in-force illustration. Mr. DeAngelo expressed that while many of the suggestions have merit, some were cosmetic and that it is time to address the replacement issue, defined broadly, in a meaningful way.

Cindy Martin (Mass.) suggested that it would be helpful if the interested parties could hear a discussion among the members of the subgroup as to their ideas for appropriate replacements and their market conduct experience. This would signal to them what were high priorities of the regulators. Mr. Higgins drew the attention of the working group members to the handout that listed the regulatory proposals and said these could form a part of this discussion. They are:

1. Minimum internal audit and compliance procedures (Pa.)
2. Reporting of agent "replacement" volume (Pa.)
3. Credit for suicide and contestability (W.Va.)
4. New York Regulation 60 amendments
 - i. applicable to annuities
 - ii. definition of replacement form
 - iii. notice to replaced insurer within five days
 - iv. replaced insurer must provide on in-force policies within 20 days
 - v. 60-day cooling off period
 - vi. internal replacement controls

Mr. DeAngelo asked members of the subgroup to prepare written materials for Ms. Johnson by Jan. 17, 1997, for distribution to the working group. He said a conference call would be scheduled at the end of January where the working group would share its thoughts, and the interested parties could listen to input. Al Dawson (ACLI) said that New York's draft of a new Regulation 60 on replacement has some good additions. He said one interesting requirement was that for every sale a form was filled out and the results of the questionnaire determined whether the sale should be defined as a replacement. Mr. Plybon cautioned the working group to remember that consumers have the right to make wrong decisions, and said the working group could not legislate away the right to replace a policy. Mr. Higgins said the outline prepared by Mr. DeAngelo that pointed out issues and possible regulatory responses was a good start to drafting a new replacement regulation.

ATTACHMENT ONE-B1

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 that explain and elaborate on any specific details contained in the questions. Please answer every question as fully and succinctly as possible.

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.

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

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

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

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

- 5) 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? _____

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

7) 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 the compensation and discipline systems utilized by your company. Please equate job titles in this survey to those positions that correspond to your organization.

8) What has been your 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 _____ %

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

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

10) 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?

11) Does the company have established written disciplinary guidelines? _____

If so, when enacted? _____

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

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

14) How and to whom are disciplinary actions reported? _____

15) Are these records maintained electronically or manually? _____

16) Are any current agents or sales managers compensated solely for new agent recruitment? _____

If so, in what manner and how calculated? _____

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

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

19) Have these commission schedules been modified in the last five years? _____

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

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

22) 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? _____

23) 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? _____

24) If so, under what circumstances and to what extent are the commissions reduced? _____

25) Are paid commissions recaptured when replacements are later identified? _____

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

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

28) How are agency general managers compensated? _____

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

30) 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. _____

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

32) Please provide the Subgroup with the company's established guidelines for promotion within the marketing area. _____

III. General Sales Practices and Use Of Illustrations

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

34) Are agents provided or do they have access to, either periodically or through blanket requests, data on accumulated dividends and/or cash values on an agent's book of business? _____

35) Does the company offer agents sales illustrations that show premiums abbreviating or vanishing after a certain number of years? _____

36) Do the company's rate manuals indicate the number of years the insured would be required to make premium payments from his or her own funds? _____ Are the current dividend scales or excess interest rate included in the rate manual data? _____

37) Is an agent required to disclose with the application whether an illustration was used? _____

IV. Replacement Sales Practices and Detection

38) 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? _____

39) Does this system generate any periodic reports? _____

If so, to whom are the reports disseminated? _____

(Please provide a sample of a report produced by this system.

Please also include for monitoring both internal and external replacements.)

40) Does the company have systems for monitoring new life insurance sales that are funded by values from existing policies? _____

41) Please describe what procedures the company initiates to correct any improper replacement activity. _____

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

43) 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. _____

44) What agent training is sponsored by the company that addresses financed or replacement sales? _____

V. Portfolio and Dividend Changes

45) Circle the following to indicate the method of allocating interest to dividends that is used in calculating the dividend scales for new participating products:

Average Portfolio

Investment Generation Method

Other

46) 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? _____

VI. Complaints

47) How does your company monitor complaint volume? _____

48) What systems are currently in place to monitor agent compliance with company and regulatory requirements? _____

49) Does the company provide 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

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

51) What management reports are generated to track compliance by either the company or its marketing force? _____

52) To whom is the report disseminated? _____

Please provide a sample of each report.

53) 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 TWO

Annuities Working Group of the Life Insurance (A) Committee December 5 and December 15, 1996

The Annuities Working Group of the Life Insurance (A) Committee met by conference call on Dec. 5, 1996, and in the Bonn Room of the Marriott Marquis in Atlanta, Ga., at 9 a.m. on Dec. 15, 1996. Jerry Fickes (N.M.) chaired the meetings. The following working group members participated: Sheldon Summers and Woody Girion (Calif.); Roger Strauss (Iowa); Howard Max and Randi Reichel (Md.); Rick Morse (N.Y.); Tony Higgins (N.C.); Tom Foley (N.D.); Kip May (Ohio); Richard McGavock (Ore.); Ted Becker (Texas); and Dixon Larkin (Utah).

1. Charitable Gift Annuities Model Act

Jerry Fickes (N.M.) introduced Mike Batte (N.M.), who drafted the initial draft of the Charitable Gift Annuities Model Act and asked him to go through the draft section by section highlighting the features of the model (Attachment Two-A). Mr. Batte said he reviewed the laws or regulations of most states on charitable gift annuities and identified four major features of most of the laws: (1) a reserve requirement; (2) asset or investment requirements (solvency); (3) reporting requirements; and (4) examination requirements. Allan Keith (Keith Financial Planning) noted that many charitable remainder trusts are written with the charity as a trustee, but not a guarantor. He suggested it would be helpful to make a distinction in the scope section between that situation and where the charity guarantees payment. Mr. Batte responded that the scope sections already seem to exclude them. Mr. Fickes said it would be helpful to specifically exclude these type of trusts and asked Carolyn Johnson (NAIC/SSO) to draft a provision defining annuities that are not included under the model act such as charitable remainder trusts.

Mr. Batte drew the attention of the working group members to Section 3, which defined five areas that were most commonly addressed in state laws on charitable gift annuities. Roger Strauss (Iowa) asked if a surety should be required to be sure the funds were available when needed. Richard McGavock (Ore.) said that in Oregon special security deposits or bonds are not required because of the additional cost to the charity. He questioned whether such bonds would even be available in the marketplace. He suggested that it would have to be a large security deposit or surety to provide meaningful protection. Howard Max (Md.) reported that, when his state is doing a regulation, it adds a disclosure requirement so people would understand that the charitable gift annuity was not covered by the state's insurance guaranty fund. The working group decided to add a similar provision to Section 9 of the model.

Mr. Batte next reviewed Section 4 on surplus and reserves. He reported that many charitable organizations used the rates published by the American Council of Gift Annuities. The model was drafted with a reserve requirement calculated either on the basis of the assumptions underlining the rates adopted by the American Council of Gift Annuities or in accordance with the Standard Valuation Law. Mr. Batte said he had reviewed the rates suggested by the Council and found them to be conservative. Mr. Max said that many charities had come to Maryland's regulation hearing and had asked Maryland to change its regulation to delete a requirement to comply with reserve requirements of the Standard Valuation Law. He said the charities found this to be an onerous requirement because they did not have an actuary to calculate reserves based on the Standard Valuation Law and did not wish to spend funds in that manner. Mr. Max said the Maryland regulation draft also had included a requirement that an actuary certify to reserves, and that provision was deleted and the regulation now requires a CPA to certify the reserve. Mr. Keith said he had been unable to acquire background information on the assumptions used by the American Council of Gift Annuities and suggested that using those assumptions would not relieve the charity from the requirement to use an actuary. Initial review of the information he had been able to obtain indicated to him that the requirements were even more conservative than the Standard Valuation Law. Mr. Max reported that his experience was that the charities generally put the entire contribution in reserve so that a calculation was not required. Rick Bean (Calif.) said that California's law requires a segregated account and that provides a basic protection for charitable gift annuitants in California. Mr. Batte asked if the working group thought it would help to change Section 4A. Mr. Max said that the Maryland draft had originally been written with a segregated account and a statement that the assets of the account were not liable for other debts of the charity. He was told at the hearing that a provision such as that would mean the charitable gift annuity would not qualify as a donation under federal law. Mr. Fickes agreed to research this point.

Mr. Strauss asked if charitable organizations were providing information and comments to the working group. Mr. Fickes responded that the New Mexico charitable gift organization had been in contact with the department and had expressed concern about a requirement to use an actuary. He also added that the national group had been invited to the NAIC meetings and was aware of the working group's project.

Mr. Keith commented that the lack of uniformity in states on the issue of reserve standards created great difficulties. He said the different filing dates meant that it was necessary to recalculate the assumptions for reserves.

Mr. Batte pointed out that Section 5 of the draft requires that assets in the segregated account be invested according to the laws governing investments of life insurers. Mr. Max said that Maryland had started with that same idea, but that charities had urged instead the application of the prudent person standard under trust law. Some of the working group members suggested that some of the parts of Section 4 would be more sensibly placed within Section 5. The working group decided to consider that more thoroughly at a later meeting of the group.

Mr. Bean reported that California has a separate chapter dealing with grants and annuities, and they are not subject to the investment laws or the Standard Valuation Law. He said the charitable organizations were limited to very safe and liquid investments like government bonds. He agreed to provide a copy of the California bulletin describing their rules to the members of the working group.

The working group next turned to Section 7 on examinations. Mr. Fickes asked if the working group members thought insurance departments should be examining the charities. Mr. Max responded that charities would not want to pay for such an examination. Mr. Strauss questioned whether the states would have the staff to examine charities.

Tony Higgins (N.C.) asked if this model would put states in the position of setting standards without any authority to enforce them. He urged that such a half measure only invited headaches. He said in North Carolina any annuity had to be funded through a licensed insurer. Mr. Strauss suggested that perhaps the working group should go back to the Life Insurance (A) Committee for further direction. Mr. Fickes suggested that after general exposure of a model the working group could ask for comments and hold a hearing at the Summer or Fall National Meeting in 1997. This was the consensus of the group.

2. Survey of States on Annuity Issues

Mr. Fickes next turned the attention of the working group members to the survey of state annuity laws that he had asked Ms. Johnson to prepare. He said the document was only two pages in length with multiple choice responses so that it would be easy for states to respond. He asked for working group members' comments on additions or deletions from the survey and asked whether they thought it would be helpful information. Mr. Foley suggested that it was important for the working group to ask what kind of regulation the states have in place rather than just whether there is a law. He suggested putting together a grid with six or eight attributes common to different types of laws rather than isolating on a specific law or regulation. Robert Katz (Ohio) said the survey was good because it would be helpful in his state where there were few laws or regulations on annuities. Sheldon Summers (Calif.) said that since the nonforfeiture law was being revised, it would be helpful to include an option such as "may need revision" as one of the options for states to select.

Mr. Fickes asked those who had comments on the survey to send them to Ms. Johnson before the end of the year, and a revised version incorporating those comments would be distributed to the working group early in January.

3. Discuss Glossary of Annuities

Barbara Lautzenheiser (Lautzenheiser and Associates) reported that an American Academy of Actuaries (AAA) group is working on a glossary of terms. She said a request had been put out on the Internet to get responses from interested parties and the information being prepared by technical resource advisors to the Life Disclosure Working Group was also utilized. She said the AAA Committee on Life Insurance had not reviewed the draft, so it could not yet be considered a final report. She said the members of the drafting group expect to have this project completed by the Spring National Meeting (Attachment Two-B).

4. Equity-Indexed Annuities

Tom Foley (N.D.) reported that the Life and Health Actuarial (Technical) Task Force had spent time discussing equity-indexed annuities. He said that he and other regulators have been asking questions about the product at the last several NAIC meetings and discussing accounting ramifications and investment requirements. Mr. Foley noted the product has tremendous potential for consumers, but cautioned regulators that the product might be moving too fast because there were many unanswered questions. He said there were guaranty fund, investment and reserve implications that needed to be explored. The AAA has been asked to make reports to the Life and Health Actuarial Task Force quarterly. Mr. Foley said that one of the most important issues was disclosure so that a consumer recognized what risks were involved in this type of product. He challenged insurers to provide him with good disclosure statements that could also be shared with the Life Disclosure Working Group. Mr. Foley said at this point he had received one disclosure form from Charlotte Liptak (Transamerica) but nobody else had provided one. Rick Morse (N.Y.) agreed that regulators need to move on a fast track with disclosure of this type of product. He said it was helpful to approach it from the viewpoint of a consumer's expectations and suggested that historical experience would be meaningful. He noted that Susan Nash (Securities and Exchange Commission—SEC) said in a public forum that the SEC was looking closely to determine if equity-indexed annuities should be a registered product. James Hunt (Consumer Federation of America) agreed with the perception of urgency because he saw a great potential for disappointment on the part of consumers. He thought the public was entitled to know what chance there was that the return on the product would be a low percentage. He noted that consumers who were familiar with mutual fund investments considered the dividend reinvestment as part of the results, and might not realize that there was no similar reinvestment for this product. It was agreed that the Life Insurance (A) Committee should be informed that investment laws, examination rules and treatment by guaranty funds should be referred to the appropriate committees.

5. Presentation from the National Securities Clearing Corporation

Walter Siebecker and Karen Saperstein gave a presentation on the National Securities Clearing Corporation and its functions. The organization will soon be introducing an annuities processing service and Mr. Siebecker and Ms. Saperstein reviewed the

function of the organization and the annuities processing for members of the working group and interested parties. The program would provide daily values of annuities to brokerage houses in their client base. They would also handle the exchange of paper records (paperless in many cases) between the insurance company, the broker or brokerage house and the annuitant.

6. Charges for 1997 and 1998

Mr. Fickes said the first decision that should be made would be whether to recommend continuation of this working group in 1997. Mr. Katz responded that the NAIC needs a forum for discussion of annuity issues. He said it was too important to risk being ignored. Mr. Fickes responded that this had been the original reason for the working group's existence. The working group agreed on the following charges for 1997:

1. Review various types of annuities and suggest to the parent committee where a resolution if necessary should be sought. This work should be ongoing.
2. Develop a model law on charitable gift annuities by the Fall National Meeting.
3. Develop a glossary of annuities by the Fall National Meeting.
4. Study and make recommendations relating to annuities and the senior population including suitability, replacements and marketing. Make report by Winter National Meeting.

The suggested charge for 1998 is:

1. Review various types of annuities and suggest to the parent committee where resolution, if necessary, should be sought.

Upon motion duly made and seconded, the working group agreed to forward these recommendations for consideration by the Life Insurance (A) Committee.

ATTACHMENT TWO-A

Charitable Gift Annuities Model Act Draft: 12/5/96

- 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

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

Section 2. Definitions

- A. (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 gift annuity" does not include a charitable remainder trust or a charitable lead trust or other similar arrangement where the charitable organization does not have a financial obligation to make annuity payments and does not issue the annuity or guarantee payments.

- B. "Charitable organization" means an entity described by:

- (1) Section 501(c)(3) Internal Revenue Code of 1986 [26 U.S.C. Section 501(c)(3)]; or
- (2) Section 170(c), Internal Revenue Code of 1986 [26 U.S.C. Section 170(c)].

Section 3. Certificate of Authority

A. A charitable organization shall not receive transfer of property, conditioned upon its 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.

B. 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 (2) of the applicant's officers. The application shall include or be accompanied by such proof as the commissioner may reasonably require that the applicant is qualified under this Act. At filing of the application the applicant shall pay to the commissioner the applicable filing fees as specified in [insert citation].

C. If after such investigation as the commissioner deems advisable, the commissioner finds that the applicant is in sound financial condition and is otherwise qualified, 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 in writing stating the reasons for denial.

D. The certificate of authority of a charitable organization issued under this Act shall continue until suspended or revoked by the commissioner or terminated by the organization, subject to continuance each year by payment on or before March 1 of the continuance fee of \$[insert amount] and filing of the annual report.

E. A person acting on behalf of a charitable organization to solicit the transfers of property in exchange for annuity payments shall not be required to be licensed; however, the person shall be authorized in writing by the charitable organization to act on its behalf. The charitable organization shall keep a file of current written authorizations.

Section 4. Surplus and Reserves

A. A 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 [insert number]% of the reserves or \$[insert amount], whichever is greater.

B. (1) Reserves on the outstanding annuities shall be calculated either:

(a) In accordance with [insert citation to the Standard Valuation Law];

(b) To equal or exceed reserves calculated on the basis of the assumptions underlying the rates adopted by the American Council of Gift Annuities that are in effect at the time of issuance of the charitable gift annuity; or

(c) Other assumptions prescribed by the commissioner.

(2) In determining the reserves, a deduction shall be made for any portion of the annuity risk that is reinsured by an authorized insurer or reinsurer.

C. 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 found in [insert section].

Section 6. Annual Reports

A. A charitable organization authorized under this Act shall annually, on or before the first day of March, file a report verified by at least two (2) principle officers with the commissioner covering the preceding calendar year.

B. The report shall be on forms prescribed by the commissioner and shall include:

(1) A financial statement of the organization, including its balance sheet and receipts and disbursements for the preceding year;

(2) Any material changes in the information;

(3) 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 that terminated during the year;

(4) The amount of annuity payments made during the year and the amounts transferred from the segregated account to the general account during the year; and

(5) Other information relating to the performance of the charitable gift annuity segment of the charitable organization necessary to enable the commissioner to:

- (a) Issue certificates of authority;
- (b) Ascertain maintenance of records;
- (c) Ensure solvency;
- (d) Respond to consumer complaints; and
- (e) Conduct hearings to determine compliance with this Act.

Section 7. Examination

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

Section 8. Filing of Contracts

A. An authorized charitable organization shall file for information with the commissioner a copy of each form of agreement that it proposes to issue to donors in exchange for property transferred to the organization. (Within [insert number] days the commissioner shall approve or disapprove the proposed agreement forms and shall notify the charitable organization as soon as practicable.)

Drafting Note: Insert the bracketed material in prior approval states.

B. Each annuity agreement form shall include the following information:

- (1) The value of the property to be transferred;
- (2) The amount of the annuity to be paid to the transferor or the transferor's nominee;
- (3) The manner in which and the intervals at which payment is to be made;
- (4) The age and sex of the person during whose life payment is to be made;
- (5) The reasonable value as of the date of the agreement of the benefits created; and
- (6) The date that payments are to begin.

Section 9. Disclosure

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

- (1) The value of the property transferred;
- (2) The amount of the periodic annuity benefits to be paid;
- (3) The manner in which and the intervals at which payment is to be made;
- (4) The reasonable value as of the date of the agreement of the benefits created; and
- (5) The date that payments are to begin.

B. In addition to the above disclosure, the charitable organization shall obtain a signed statement from a prospective donor acknowledging that he or she has been informed that payments made under a charitable gift annuity are backed solely by the full faith and credit of the organization and are not insured or guaranteed by an insurance company or backed in any way by the State of [insert state].

~~B.C~~ The requirements under Subsection A of this section may be satisfied by an acknowledgment that is a part of the annuity agreement that is signed by the donor.

Section 10. Severability

If any provision of this Act or the application of the 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.

Section 11. Other Applicable Code Provisions

1. Receivership Law
2. Hazardous Financial Condition
3. Unfair Trade Practices
4. Investments

ATTACHMENT TWO-B

A Report to the NAIC Annuities Working Group
of the Life Insurance (A) Committee
on Descriptions of Annuities
from the American Academy of Actuaries Committee on Life Insurance
December 1996

The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. In addition to setting qualification standards and standards of actuarial practice, a major purpose of the Academy is to act as the public information organization for the profession. The Academy is nonpartisan and assists the public policy process through the presentation of clear, objective analysis. The Academy regularly prepares testimony for Congress, provides information to senior federal elected officials and congressional staff, comments on proposed federal regulations, and works closely with state officials on issues related to insurance.

This report was prepared by an Academy Working Group of the Committee on Life Insurance, chaired by Barbara Lautzenheiser, at the request of the NAIC Annuities Working Group of the Life Insurance (A) Committee. The report is a draft still in process which includes general characteristics of an annuity and a glossary of various types of annuities. This report is not intended to provide a comprehensive list of annuities nor are the terms necessarily agreed to by every member of the Committee on Life Insurance. It sets a framework for discussion as the NAIC considers regulation of annuity products.

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I. Introduction

The National Association of Insurance Commissioners Annuities Working Group of the Life Insurance (A) Committee is working on a glossary of annuities and asked the American Academy of Actuaries Committee on Life Insurance to assist them in their efforts.

II. General Characteristics of Annuities

Each annuity product has general characteristics which determine the type of annuity. These general characteristics are as follows:

Immediate vs. Deferred

The immediate vs. deferred characteristic of an annuity determines when periodic payments begin. An immediate annuity is a contract for a series of periodic payments which begin on or within a short time after the issue date. A deferred annuity is a contract designed to accumulate funds with the intention of making periodic payments at some future time.

Single vs. Periodic - Premium Payments

Premiums for an annuity contract can be either a single premium or periodic premiums. A single premium contract is one for which only one premium is paid. A periodic premium contract is one in which premiums are paid over time. These periodic premiums can be fixed or flexible.

Period Certain vs. Life Contingent - Annuity Payout Benefit

The main benefit in an annuity contract is the payout benefit. This characteristic determines how long the benefit is payable. A period certain annuity pays the annuity benefit for a pre-determined length of time (e.g., 10 years). A life contingent annuity pays the annuity benefit for the life of the annuitant. Hybrids exist which combine these two characteristics (e.g., a life & 10 year certain annuity pays the annuity benefit for the greater of the annuitant's life or 10 years) or which refund all or a portion of the purchase price should the annuitant die prematurely.

Fixed vs. Variable - Accumulation

A fixed annuity contract provides principal guarantees in which the underlying assets are usually held in an insurer's general account. Some fixed annuities credit interest at only a guaranteed interest rate. Others credit interest at a crediting rate periodically declared by the insurer, but in no event lower than the guaranteed rate. Still others credit interest at two crediting rates (two-tier), with the higher fund value for annuitization and the lower fund value for cash surrender, and with each rate always greater than the guaranteed rate. Still others link the credited interest rate to an external index or reference.

Fixed vs. Variable - Annuity Payout Benefit

Under a fixed annuity payout contract the annuitant will receive the same periodic payment each time.

Under a variable annuity payout contract, the annuitant receives a payment which varies depending on the investment performance of variable funds.

Other variations in annuity payouts have emerged which base payout amounts on a pre-determined but varying value (e.g., a constant percentage increase), a formula or index (e.g., increases based on the Consumer Price Index, Standard & Poor's, etc.), or other variations.

Qualified vs. Non-Qualified

This characteristic determines whether or not an annuity is part of a "qualified" retirement plan. A qualified annuity is one that is part of a qualified retirement plan and as such meets certain requirements under the Internal Revenue Code. A non-qualified annuity is not part of a qualified retirement plan.

Individual vs. Group

An individual annuity is a contract which usually covers one named annuitant and is owned by an individual who maintains control of the contract. Although the named annuitant is often the owner of the individual annuity, there are exceptions. An annuitant under a structured settlement annuity, for example, does not have control of the contract. In addition, employers or trusts may purchase individual annuities on behalf of their employees or beneficiaries, retaining control of the contracts until and unless they are otherwise assigned.

A group annuity is a contract which covers more than one annuitant and which is owned by an employer, pension plan, association, union, or trust, which exercises control over the contract. It should be pointed out that the amount of control varies widely. A group annuity using a separate account may have a distinct separate account for each large contract holder and/or may pool assets of several contract holders in one separate account. Separate accounts may be book value or Regulation 128 separate accounts. Group annuities may also be unfunded or funded but not guaranteed.

Single Life vs. Joint Life

A single life annuity is an annuity which covers a single annuitant. A joint life or joint and survivor annuity is an annuity which covers two or more annuitants. A joint life annuity ceases payments upon the first death. A joint and survivor annuity continues payments until the last death.

Participating vs. Non-participating

An annuity may be participating or non-participating in company experience, before and/or after annuitization. Participation may occur through rate credits, dividends, excess interest or by declared rates. Participation may also occur only in certain elements (e.g., interest) and there may be different structures for sharing in the participation.

Death Benefits vs. No Death Benefits

Annuities may or may not provide death benefits before or after annuitization or both.

Guaranteed Purchase Rates at Issue vs. Non-Guaranteed Purchase Rates at Issue

Purchase rates (the rates at which a fund is annuitized into periodic payments) may or may not be guaranteed at issue. Some annuities do not guarantee purchase rates at issue, but guarantee purchase rates upon annuitization or guarantee purchase rates for a period of time during annuitization (e.g., one year).

Surrender Benefits vs. No Surrender Benefits

Annuities span the full range from no surrender value before or during annuitization to full lump sum book value at any time, in addition to lump sum book value less a surrender charge, installment payouts, market-value adjusted, formula market values, true market values, or combinations of the above.

Securities and Exchange Commission Registered vs. Non Securities and Exchange Commission Registered

Annuities may or may not be Securities and Exchange Commission registered products.

It is important to note that for any one purpose, many of the thousands of combinations of the above characteristics could be combined into a number of types of annuities. In order to determine which consolidation would be appropriate would depend upon the regulatory development in areas related to disclosure, reserving, nonforfeiture, licensing, etc.

III. Descriptions of Various Annuities

Alternate Guaranteed Investment Contract (Synthetic GIC). A group contract under which all contract assets are held by a third party custodian and are owned by the contract owner. The insurer guarantees principal and a pre-established rate of return for certain benefit payments. These contracts receive book value accounting treatment. Synthetic Guaranteed Interest Contracts are guarantees with a set interest rate for some time period for certain types of withdrawals. Funds may not even be held by an insurance company, but must meet certain underwriting guidelines to maintain guarantees.

Certificate of Annuity (COA) or CD Annuity (CDA). A variation of the single premium deferred annuity providing for a fixed guaranteed interest rate during a fixed accumulation period. Withdrawals during the accumulation period are not permitted. At the end of this period, the client may renew the COA or CDA for another period or elect another benefit option.

Equity-Indexed Annuity (EIA). An interest-indexed contract in which the external reference to which the crediting interest rate is linked is an equity-indexed reference. All, or a specified portion of the principal (e.g., 80%), is guaranteed. The contract may be funded in the insurer's general account, with the insurer purchasing a call on the equities index to get the performance return for market rises. Alternatively, the contract may be funded in an equities account with the insurer purchasing a put on the index to get the principal protection for market drops. The premium contributions participate in the gains or losses of a particular stock market or interest rate index. The EIA also has a minimum guaranteed value.

Flexible Premium Deferred Annuity (FPDA). A contract where the contract holder contributes premiums on a monthly, quarterly, or annual basis for an annuity contract with a guaranteed interest rate. Premium amounts are not fixed and thus may be increased or decreased as the client desires within contractual limits. Benefit options are available at the end of the accumulation period.

Fully Guaranteed Annuity. A contract which provides a stated return (benefit) on the premiums, with no provision for non-guaranteed amounts. Benefits may be guaranteed to increase with a stated external index, such as the Consumer Price Index.

Guaranteed General Account Contract. A contract under which all contract assets are allocated to the insurer's general account, where they are commingled with the assets of all of the insurer's other general account contracts. General account contracts may be either non-participating (e.g., guaranteed investment contracts) or participating (e.g., immediate participation guaranteed contracts or deposit administration contracts). Generally, there is a guaranteed return of principal as long as the contract is in effect. Furthermore, these contracts receive book value accounting treatment although they are subject to adjustment under certain circumstances.

Guaranteed Separate Account. A contract which has book values of participant accounts guaranteed at a set rate of interest for some time period and for certain types of withdrawals. Funds are held in a separate account and the contract is valued at market.

Interest Draft Account (IDA). A supplemental contract used for the convenience of a beneficiary. An IDA bears interest and gives the beneficiary check-writing privileges for as long as needed until a more suitable product can be found.

Interest-Indexed Annuity. A contract in which the crediting interest rate is linked to an external reference. The contract contains a minimum guaranteed value based upon a guaranteed interest rate. The insurer assumes the risk associated with the investment decisions. The assets underlying the contract are usually in a general account, especially a non-registered contract. Usually the product is marketed as a fixed annuity product. If marketed as a security under federal law, the product may be subject to a greater degree of regulation, including registration with the Securities and Exchange Commission.

Market-Value Annuity (MVA). Under these contracts, withdrawal of the cash value is subject to a market-value adjustment. Under this contract, the underlying assets are held in a fixed account and the values are guaranteed if held for a specified period. The contract contains nonforfeiture values which are usually based upon a market-value adjusted formula if held for a shorter period. Contracts may provide minimum guaranteed values in accordance with standard nonforfeiture regulations. The assets underlying the contract must be in a fixed account during the period or periods when the contract holder may surrender the contract.

Market-Value Separate Account Contract. A contract under which all contract assets are allocated to either a pooled or individual separate account. The actual investment experience of the separate account is reflected directly in the investment

results of the contract, which does not provide a guaranteed return of principal. These contracts receive market-value accounting treatment.

Modified Guaranteed Annuity. A contract, the underlying assets of which are held in a separate account, and the values of which are guaranteed if held for specified periods. The contract contains nonforfeiture values that are usually based upon a market-value adjustment formula if held in the separate account. The assets underlying the contract must be in a separate account during the period or periods when the contract holder may surrender the contract.

Retirement Annuity Contract. A contract where the contract holder contributes premiums on a monthly, quarterly, or annual basis for an annuity contract with a guaranteed interest rate. Premium amounts are fixed.

Reverse Mortgage. A form of home equity conversion specifically suited to older homeowners. The equity in the house is converted into spendable cash by providing payments to the homeowner until the due date while he/she still lives in-house. At the due date, a single sum is paid to the lender, typically by selling the house.

Single Premium Deferred Annuity (SPDA). A contract where the contract holder deposits a single sum of money in return for an annuity contract with a guaranteed interest rate for a specified period of time. Renewal rates are subject to company strategy, but typically are guaranteed for subsequent time periods. Benefit options are available at the end of the accumulation period.

Single Premium Immediate Annuity (SPIA). A contract where the contract holder deposits a single sum of money and begins to receive immediate and regular guaranteed income. Benefit options may include a defined amount of income or a period of time to receive payments. The period of time may include a fixed period, the remaining lifetime, or some combination.

Structured Settlement Annuity (SSA). This contract is an SPIA contract used in personal liability lawsuits to fund future periodic payments, based on an agreed upon schedule, for a plaintiff or other claimant to compensate or otherwise pay for a personal or physical injury or sickness suffered by the individual. The plaintiff does not own or otherwise have control over such an annuity.

Tax Sheltered Annuity (TSA). A special type of qualified annuity available only to certain individuals, such as those employed by public schools or non-profit organizations. It may be a fixed or variable annuity; premium contributions are made by the employer, and it must meet certain requirements for minimum participation and nondiscrimination.

Two-Tiered Annuity. A fixed contract which has a tier difference between the annuitization value and the cash surrender value. The tier difference is often created by a difference in the interest rates credited to the annuitization value (a long-term rate) and the cash surrender value (a short-term rate). A tier difference may also be created by greater expense charges assessed against the cash surrender value or by a permanent surrender charge. If the owner chooses annuitization at maturity, he/she will receive the higher annuitization value.

Variable Annuity (VA). A contract where the contract holder is given investment options for his/her premium deposits. Premiums are deposited into the general account or segregated separate accounts. Each separate account has a different investment goal, risks, and returns, and contract holders can transfer money between accounts without triggering taxation, subject to plan limitations. There is no guarantee of interest. Performance is based strictly on the performance of the underlying funds. Premiums may be made as a single sum or as periodic payments. Upon annuitization, the client may elect fixed payments, variable payments depending on the investment performance of the underlying account value, or a combination of the two. Underlying funds may be managed internally or externally.

ATTACHMENT THREE

Viatical Settlements Working Group of the Life Insurance (A) Committee Atlanta, Georgia December 17, 1996

The Viatical Settlements Working Group of the Life Insurance (A) Committee met in the Bonn Room of the Marriott Marquis in Atlanta, Ga., at 11 a.m. on Dec. 17, 1996. Tom Foley (N.D.) chaired the meeting. The following working group members or their representatives were present: Michael Bownes (Ala.); Don Koch (Alaska); Kevin McCarty (Fla.); Robert Heisler (Ill.); Lester Dunlap (La.); Rick Morse (N.Y.); Wake Hamrick (N.C.); Gary Chartier (Okla.); Joel Ario (Ore.); and Rhonda Myron (Texas).

1. Discuss Disclosure for Viatical Settlement Tax Treatment

Tom Foley (N.D.) asked Carolyn Johnson (NAIC/SSO) to describe the disclosure statement that she had been assigned to prepare. She said the working group had decided at the Fall National Meeting in Anchorage to prepare a disclosure document that would help consumers decide if proceeds of a viatical settlement would be taxable. Rhonda Myron (Texas) suggested that in cases where it appeared that the viatical settlement would be taxable, the language should say "your viatical settlement *may be* fully taxable." She said it was not appropriate for those distributing this disclosure statement to say the settlement would definitely be taxable. Lester Dunlap (La.) asked if there had been any consideration of how to put this document in the hand of policyholders. Gary Choades (Viaticus) applauded the working group for moving forward with this guidance and offered some suggestions for changes to the document. He suggested adding to question number two: "Is your viatical settlement provider

licensed as a viatical settlement provider in this state?" Mr. Choades also indicated that he spent some time in discussions with federal regulators and had been assured that the interpretation that would be taken by the Internal Revenue Service was that payments made to chronically ill persons could be used for any purpose and were not limited to long-term care services. He also asked how an individual will be able to determine if the provider is meeting the requirements in federal law that reference the NAIC model. He was uncomfortable with having the viator ask the provider, but he did not have an alternative suggestion. John Cutler (American Association of Retired Persons—AARP) said that the tax provisions regarding chronically ill persons were very important to his membership. He suggested this exemption be given the same level of importance as the exemption for those who have been defined as terminally ill. Mr. Choades agreed that viatical settlement funding for chronically ill persons would be an important force in the market because there are now 99 million chronically ill people in this country.

Mr. Foley encouraged more input on the disclosure document (Attachment Three-A). He asked that comments on the draft be provided to Ms. Johnson by Jan. 3, 1997, and suggested a conference call the third week in January 1997 to review those comments. Because the tax change takes effect Jan. 1, 1997, the working group felt some urgency about completing this project.

Mr. Foley asked for input from members of the working group as to the appropriate method of distribution of the disclosure statement. Mr. Dunlap responded that the insurance department can serve as an unbiased party to answer questions about viatical settlements and suggested this document would be useful for department use. Holly Roth (Viaticus) agreed that the insurance department could provide this type of information and suggested the department would also be a useful source of information on who was licensed in the state. Mr. Foley suggested that on the January conference call the working group also consider techniques for the insurance department to more formally provide information to consumers.

2. Review Status of Actuarial Study

Mark Peavy (NAIC/SSO) said that at the Fall National Meeting, Texas and New York representatives offered data on viatical settlements in their states. He said the Texas data was still being verified but he had been able to use the New York information to prepare a study of that state's experience (Attachment Three-B). The chart in Mr. Peavy's memo contains information showing individuals who viaticated a policy and died during 1995. He pointed out that the average expected months until death was in most instances larger than the average actual months until death and pointed out the variation in the percentages of face amount that were paid. Mr. Choades commented that the projected life expectancy of purchasers shown in the chart was very typical of his company's experience. He said that on the chart 6% of the viators had less than six months to live, and his company's experience was that very few viators with that short a life span desire to viaticate a policy. He said the bulk of transactions were for people who had 12 to 18 months of life expectancy. Mr. Choades pointed out, that since the New York data used only included individuals who died in 1995, many of those who had exceeded the life expectancy that had originally been estimated would not have died and thus would not be included in the study. He also asked regulators to remember the risk involved in writing viatical settlement business. He gave as an example the development of protease inhibitors, which have vastly changed the life expectancy of AIDS patients. He urged regulators not to develop a complex actuarial table. He said Congress had referred to the simple NAIC table in the Health Insurance Portability and Accountability Act of 1996, and while this was not perfect, it was easy to understand.

3. Discuss State Modifications to NAIC Model Act and Regulation

Mr. Foley drew the attention of the working group members to a summary that had been prepared itemizing ways that states had varied from the NAIC Viatical Settlements Model Act and Model Regulation (Attachment Three-C). He asked for comments from the working group members about their state laws. Kevin McCarty (Fla.) said that the Florida law had a grandfather provision for companies already in the marketplace. He said that few applications had been received at this point. Robert Heisler (Ill.) said that Illinois is preparing a regulation and would have it completed in 60 to 90 days. Mr. Foley reported that North Dakota had only received one application and it is being processed.

4. Discuss Charges for 1997 and 1998

The working group agreed that an appropriate charge for 1997 was: "Adopt amendments to Viatical Settlements Model Act and Regulation. Complete an actuarial study to determine appropriate minimum payouts and include results in amendments." Ms. Myron asked if it was the intent of the working group to only amend the payout table. Mr. Foley responded that the charge was broad enough to encompass any amendments the group might decide were appropriate.

Mr. Dunlap encouraged those who were in the business of viatical settlements to contribute to the process as amendments were being drafted and encouraged participation in the working groups of states, particularly those that had enacted viatical settlement laws.

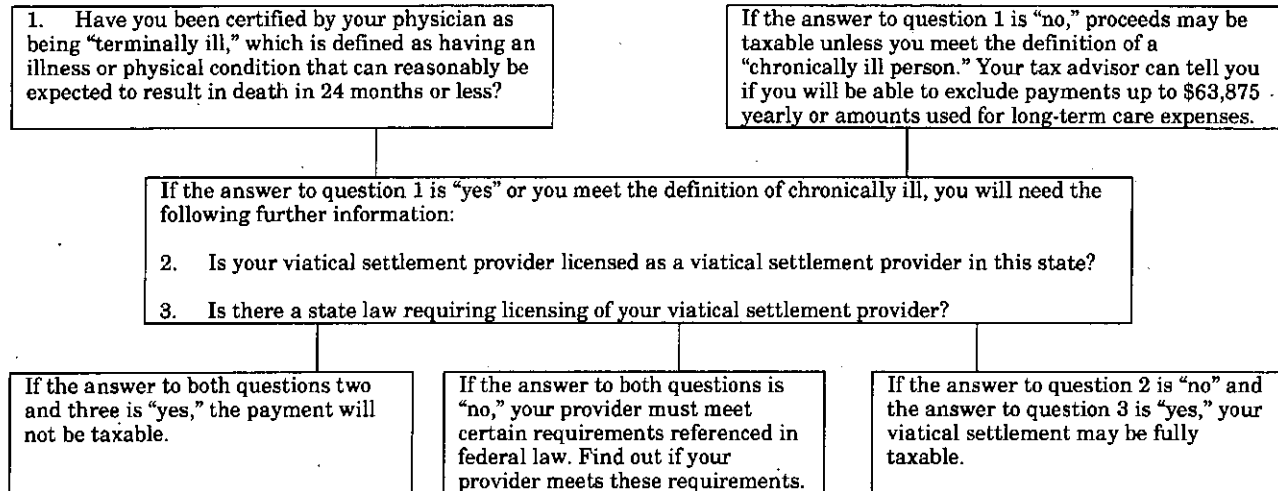
Having no further business, the Viatical Settlements Working Group adjourned at noon.

ATTACHMENT THREE-A

Disclosure of Tax Ramifications of Viatical Settlement to Policy Owner

Effective Jan. 1, 1997, life insurance proceeds received as the result of a viatical settlement are not included in federal taxable income if certain requirements are met. For further determination of your own situation, you should consult your tax advisor.

This is the information you will need:



For further information about licensed providers or other requirements, check with your state insurance department.

ATTACHMENT THREE-B

To: Tom Foley, Chair, Viatical Settlements Working Group
 From: Mark Peavy, NAIC Life/Health Actuary
 Date: Dec. 4, 1996
 Subject: Actuarial Study of Viatical Settlements

Tom, this is a brief update on where things stand on the review of the data received from the New York Department of Insurance. They were extremely helpful in their providing of data. They sent me three schedules from the 1995 annual report that viatical settlement companies file: Schedule 6, Schedule 7 and Schedule 8. These schedules represent experience from 17 companies.

Schedule 6 is somewhat comparable to Schedule O of the life insurance annual statement; i.e., it attempts to track the amount collected by the viatical settlement company when the viator dies vs. the amount which was paid to the viators. Unfortunately, the information contained on the Schedule 6s provided is essentially unusable. Most of the companies appear not to have understood how to properly complete the schedule.

Schedule 7 and Schedule 8 are very similar to each other. Part of the data recorded is: the face amount of the policy purchased, the amount paid to the viator for that policy, the date money was paid to the viator, and the life expectancy of the viator at the time the settlement was negotiated. Schedule 7 records this information for people who died in 1995 (and also reflects the actual length of time between (a) the settlement date between the viatical settlement company and the viator and (b) the death of the viator). Schedule 8 records this information for viators who sold their policies in 1995 and did not die before year-end.

In trying to analyze the New York information I only used the data in Schedule 7. There were more than 600 viators who died during 1995, so I thought that provided some fairly extensive information. Just scanning Schedule 8 it looked like there were more than 1,000 names listed there (a complicating factor in analyzing the data is that all of the information had to be entered manually). In any event, I think Schedule 7 gives us some useful information. The only thing Schedule 8 might add would be to see if there were any trends noticeable in the amount paid viators between 1995 and prior years, but that will have to wait for another study.

It should also be noted that I did absolutely no "quality control" analysis of this data. I simply manually entered the numbers as they appeared on the report. In addition to relying on my accuracy in entering the data, we will need to rely on Rick Morse of the New York Department and members of the audience at the Winter National Meeting to tell us if there are any reasons why we should be circumspect in our use of these numbers. In short, the table which follows should be regarded as very preliminary in nature until we have had the chance to publicly discuss it in Atlanta.

Shown below is my summary of the information provided in the Schedule 7s:

Number of Viators	Range of Months (M) Expected Until Death	Average Face Amount (000's)	Average Paid Viator (000's)	Average % of Face Amount	Average Months Expected Until Death	Average Actual Months Until Death	Highest % Paid a Viator	Lowest % Paid a Viator
3	0=M	\$66.67	\$47.85	72%	0.00	3.67	92%	61%
40	0<M<6	\$83.11	\$59.73	72%	5.01	3.02	92%	67%
176	6<=M<12	\$84.06	\$62.36	74%	8.27	7.29	95%	52%
265	12<=M<18	\$71.74	\$51.73	72%	13.25	9.37	89%	41%
92	18<=M<24	\$65.26	\$42.96	66%	19.20	11.97	81%	41%
56	24<=M	\$102.71	\$59.15	58%	26.41	11.80	76%	32%

I am looking forward to seeing you in Atlanta. In the meantime, please feel free to give me a call if you have any questions or comments.

ATTACHMENT THREE-C

State Variations From Viatical Settlements Model Act

Florida:

1. Statute includes list of information to submit in application, including biographical affidavit and fingerprints of board of directors, executive committee. 10% owners, etc.
2. Not deemed "untrustworthy" if convicted of felony more than five years ago and civil rights restored by governor.
3. Deposit requirement of \$100,000 or deposit of \$25,000 and \$75,000 surety bond.
4. May have license revoked if found guilty or pleads nolo contendere to felony or misdemeanor involving fraud or moral turpitude. (Expansions from model underlined.)
5. Penalty of \$2,500 for nonwillful violation or \$10,000 for each willful violation.
6. Tells effect of suspension or revocation of license and reinstatement process.
7. Broker requirements in statute include fingerprint requirement, exemption from licensing for individual licensed as a life insurance agent. May require photograph as part of application process. After 7/1/97, may require education, experience for license.
8. Viatical settlement provider may not use any person to perform functions of broker unless the person holds current valid broker license.
9. Examination section does not include confidentiality provision like model.
10. Defines more extensively the role and responsibilities of escrow agent.
11. May not negotiate viatical settlement if policy contains accelerated benefits provision allowing a payment in advance of death equal or exceeding the time period available under the viatical settlement or of an amount equal or exceeding the amount available under the viatical settlement unless the issuer of policy refused to provide the accelerated benefit.
12. Department may not directly or indirectly regulate the amount paid as consideration.
13. Private cause of action.

Illinois

1. License agents rather than brokers; agent must be appointed by at least one viatical settlement provider. Viatical settlement provider assumes responsibility for actions of appointed agents. Viatical settlement providers must keep a record of complaints against their appointed agents, as well as complaints against themselves.
2. Exempts sophisticated investors who invest in or lend to licensed viatical settlement providers from requirements of the law. Does not include model exemption for those entering into no more than one settlement agreement per year.

3. Requirement to provide director with change of business address within 30 days.
4. Must disclose any affiliation between the viatical settlement provider and the issuer of the insurance policy. Must also inform viator of any possible loss of coverage if the policy being viaticated is a joint policy or involves family riders. If there are any other benefits beside death benefits and nonforfeiture benefits, these must be described and options available to the viator discussed. These might include accidental death benefits, waiver of premium benefits, etc.
5. Agent must disclose its identity, provider's identity and the nature of the relationship between them.
6. A provider may not sell or transfer a viaticated policy except to another licensed provider or a person not required to be licensed. The insurer may not accept assignment of a policy from a viatical settlement provider not licensed in the state and shall notify the director of an attempted transaction.
7. If the viator dies during the 15/30 day rescission period, the contract is deemed rescinded subject to return of the viatical settlement payments.
8. An agent may not accept a fee from an unlicensed viatical settlement provider. A viatical settlement provider may not pay a fee to a person not appointed as its agent.
9. If the viator rescinds the contract, the provider must notify the issuer of the insurance policy within 20 days.

Indiana

1. Does not include exemption for person funding no more than one viatical settlement per year.
2. No provision for confidentiality of viators in examination.
3. Penalty: \$25,000 to \$100,000 per violation of the law.

Kansas

1. Notify the commissioner if intend to discontinue transacting business in the state.

Louisiana

1. Discounts similar to model regulation are in statute, without specifying a percentage for life expectancy longer than 24 months. Commissioner discretion to vary 10% based on current economic conditions or if policy is in contestability period.
2. Statute requires commissioner to set a bond requirement by regulation.

Minnesota

1. License automatically revoked for failure to pay licensing fees.
2. Many provisions from model regulation are included in law: report of policies viaticated, requirement for lump sum payment, discounts, etc.

New York

1. Requires delivery of booklet with information about how viatical settlements work and much of the disclosure information in the model. Must also include identity of any individual who will receive compensation for arranging viatical settlement and the terms of that compensation.
2. Broker is assumed to be agent of company unless written agreement making him agent of viator.
3. Group life insurance policy may not restrict the covered person from making assignment other than by gift.
4. Regulation specifies items to include in application, including past three years' audited financial statements, documents filed with Securities and Exchange Commission and state securities regulators, etc.
5. Required to notify department of any change of address of viatical settlement provider or broker.
6. Provider must submit pricing memorandum providing a description of the method and assumptions used in determining the value to be paid viators. Contents of memorandum specified.
7. If viator dies prior to 15-day rescission period, transaction void and money and policy returned.
8. Proposal to viaticate must include insurance contract death benefit in each of next 10 years of not viaticated, amount of death benefit to be viaticated, cash value, net cash surrender value net of loans, amount offered, accidental death benefit, other waivers, etc.

9. Insurer required to provide information requested by viatical settlement provider within 10 business days of request.

North Carolina

(No significant variations from model act)

North Dakota

1. Annual statement filed each year is report of policies viaticated and amounts paid (as in model regulation) rather than financial report.
2. No authority to adopt regulation, thus no regulation of brokers.

Oregon

1. Provider must maintain records of all transactions for five years from the date of their creation.
2. "Attending physician" is defined. He or she must make determination that viator has a terminal illness or condition.
3. Regulation requires \$150,000 in unimpaired capital or deposit with commissioner or surety bond.
4. Contract must be in not less than 12 point type, written in clear, understandable terms. May not contain any limitation or restriction on the use of the proceeds.
5. Minimum payments are generally 10% higher than in model, but may be reduced by minimum premium required to keep the contract in force for the duration of the remaining life expectancy.
6. Disclosure statement attached to regulation.

Texas

1. Registration of viatical settlement providers and brokers.
2. Broker must include with registration form a list identifying all companies or brokers from whom the broker has received or shared commissions.
3. Providers and brokers must file quarterly report of events occurring during the three-month period prior to report. Annual report of activities due in March.
4. Written materials must explain how viatical settlements work.
5. Application forms must be written in English and Spanish.
6. Viator may designate adult to receive inquiries about health of viator.
7. Viatical settlement provider must notify viator of intent to sell or otherwise transfer the policy and provide the identity of the person to whom the company proposed to transfer the policy.
8. May not discriminate between viators with and without dependents.
9. May not enter into settlement that provides "unjust" payment. Commissioner may consider several elements in arriving at that conclusion. No percentage discounts specified.
10. Must disclose to viator the amount of the compensation paid to broker upon request of the viator.
11. If viatical settlement provider sells its interest in the policy, must appoint the broker or original company to make all inquiries to the viator regarding health status and other matters.

Vermont

1. Exempts corporation or partnership buying life insurance policy of its employee or retiree from the law.
2. Provisions for withdrawal of approval of contract form.
3. Seven-day unconditional right to cancel. If die during cancellation period, contract is rescinded.
4. Fee or commission charged by broker may not exceed 2% of amount paid to viator.
5. Provider must submit bond or letter of credit in amount of \$50,000 for the benefit of the commissioner.

6. May revoke license or refuse to renew if licensee has been convicted of misdemeanor involving moral turpitude.
7. Broker must have passed life insurance examination and have had two years' experience as an insurance agent or comparable employment.
8. Broker may not be agent of provider, but has a fiduciary duty to represent the viator.
9. Regulation contains section on insurer responsibilities: insurer not required to pay a viatical settlement provider proceeds unless, on the date the viatical settlement contract was signed, it was a licensed provider. Insurer relationship with provider must be disclosed. Any accidental death benefit payable must go to the beneficiary or estate of the viator. Insurer obligation to release information about the life insurance policy within 10 days after receiving appropriate forms.
10. Standards for payments are higher than model. In addition to percentages, increased by net cash surrender value, reduced by premiums expected to keep the contract in force for the viator's remaining life expectancy. The premiums are put in trust, and if not used due to earlier death, are property of provider.
11. Method of determining life expectancy involving viator's physician and one selected by provider is detailed.
12. Disclosures required *prior to signature*. Model says by date of contracting. Disclosure form.
13. Must test readability of contracts and forms with Flesch readability formula. Score of 40 or more required. At request of viator, must provide contracts and forms in Braille, large print, etc.
14. Form for report each March 31 of types of policies viaticated, etc.

Washington

1. May levy fine of \$10,000 for each violation of chapter.
2. Provider may not transfer policy to an investor or other entity that does not hold Washington license as a viatical settlement provider. If attempts to do so, policy is returned to viator, but viator is not required to return the proceeds.
3. License application for provider requires disclosure of all 10% stockholders, officers, partners, etc. Biographical affidavits, fingerprint cards required, as well as disclosure of any regulatory action taken against any of them, or any criminal or civil action taken or pending.
4. License application of broker also requires fingerprint card. Broker must be appointed by each provider he or she represents. Broker must pass life insurance agent examination, but need not be a licensed agent.
5. Contract must be in no less than 10 point type.
6. If less than full policy value transferred, provider must obtain a bond in favor of all other beneficiaries in an amount sufficient to guarantee the payment of all premium for the balance of the premium-paying period.
7. Amount of minimum payment is less than model standards, plus provider may subtract an amount required to pay premiums, an allowance of 15% to provide for its expenses and profit, and an allowance for the time value of money, calculated at the rate of 15% per annum.

Wisconsin

1. Viatical settlement not subject to state income tax.
2. Minimum percentages of payout from model regulation are included in statute with some changes, extending out to more than 48 months.
3. Owner of life insurance policy may not be required to enter into viatical settlement as a condition for public assistance.
4. Authority to set maximum commissions for broker.
5. Many provisions from model regulation are included in law. Report of policies viaticated, requirement for lump sum payment, discounts, etc.

ATTACHMENT FOUR

Synthetic GIC Working Group of the
Life Insurance (A) Committee
Atlanta, Georgia
December 17, 1996

The Synthetic GIC Working Group of the Life Insurance (A) Committee met in the Bonn Room of the Marriott Marquis in Atlanta, Ga., at 1 p.m. on Dec. 17, 1996. Reginald Berry (D.C.) chaired the meeting. The following working group members or their representatives were present: Sheldon Summers (Calif.); Jack Gies (Conn.); Lynda Kiebold (N.J.); and Francis "Rick" Morse (N.Y.).

Reginald Berry (D.C.) asked Brian Hendeges (Ætna), coordinator of the technical resource advisors, to comment on the input that had been received on the initial draft of a Synthetic Guaranteed Investment Contracts Model Regulation. Mr. Hendeges said there was a great deal of interest in this issue and he applauded the working group for drafting a model regulation that would provide a degree of uniformity to this market place. He explained that his plan was to bring together a "core" group of a half dozen or so interested parties to meet and then to use their work product as a document to gather ideas from other interested parties. He also noted that Larry Gorski (Ill.) had pointed out the need to focus on reserves and the technical resource advisors intended to add that to their work product. Mr. Hendeges said he had communicated with the interested parties to determine their level of interest and wanted to get a full cross-section of viewpoints. He said the comments fell into a number of different categories:

1. The need to recognize a variety of products that are synthetic guaranteed investment contracts (GICs). He said the initial draft of a regulation covered only one type of synthetic GIC.
2. Several comments on reserving were included in the submissions. He emphasized the importance of building on the existing regulations on separate accounts, risk-based capital, etc., as a starting point.
3. Substantial comments were received on the scope of the regulation. The draft from the Fall National Meeting mostly applies to defined contribution plans that guarantee principle. He suggested a broader scope would be useful.
4. The proposed filing arrangement is cumbersome. He said many of the commentators expressed a desire for a master or a prototype filing rather than have each plan filed with the insurance department.
5. There were numerous comments about the required provisions in the model. Some comments suggested different approaches, and he said the technical resource advisors would review those suggestions.
6. Several comments suggested the importance of paying attention to other products that have similar characteristics.
7. The regulators are reminded there are many non-insurance competitors and it is important to keep in mind the necessity for a level playing field.
8. Miscellaneous. Mr. Hendeges said there were a number of comments on other issues that did not neatly fit in these categories.

Mr. Hendeges said the plan was for the core group of technical advisors to meet in January and provide some input to the working group at that time as to how the model regulation should look.

Mr. Morse asked for Mr. Hendeges' general opinion of the initial draft, which he said had been based on the policy in New York. Mr. Hendeges said the draft seemed to treat synthetic GICs as more risky than other insurance products, which is not necessarily true. But he said much of the draft is excellent. Mr. Morse said it was his belief that the working group should address a fairly narrow range of activities, certainly not extended to financial guaranty insurance or muni-GICs. Mr. Morse also noted it was important to look at the impact on the general account. He cautioned that a synthetic GIC contract could last for many years and during that period of time the investment strategy could change, the investment advisor could change, and there could be many other variations. He opined the regulators had valid concerns based on recent history. Mr. Morse said that there was a serious learning curve problem because many states had little knowledge of how to handle synthetic GICs and a lot of education of regulators is needed.

Mr. Morse said that it seemed to him comments about filing requirements were a major concern in the letters received so far. He said in New York a company is required to file a generic form and get it approved and then submit each contract after it has been negotiated and put into place. He asked if there was a need for a model law or whether most states would be able to put a regulation in place under their existing authority. He suggested this would be an appropriate item for review by the technical resource advisors.

Jack Gies (Conn.) asked if the basic risk being addressed was the general account. Mr. Hendeges responded that this is a large component and will surely be reviewed when the reserves section is being drafted. Mr. Gies asked if a uniform regulation could address all types of products and Mr. Hendeges responded that a challenge to the group was to be consistent and yet to address all types of policies.

Donna Claire (Claire Thinking, Inc.) said that at Mr. Gorski's request, the American Academy of Actuaries (AAA) formed a subgroup of its Life Insurance Committee to look at reserve standards for synthetic GICs. She said the AAA has a review

process in place and can help with the focus on consistency. Mr. Gies responded that he saw the involvement of the AAA as helpful.

The working group discussed and agreed to ask the Life Insurance (A) Committee for the following charge for 1997: develop a model law and/or model regulation for the product known as a "synthetic GIC" by the Winter National Meeting.

Sheldon Summers (Calif.) said his state has encountered a product with a provision where the insurance company will loan up to 50% of the contract value. He said the issue in California was how to account for that loan. He said this had an effect on risk-based capital. Mr. Gies asked what the objective was for lending up to 50% of the contract value. Ms. Claire responded that if the assets include low quality illiquid assets, such as real estate, it will not be necessary to liquidate the assets to make payments. The danger is that, if assets ultimately sell at a loss, there may not be funds to pay off the loan. The working group agreed to schedule a conference call in February to discuss the report that will be provided by the technical resource advisors. The group discussed scheduling an interim meeting and decided that might be a more appropriate activity after the Spring National Meeting.

Mr. Berry reiterated the Chair's desire to have a model regulation developed that will assist the industry to safely compete with sellers of products that are similar to synthetic GICs. In addition, he suggested initiating education efforts in 1997 designed to enlighten more regulators about synthetic GICs.

Having no further business, the Synthetic GIC Working Group adjourned at 1:50 p.m.