

LIFE INSURANCE (A) COMMITTEE

Reference:

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Terri Vaughan, Chair—Iowa.
Greg Serio, Vice Chair—N.Y.

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MINUTES

The Life Insurance (A) Committee met in the Grand E Room of the Omni Rosen Hotel in Orlando, Fla., at 9 a.m. on March 19, 1997. A quorum was present and Greg Serio, Vice Chair, (N.Y.) chaired the meeting. The following committee members or their representatives were present: Patrick E. Kelly, (D.C.); Roger Strauss on behalf of Terri Vaughan (Iowa); Lester Dunlap on behalf of James H. Brown (La.); Dwight K. Bartlett III (Md.); Don Judson on behalf of Linda Ruthardt (Mass.); Tom Rushton on behalf of Chris P. Krahling (N.M.); Tom Foley on behalf of Glenn Pomeroy (N. D.); and Don Green on behalf of John Crawford (Okla.).

1. Adopt Minutes of the Jan. 22, 1997, Conference Call

Roger Strauss (Iowa) moved, and Rick Morse (N.Y.) seconded, a motion to adopt the minutes of the Jan. 22, 1997, conference call. Mr. Morse asked the record to show that the disagreement between he and Steve Krause (American Council of Life Insurance—ACLI) referred to in the minutes was due to the fact that they were talking about different things. This miscommunication was because the rules are different for the period up to the end of 1998 and after 1998. The motion passed (Attachment Eight).

2. Consider Asking for Charge to Provide Further Input to U.S. Department of Labor

Mr. Morse gave a brief update of the issue. He said in December 1993 the U.S. Supreme Court rendered a decision in the case of *John Hancock Mutual Life Insurance Co. v. Harris Trust and Savings Bank* that made the general account of insurers subject to the fiduciary standards of the Employee Retirement Income Security Act (ERISA). Pursuant to Section 1460 of the Small Business Protection Act of 1996, the U.S. Department of Labor (DOL) must release proposed regulations by the end of June 1997, establishing standards for insurance policies and contracts that will be deemed to be in compliance with the fiduciary standards of ERISA. The regulations will apply to policies and contracts issued to pension plans and welfare benefit plans prior to Jan. 1, 1999. As of that date, all annuity contracts, life insurance policies and health insurance policies issued to employee benefit plans will be subject to the fiduciary standards of ERISA unless the contract or policy is a "guaranteed benefit policy" under ERISA. There is need for either federal statutory or regulatory action to more clearly define a "guaranteed benefit policy." In a letter from Commissioner Terri Vaughan (Iowa), chair of the NAIC Life Insurance (A) Committee, Commissioner Vaughan offered that the NAIC would be prepared to create a working group or task force to work with the DOL in the common areas of concern. In light of this offer, Mr. Morse moved that the Life Insurance (A) Committee ask for a charge to analyze the DOL's proposed regulation and provide comment. Commissioner Patrick Kelly (D.C.) seconded the motion. The motion passed.

3. Ratify Appointment of Working Groups and Their Assignments

Acting Superintendent Greg Serio (N.Y.) asked the entire Life Insurance Committee to ratify the appointment of the working groups and the distribution of the charges that had been made by Commissioner Vaughan. Acting Superintendent Serio asked for one change to the list as prepared. He asked that, pending approval of the Illinois Insurance Director, Larry Gorski (Ill.) be appointed chair of the Synthetic GIC Working Group. Mr. Strauss moved, and Commissioner Dwight Bartlett III (Md.) seconded, a motion to ratify the working group membership and charges. The motion passed (Attachment One).

4. Report of the Annuities Working Group

Tom Foley (N.D.) reported for Jerry Fickes (N.M.). He noted the working group heard a report from representatives of the American Council of Gift Annuities and said this will help in the development of the Charitable Gift Annuities Model Act. He drew the attention of the Life Insurance Committee to the Glossary of Annuity Terms that is attached to the working group report. He said this is to be distributed to the states for their use, but it is not an official document of the NAIC. Rather, it is designed to assist the states as they discuss annuities. Mr. Foley moved, and Mr. Strauss seconded, a motion to adopt the Annuities Working Group report.

Acting Superintendent Serio asked if there were any comments on the Annuities Working Group report. Scott Cipinko (National Alliance of Life Companies—NALC) expressed concern about the manner in which this document might be used. He questioned whether this document became another model of the NAIC without having gone through the process. Mr. Foley asked Carolyn Johnson (NAIC/SSO) to read the introductory paragraph to the Glossary of Annuity Terms that describes the purpose of the working group in including this document. Mr. Cipinko expressed concern that, because this document was coming from the NAIC, it would be used for more than that. Mr. Strauss responded that this document could be seen as similar to the Questions and Answers document prepared by the Life Disclosure Working Group, which is designed to be informational. Mr. Cipinko said it had been his original understanding that the document would be used to help the Annuities Working Group draft a regulation. Acting Superintendent Serio said it is a hazard of any advisory organization that someone might misuse advice. He expressed the view that the Annuities Working Group had worked hard to make sure this document was not misused. Mr. Cipinko suggested it is not the role of the Life Insurance Committee to advise states, but rather it is the role of the Plenary. Barbara Lautzenheiser (Lautzenheiser & Associates) said she had served as a facilitator in the development of the document and noted that it was very clear that this was not intended to cover every type of annuity, but rather to provide a framework for discussion. She said she thought the

Glossary of Terms was simply designed to serve as an aid. Doug Barnert (Barnert Associates) suggested the officers might look dimly at each working group making its own pronouncements. He suggested this type of document should at least go through the officers.

Acting Superintendent Serio asked if there were any further questions, and hearing none, the motion was adopted (Attachment Two).

5. Report of the Replacement Issues Subgroup

Cynthia Cadella (N.J.) reported for Paul DeAngelo (N.J.) that the Replacement Issues Subgroup had addressed a survey of insurers and development of model laws on replacement issues. She noted the subgroup had committed to development of several model laws through its 1998 charges. Mr. Strauss moved, and Commissioner Bartlett seconded, a motion to adopt the report of the Replacement Issues Subgroup. Cindy Martin (Mass.) commented that there was quite a bit of disagreement on the process that should be used by the Replacement Issues Subgroup. She noted that this was just the beginning of the process and the subgroup will make changes as it goes along. The motion to adopt the report passed (Attachment Three).

6. Report of the Synthetic GIC Working Group

Mr. Morse reported that the Synthetic GIC Working Group met and discussed the development of the Synthetic Guaranteed Investment Contract (GIC) Model Regulation. It is the intent of the working group to have the regulation and an implementing model act prepared for adoption by the end of 1997. Mr. Morse moved, and Commissioner Bartlett seconded, a motion to adopt the report of the Synthetic GIC Working Group. The motion passed (Attachment Four).

7. Report of the Viatical Settlements Working Group

Lester Dunlap (La.) reported that the Viatical Settlements Working Group met by conference call and at the Spring National Meeting and discussed matters related to its charge. It has received comments and recommendations from interested parties and will review those and the state variations in viatical settlement laws to develop a revised Viatical Settlements Model Act. An interim meeting will be held to create a first draft. He said the goal is to complete the Viatical Settlements Model Act by the NAIC Winter National Meeting and the group requested a charge to complete a revised Viatical Settlements Model Regulation in 1998. He noted that the group was considering asking for a charge about viatical settlement investment activities and described advertisements touting a 25% return for investors. The working group also discussed a tax disclosure statement that they considered vital to educate the public and discussed developing an informational brochure or pamphlet similar to one in use by the Texas Insurance Department. Mr. Dunlap said it was vital for state insurance departments to have information available to assist life insurance policyholders in making these important financial decisions. Mr. Dunlap moved, and Mr. Strauss seconded, a motion to adopt the report of the Viatical Settlements Working Group. The motion passed (Attachment Five).

8. Report of the Life Disclosure Working Group

Mr. Morse reported that the Life Disclosure Working Group met twice during the Spring National Meeting and identified three areas for discussion: 1) whether to require or prohibit an illustration for annuity products; 2) whether to develop a disclosure document; and 3) a three-level approach to illustrations for annuities. He said the working group expected to hold an interim meeting in connection with the life insurance illustrations symposium being held in Washington, D.C., at the end of April. The working group discussed equity-indexed products and reviewed a disclosure document being prepared for use in North Dakota by Mr. Foley. The working group is asking for comments on this document and Mr. Morse suggested this would be helpful to the working group in developing a model on equity-indexed products. Mr. Morse said a considerable amount of time was spent discussing equity-indexed products and the suggestion was made that the working group ask the Life Insurance Committee for permission to hold a symposium on equity-indexed products. The ACLI had offered to assist in lining up speakers for that project. The working group also discussed Internet marketing of

life insurance products and the concerns of whether companies are following the rules as adopted in several states. Mr. Morse said it was his hope that information could be disseminated to these Internet marketers so they would better understand illustration requirements. Mr. Morse moved, and Mr. Strauss seconded, a motion to adopt the report of the Life Disclosure Working Group. The motion passed (Attachment Six).

Mr. Morse also moved, and Mr. Dunlap seconded, a motion that the Life Insurance Committee authorize the working group to facilitate two seminars for state regulators and other interested parties, one in May in Kansas City and one at the Summer National Meeting, to discuss equity-indexed products. It was suggested that the motion be broadened to make clear that this could be under the auspices of the working group or handled by the NAIC's Education Department. The mover and seconder of the motion agreed this was a helpful amendment. John Booth (ACLI) suggested adding even more flexibility by not pinning the working group to a specific date. He suggested amending the motion to replace the specific date with "as soon as practicable." The mover and seconder agreed to this amendment and the motion was adopted as amended.

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

Mr. Foley reported that the Life and Health Actuarial (Technical) Task Force had considered two technical actuarial guidelines that it wished to present to the Committee. The one designated Actuarial Guideline MMM is being suggested for adoption and a revised Actuarial Guideline XXXIII is being suggested for exposure at this time. Mr. Foley said the task force continued discussion of a redraft of the Nonforfeiture Law and had extensive discussion about revising the Standard Valuation Law. He reported that the American Academy of Actuaries (AAA) has appointed a committee with Robert E. Wilcox (Deloitte & Touche) as chair to prepare background material for the task force's consideration. Mr. Foley said equity-indexed products were also discussed by the task force. Mr. Gorski is chairing a group that will report to the task force in June with regard to reserves, investments and nonforfeiture issues. Mr. Foley moved, and Mr. Strauss seconded, a motion to adopt the report of the Life and Health Actuarial (Technical) Task Force. The motion passed.

10. Discuss 1998 Charges

Mr. Foley moved, and Tom Rushton (N.M.) seconded, a motion to adopt the 1998 charges. Mr. Rushton said that Mr. Fickes had asked him to raise three additional issues to be forwarded to the Executive Committee for possible inclusion in the charges for this or some other committee at the NAIC. The three issues he felt needed to be considered were 1) the extent of guaranty coverage for equity-indexed products; 2) reinsurance of equity-indexed products; and 3) investments of insurers issuing equity-indexed products. Commissioner Bartlett suggested deleting a phrase in the charges that was unclear and the working group agreed to do so. Patty Parachini (ACLI) suggested adding a charge to consider revisions to the Accelerated Death Benefits Model Regulation. She said the committee responding to issues from the Health Insurance Availability and Portability Act of 1996 (HIPAA) were not considering changes to that model, and she thought there were inconsistencies with federal law. She suggested adding a charge for 1998 to review that model. Mr. Foley suggested that it was not appropriate to wait until 1998, but that this should be a request for a 1997 charge. The motion to adopt the 1998 charges and forward them to the Executive Committee was passed (Attachment Seven).

11. Any Other Matters Brought Before the Committee

Mr. Strauss said he recognized a problem with the 1997 charge regarding equity-indexed products and moved to request to the Executive Committee that the charge be revised. Commissioner Bartlett seconded the motion. The revised charge Mr. Strauss suggested should be worded "Define issues and achieve coordination between NAIC groups that may have assignments that impact on the issue of equity-indexed products (i.e., Internet Working Group, Life and Health Actuarial Task Force, Blanks (EX4) Task Force)." Hugh Alexander (Alexander & Crabtree) suggested that each time an innovative product came along it would require forming another working group if the committee followed this procedure. He suggested creating a standing working group to review and coordinate any type of new

products. Mr. Foley opined that the Committee had enough on its plate right now, but maybe that should receive more discussion toward the end of the year. The motion to request the revised charge was adopted.

Commissioner Bartlett moved, and Mr. Strauss seconded, a motion to adjourn. The motion passed.

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

ATTACHMENT ONE

Life Insurance (A) Committee
1997 Working Groups And Charges
Draft: 3/18/97

Annuities Working Group:

Jerry Fickes, Chair	New Mexico
Woody Girion	California
Roger Strauss	Iowa
Howard Max	Maryland
Rick Morse	New York
Tom Jacks	North Carolina
Tom Foley	North Dakota
Kip May	Ohio
Richard McGavock	Oregon
Ted Becker	Texas
Dixon Larkin	Utah

Charges:

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

Life Disclosure Working Group:

Rick Morse, Chair	New York
Tom Foley, Vice Chair	North Dakota
Don Koch	Alaska
Sheldon Summers	California
Frank Dino	Florida
Roger Strauss	Iowa
Lester Dunlap	Louisiana
Paul DeAngelo	New Jersey
Jerry Fickes	New Mexico
Tom Jacks	North Carolina
Ted Becker	Texas
Troy Pritchett	Utah

Charges:

- Establish model requirements for policy illustrations or ledger information disclosed or made available to consumers of variable life insurance and annuities. Recommend adoption of model regulation on annuities by Fall National Meeting and variable life by Winter National Meeting.
- Monitor the emergence of equity-indexed products and make appropriate recommendations.

Replacement Issues Subgroup:

Paul DeAngelo, Chair	New Jersey
Erin Klug	Arizona
Richard Rogers	Illinois
Rosanne Mead	Iowa
Lester Dunlap	Louisiana

Cindy Martin	Massachusetts
Hollis Allen	Minnesota
Cindy Amann	Missouri
Rick Morse	New York
Angela Ford	North Carolina
Kip May	Ohio
Joel Ario	Oregon
Ted Becker	Texas
Tom Van Cooper	Vermont

Charge:

- Make recommendations for changes to Life Insurance Replacements Model Regulation and on other issues related to problems of churning.

Synthetic GIC Working Group:

Rick Morse, Chair	New York
Woody Girion	California
Jack Gies	Connecticut
Reginald Berry	District of Columbia
Larry Gorski	Illinois
Lynda Klebold	New Jersey

Charge:

- Develop a model law and/or model regulation for the product known as a "synthetic GIC" by the Winter National Meeting.

Viatical Settlements Working Group:

Lester Dunlap, Chair	Louisiana
Michael Bownes	Alabama
Don Koch	Alaska
Kevin McCarty	Florida
Ron Kotowski	Illinois
Marlyn Burch	Kansas
Jim Schneider	Maine
Tom Jacks	North Carolina
Tom Foley	North Dakota
Rick Morse	New York
Comm. John Crawford	Oklahoma
Joel Ario	Oregon
Rhonda Myron	Texas
Dixon Larkin	Utah
Jackie Hughes	Vermont

Charge:

- Adopt amendments to Viatical Settlements Model Act and Regulation. Complete an actuarial study to determine appropriate minimum payouts, and include results in amendments by December 1997.

ATTACHMENT TWO

Annuities Working Group
Orlando, Florida
March 16, 1997

The Annuities Working Group of the Life Insurance (A) Committee met in the Grand A Room of the Omni Rosen Hotel in Orlando, Fla., at 9 a.m. on March 16, 1997. Jerry Fickes (N.M.) chaired the meeting. The following working group members or their representatives were present: Ronald Rosen (Calif.); Roger Strauss (Iowa); Randi Reichel (Md.); Rick Morse (N.Y.); Tom Jacks (N.C.); Tom Foley (N.D.); Joel Ario (Ore.); Ted Becker (Texas); and Troy Pritchett (Utah).

1. Adopt Minutes of Feb. 12, 1997, and Feb. 27, 1997, Conference Calls

Roger Strauss (Iowa) moved and Troy Pritchett (Utah) seconded a motion to adopt the minutes of the Feb. 12, 1997, and Feb. 27, 1997, conference calls of the Annuities Working Group. The motion passed (Attachment Two-C).

2. Discuss Glossary of Annuities

Barbara Lautzenheiser (Lautzenheiser & Associates) discussed the glossary of annuity terms that the American Academy of Actuaries (AAA) had developed. Ms. Lautzenheiser said changes to the draft presented to the working group at the 1996 Winter National Meeting had been incorporated into this document and she was presenting it as the final work of the AAA. Rick Morse (N.Y.) questioned the definition of immediate vs. deferred annuities. He wondered about the "relatively" short time after which the periodic payments would begin. Ms. Lautzenheiser said the AAA group had hesitated to put in a specific date. Mr. Morse suggested that a bright line test would be useful. Ted Becker (Texas) said that a 13-month period is included in one of the actuarial guidelines. Arnold Dicke (AAA) said that if this is to remain an AAA document he would be uncomfortable with inserting the 13-month provision, but if this document is to become a NAIC document, words could be inserted such as "under some state regulatory provisions, a 13-month period is included."

Scott Cipinko (National Alliance of Life Companies—NALC) asked about the intended regulatory impact of adopting this document. Jerry Fickes (N.M.) responded that he envisioned this document being adopted by the NAIC as a guideline, rather than a law. He suggested it was a tool for regulators to use in speaking to each other to be sure they were talking about the same thing. He thought it would serve as an aid to understanding a rapidly changing field and would give regulators a common frame of reference. Mr. Cipinko suggested adding a preamble like the one used in the life insurance illustrations question and answer document that stated this purpose to the reader. Tom Foley (N.D.) offered to work with staff to prepare such a preamble so this document could be reviewed by the A Committee (Attachment Two-A).

Mr. Becker asked if the AAA intends to distinguish in this document between life insurance and annuities. Ms. Lautzenheiser responded that the document did not because drawing a distinction is difficult. She suggested it would be appropriate to make note of that also in the preamble. William Fisher (Massachusetts Mutual) suggested another change to the definition of immediate vs. deferred. He questioned language saying the funds were accumulated "with the intention" of making periodic payments. He suggested that the insurer was not always certain of the intention of the annuitant, but rather suggested language saying the funds were accumulated "to provide the option" of making periodic payments.

Mr. Fickes suggested that it might be useful to prepare a question and answer document for annuities similar to what the Life Disclosure Working Group had done on the issue of life insurance illustrations. He said the working group could discuss these issues over the course of the year in response to questions from states and others. He also asked the AAA to update this document periodically as the definitions changed and he thanked the AAA for its work. Mr. Fickes suggested that the document be presented to the A Committee and then forwarded to the states. He requested that all parties send suggestions for questions and answer discussion to Carolyn Johnson (NAIC/SSO).

3. Discuss Charitable Gift Annuities Model Act

Mr. Fickes introduced Frank Minton and Clinton Schroeder (American Council of Gift Annuities—Council). Mr. Fickes said these two representatives had come to provide information and comment to the working group in development of a model law on charitable gift annuities. Mr. Minton said the Council provides guidance to charities that issue gift annuities and helps the charities understand the various state laws. He welcomed the NAIC initiative that could achieve some degree of uniformity in state law and noted that it is not easy for charities to deal with a wide variety of state requirements. He noted that state regulators and the American Council of Gift Annuities had similar goals of protecting donors and keeping the burden on charities light. Mr. Schroeder described early efforts in the 1970s to develop uniform legislation for charitable gift annuities. He noted that under the Internal Revenue Code there is a specific exemption for charities, as defined, and the Internal Revenue Code says they are not to be treated as commercial insurance. He said the Council issues suggested rates that are informational only because the Council has no authority to make a charity follow its rates. The rates are determined by an actuary so that at least 50% of the gift will be left for the charity. He said in recent years the returns on the charities' investments had been very good so that most charities had done better than the 50% gift. Mr. Schroeder said the contract for a charitable gift annuity is generally very brief; it acknowledges the receipt of money and agrees to pay out an annuity for the individual's life. He noted that the purpose of the charitable gift annuity is for an individual to make a sizable gift to a charity and yet retain income for his or her lifetime. Because the individual's main goal is to make a gift, the rates are not competitive with insurance companies. If an individual is looking for a high return, the charity generally recommends that he or she contact an insurance company.

Mr. Minton suggested that three alternatives are available to states for regulating charitable gift annuities: (1) regulate the charity; (2) issue an exemption to the charity; or (3) the law may be silent. Mr. Minton noted that within the last three years most activity on the state level has been in adopting statutes providing for a conditional exemption for the charity. He listed some areas where the development of an NAIC model law would be very helpful to charities. He said the reserve requirements vary considerably from state to state, and some states' actuarial tables are quite out of date. Investment rules in some states for the segregated reserve funds are quite restrictive. He noted that if a charity wanted to do reserves for a number of states they ended up using the standards of the most restrictive state. Some states require a statement of reasonable commensurate value, but there is a lack of uniformity on what that means. The annual report requirements are very different; some require different information and some require it at different times of the year. Mr. Minton recommended the Annuities Working Group consider two alternative model statutes; one like the one being developed by the working group, and a second draft that a state could use to exempt charitable organizations from its laws.

Mr. Strauss moved that the draft of the Charitable Gift Annuities Model Act be exposed for comment and Mr. Morse seconded that motion. The working group adopted the motion. Mr. Fickes asked the American Council of Life Insurance (ACLI) and the National Alliance of Life Companies (NALC) to distribute the document to their members for comment and requested comments by May 15, 1997, so that the working group could have a conference call at the end of May to incorporate any suggestions.

4. Review Results of Annuity Survey

Ms. Johnson summarized the results of the survey of state insurance departments' opinions on annuity laws (Attachment Two-B). She said the most striking results of the survey were the large number of states that expressed interest in developing a model on equity-indexed contracts and the number of states that thought some of the annuity laws already developed by the NAIC need revision. She also noted a large number of states expressed interest in having model laws on the sale of annuities to seniors and on developing suitability requirements for annuity purchasers. Several states also suggested combining the regulations on two-tier annuities, equity-indexed products and interest-indexed products with the Annuity and Deposit Fund Disclosure Regulation. Another suggestion was that the Annuity Illustrations Model Regulation being developed be combined with the Annuity and Deposit Fund Disclosure Regulation. Mr. Morse said he would specifically report the interest in annuity-indexed products to the Life Insurance Committee.

Mr. Fickes asked Jack Blaine (National Organization of Life and Health Guaranty Associations—NOLHGA) whether the guaranty funds would cover an equity-indexed product. Mr. Blaine responded that the subject had been discussed by NOLHGA and the consensus was that under the guaranty fund model an equity-indexed annuity was covered as an annuity. He cautioned that it might be subject to the interest rate reduction provision and there was some question about the product design and when the interest was credited. He said the guaranteed interest part of it was clearly included but it was less clear how much of the variable part would be covered. He noted that NOLHGA members are reluctant to give advisory opinions and that a formal decision will not be made until there is an actual insolvency involving equity-indexed products. Mr. Morse noted that New York law prohibited some of the product designs that he has seen for equity-indexed annuities. New York law requires an interest crediting each year, which may affect the guaranty fund situation. Jim Mumford (Nyemaster Law Firm) noted that it was important that the assessment base for the guaranty fund include premiums for equity-indexed annuities. Charlotte Liptak (Transamerica) said the AAA has a working group looking at this issue. Mr. Strauss suggested that the working group bring this to the attention of the Life Insurance Committee as a possible issue for the Blanks (EX4) Task Force.

5. Discuss 1998 Charges

Mr. Fickes noted that the main purpose of the Annuities Working Group was to serve as a clearinghouse for various types of annuity issues. He noted that the issue of equity-indexed products had first come up at this working group and the work on this issue was currently being done by the Life and Health Actuarial (Technical) Task Force (nonforfeiture and reserving issues) and the Life Disclosure Working Group (disclosure issues). The working group reviewed the suggested charge reflecting this focus and agreed it was appropriate to recommend to the Life Insurance Committee. Ronald Rosen (Calif.) moved and Mr. Pritchett seconded a motion to adopt this recommended charge and the working group passed the motion.

Having no further business, the Annuities Working Group adjourned at 10:35 a.m.

ATTACHMENT TWO-A

GLOSSARY OF ANNUITY TERMS

Draft: 3/16/97

I. Introduction

The National Association of Insurance Commissioners Annuities Working Group of the Life Insurance (A) Committee had a charge to develop a glossary of annuities and was assisted by the American Academy of Actuaries Committee on Life Insurance. This document resulting from that effort does not try to distinguish between life insurance products and annuities.

The Annuity Working Group has been endeavoring to identify as many aspects of this topic as possible, given the current state of the annuity market, current tax laws and consumer needs. This Glossary of Annuities is the initial version of this endeavor. 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 alter any model laws or regulations or any state laws or regulations.

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

II. General Characteristics of Annuities

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

Immediate versus Deferred

The immediate versus 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 relatively short time after the issue date. Under some state regulatory provisions, a 13-month period is included. A deferred annuity is a contract designed to accumulate funds to provide the option of making periodic payments at some future time.

Single versus Periodic – Premium Payments – Accumulation Phase

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 versus Life Contingent – Annuity Payout Benefit Phase

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 versus Variable – Accumulation Phase

A fixed annuity contract, during its accumulation phase, 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 equal to or greater than the guaranteed rate. Still others link the credited interest rate to an external index or reference.

A variable annuity is a contract which, during its accumulation phase, permits the contract owner to allocate premiums to investment options, at least some of which are variable. Each variable investment option invests either directly in a portfolio of securities or in a mutual fund. Consequently, the investment experience passes directly to the contract owner. Generally there is no principal guarantee with variable investment options.

Fixed versus Variable – Annuity Payout Benefit Phase

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 versus 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 versus 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 varying 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.

Single Life versus 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 versus 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 versus No Death Benefits

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

Guaranteed Purchase Rates at Issue versus 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., 1 year).

Surrender Benefits versus 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 versus 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

Certificate of Annuity Contract. 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 annuity for another period or elect another benefit option.

Equity-Indexed Annuity Contract. 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. This annuity also has a minimum guaranteed value.

Flexible Premium Deferred 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 not fixed and thus may be increased or decreased as the client desires within contractual limits. Annuitization and other benefit options are available at the end of the accumulation period.

Fully Guaranteed Annuity Contract. 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 held in the insurer's general account, however, portfolio segmentation is sometimes done for participation features and C-3 management (including the calculation of the C-3 component of risk-based capital). Even where portfolio segmentation does not occur, investment year methods of crediting interest may be utilized. 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 Contract. A contract which has participant's 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, however, the assets and liabilities can be valued as though they were general accounts, or with both assets and liabilities marked to market.

Interest-Indexed Annuity Contract. 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 General Account Contract. A contract under which 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 can receive market or book value accounting treatment.

Modified Guaranteed Annuity Contract. 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 Contract. A form of home equity conversion specifically suited to older homeowners. The equity in the house is converted into periodic payments 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 Contract. A contract where the contract holder deposits a single sum of money in return for an annuity contract with a guaranteed interest rate or minimum guaranteed interest rate for a specified period of time. Renewal rates are subject to company strategy, but typically are guaranteed for subsequent time periods. Annuitization and other benefit options are available at the end of the accumulation period.

Single Premium Immediate Annuity Contract. 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 Contract. This contract is a Single Premium Immediate Annuity 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.

Synthetic GIC (Alternate Guaranteed Investment Contract). 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 Investment 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.

Tax Sheltered Annuity Contract. 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 Contract. 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 Contract. A contract where the contract holder is given investment options for his/her premium deposits prior to annuitization. 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 subject to plan limitations. There is no guarantee of interest during this period. 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 benefits, variable benefits 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 TWO-B

To: Annuities Working Group
 From: Carolyn J. Johnson, CLU, NAIC/SSO Senior Counsel
 Date: March 16, 1997
 Re: Survey of State Laws on Annuities

The Annuities Working Group asked states to respond to a short survey in order to assist in planning future directions. Thirty-three states responded. Following is a summary of their responses.

Annuity Topic	Page # of NAIC Model	✓ Check all that apply	
		Law in Place	Future Plans
1. Interest-Indexed Annuity Contracts Model Regulation	235-1	2 Have law or reg. in place 5 Apply model informally in state <input type="checkbox"/> Law or reg. covers equity-indexed products too	<input type="checkbox"/> Intend to adopt a law or reg. 3 Intend to use model 1 Intend to use other language 9 Do not need a law in this area 5 Model needs revision (describe in comments section)

We need to study Section 5, valuation requirements. A section on nonforfeiture requirements may also need to be added.

Our requirement is that the contract must clearly describe the methodology used to index the annuity and annuity surrender value.

Annuities are no longer required to be filed for prior approval. There are no specific statutory requirements relative to indexed annuities. The contract must meet the minimum standard nonforfeiture requirements, with a minimum guaranteed interest rate of 3%.

Evaluating at this time. Will render a decision at a later date if a regulation will be necessary.

Handled administratively through informal guidelines.

May want to develop a model covering indexed products generally. Model 235 could perhaps be a starting point.

Have asked for information based on this model in connection with interest-indexed and equity-indexed annuity filings.

2. Equity-Indexed Contracts Model Regulation	May Need?	2 Have law or reg. in place	5 Intend to adopt a law or reg. 3 Do not need a law in this area 22 A model should be developed
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In the process of developing guidelines for the acceptance of equity-indexed products. We may develop a regulation to address these products in the future. If so, it will incorporate parts of the NAIC model indexed annuity regulation and probably an NAIC equity-indexed model as well.

Evaluating at this time. Will render a decision at a later date if a regulation will be necessary.

Handled administratively through informal guidelines.

Advertising rules apply to annuities and are being used to review advertising for equity-indexed annuities. Need rule for reserves.

Development of an NAIC model would be a good idea.

Our filing requirements for equity-indexed products are the same as for other deferred annuities. We want a cover letter, transmittal form, policy form, actuarial memorandum, including demonstration of compliance with standard nonforfeiture law.

3. Definition of Annuities	May Need?	13 Have law in place defining annuities 13 Treated same as life insurance	<input type="checkbox"/> Intend to adopt a law or reg. 6 Do not need a law in this area 10 A model should be developed
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NAIC should develop a definition that distinguishes between life insurance products and annuities that are not insurance products at all.

4. Annuity and Deposit Fund Disclosure Regulation	245-1	4 Require delivery of buyer's guide 11 Disclosure standards in place 3 Apply model informally in state	2 Intend to adopt a law or reg. <input type="checkbox"/> Intend to use model 1 Intend to use other language 9 Do not need a law in this area 5 Model needs revision (describe in comments section)
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Needs updating for newer products.

We have no authority to adopt a regulation at this time.

Disclosure for preneed funeral plans.

Annuity disclosure regulation is needed. Model 245 could be a starting point. Need to combine two-tier and indexed into a more general model.

Should be single annuity disclosure regulation.

Use life insurance advertising rule for compliance.

We require delivery of a contract summary, not a buyer's guide.

5. Two-Tier Annuity Model Regulation	247-1	2 Prohibit sale of two-tier annuities <input type="checkbox"/> Other regulation of two-tier annuities 5 Apply model informally in state 5 Require disclosure <input type="checkbox"/> Require form from model <input type="checkbox"/> Created our own disclosure form	2 Intend to adopt a law or reg. 3 Intend to use model 1 Intend to use other language 8 Do not need a law in this area 6 Model needs revision (describe in comments section)
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We plan to study two-tier annuities.

Two-tier annuity model regulation needs more disclosure.

Valuation and nonforfeiture should be covered in the Standard Valuation Law and the Standard Nonforfeiture Law for Annuities respectively rather than in a separate model regulation.

We have seen very few of these products recently, but believe current laws suffice.

We have nothing specific; no prohibition.

Require disclosure of the guarantee periods applicable to any interest rates shown in the contract.

Fold into another model.

6. Model Variable Annuity Regulation	250-1	20 Require separate account 25 Require filing of contracts 19 Standards for contracts 18 Require report to policyholder 4 Apply model informally in state	2 Intend to adopt a law or reg. 1 Intend to use model <input type="checkbox"/> Intend to use other language 4 Do not need a law in this area 7 Model needs revision (describe in comments section)
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There is a need to cover reserve valuation of variable annuities in a model.

We require separate accounts, disclosure and form approval.

Another issue is certainly that of guaranteed separate accounts, which are being looked at by the separate accounts working group.

7. Modified Guaranteed Annuity Regulation	255-1	11 Have standards for market value adjusted annuities 18 Require filing of contracts 14 Requirements for contracts 11 Reserve standards 5 Apply model informally in state	1 Intend to adopt a law or reg. 1 Intend to use model <input type="checkbox"/> Intend to use other language 4 Do not need a law in this area 5 Model needs revision (describe in comments section)
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The model should specify what products with market value adjustment are allowed in the general account. Currently accept with a certificate of compliance pending promulgation of a regulation.

Model was formally adopted as a statute.

Need update and consideration of guaranteed separate account issues.

The model should be repealed and the standard nonforfeiture law revised to permit so-called market value adjustments.

8. Model Variable Contract Law	260-1	24 Law sets standards for transacting variable contract business 23 Requirements for separate accounts	<input type="checkbox"/> Intend to adopt a law or reg. 2 Intend to use model <input type="checkbox"/> Intend to use other language 5 Do not need a law in this area 5 Model needs revision (describe in comments section)
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Another issue is certainly that of guaranteed separate accounts, which are being looked at by the separate accounts working group.

9. Suitability Requirements for Annuity Purchasers	May Need?	3 Have standards in place	1 Intend to adopt a law or reg. 4 Do not need a law in this area 19 A model should be developed
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No—only variable life insurance.

We have no authority to adopt a regulation at this time.

10. Sales of Annuities to Seniors	May Need?	1 Have standards in place	1 Intend to adopt a law or reg. 5 Do not need a law in this area 17 A model should be developed
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11. Illustrations of Annuity Products Model Regulation	Under Development	3 Have standards in place 7 Apply same standards as for life insurance	5 Intend to adopt a law or reg. 10 Intend to use model <input type="checkbox"/> Intend to use other language 4 Do not need a law in this area
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No plans to set standards for annuity or life illustrations at this time.

Waiting on the NAIC. Will likely adopt model.

Illustration model regulation must consider and supplement disclosure issues surrounding two-tier products, indexed products, annuitization and purchase rate guarantees, availability of lump sum at maturity, etc.

12. Life and Health Insurance Guaranty Association Model Act	520-1	25 Have requirements similar to model 7 Add comment to show how caps vary from model 12 Exclude some types of annuities, for example, 2 funding agreements 3 deposit funds 10 unallocated annuities 2 plans under § 401(k) 4 other (comment)	1 Model needs revision (describe in comments section)
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Cap for annuities is 80% of cash value up to \$100,000 for deferred annuities in the accumulation phase and 80% of the present value of payments for annuities in the payout phase. There is also an adjustment to the interest rate credited for the four years prior to company insolvency. Variable contracts are not covered.

Our requirements are similar to the model in some areas, not in others. Our cap is \$300,000 across the board.

Do not apply to annuity contract or group annuity that is not issued to and owned by an individual. Cap on liability is \$300,000 for all benefits.

\$500,000 per life, \$1 million non-allocated group annuity contract.

Have original 1971 model with \$300,000 cap. Law is silent on types of annuities covered.

\$7.5 million for unallocated annuities, rather than \$5 million in model. Variable accounts not covered.

May need to adjust rule for equity-indexed annuities.

Caps of \$500,000 on life, health or allocated annuity benefits.

13. Replacement of Life Insurance and Annuities Model Regulation	613-1	23 Replacement law applies to annuities 19 Require notice to existing insurer 11 Law or reg. applies only to external replacements 13 Requires delivery of illustration or information to individual replacing	3 Intend to adopt a law or reg. 2 Intend to use model 1 Intend to use other language 1 Do not need a law in this area 5 Model needs revision (describe in comments section)
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Replacement of Life Insurance and Annuities Model Regulation needs to be modified to reflect life insurance illustrations model.

Would support revisions which increase consumer protection.

Replacement regulation does not apply to replacement of annuity contracts, but would apply if an annuity replaced a life contract.

Should show surrender costs of old and new on both the current and guaranteed basis.

Our replacement law applies only to life insurance, not annuities.

Model should be revised because exempts "qualified contracts."

Internal replacements are included.

14. Standard Nonforfeiture Law for Individual Deferred Annuities	805-1	30 Have nonforfeiture requirements similar to model <input type="checkbox"/> Add comment to show how vary from model	<input type="checkbox"/> Intend to adopt a law or reg. 2 Intend to use model <input type="checkbox"/> Intend to use other language <input type="checkbox"/> Do not need a law in this area 5 Model needs revision (describe in comments section)
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Model needs to specifically address two-tier and equity-indexed annuities.

Annuity nonforfeiture law should address specifically equity-indexed products and establish minimum standards for participation percentages and minimum terms for the participation percentage to be constant for 6-7 years.

Companies file new products and say the nonforfeiture law does not apply. Need to close the loopholes.

The revisions to the annuity nonforfeiture law are on hold, I believe, but could have a significant impact on some models.

Model should probably be revised to better accommodate the products insurers are currently writing.

ATTACHMENT TWO-C

Annuities Working Group
Conference Calls
Feb. 12 and Feb. 27, 1997

The Annuities Working Group of the Life Insurance (A) Committee met by conference call on Feb. 12 and Feb. 27, 1997. Jerry Fickes (N.M.) chaired the meetings. The following working group members participated: Sheldon Summers and Richard Bean (Calif.); Roger Strauss (Iowa); Howard Max (Md.); Tom Jacks and Ted Hamby (N.C.); Tom Foley (N.D.); Rick Morse (N.Y.); Kip May (Ohio); Richard McGavock (Ore.); Ted Becker (Texas); and Rosemarie Parkinson (Utah).

1. Consider Survey of States on Topic of Annuity Laws

Jerry Fickes (N.M.) asked for comments on the survey being considered for distribution to the states. Roger Strauss (Iowa) asked the purpose of the survey and Mr. Fickes responded that it would help the working group identify issues that it should address. Barbara Lautzenheiser (Lautzenheiser & Associates) asked if this is similar to a project that had been done earlier by the working group. Mr. Fickes said this survey is more extensive and would help with planning. Ms. Lautzenheiser agreed that, with the many projects before NAIC committees at this time, it would be helpful to know how to prioritize.

Mr. Fickes asked if anyone participating had suggestions for changes to the survey previously drafted. Ms. Lautzenheiser suggested adding an entry under the two-tier annuity section to reflect other specialized laws that might be in place in states. Jim Mumford (Nyemaster Law Firm) said it would be helpful to have information about guaranty fund coverage of annuities. The working group agreed to add entries to identify state exclusions of unallocated annuities, funding agreements, deposit funds, and to identify other variations that might be in place in a state. Mr. Strauss moved that the annuities survey (Attachment Two-B) be sent to the states with the changes discussed at the meeting. Richard McGavock (Ore.) seconded the motion, and it was adopted by the working group. The group agreed to ask for responses by March 3, 1997. Discussion took place on how to get a good response to the survey and the working group decided to send a copy of the survey to the commissioner and to the head of the Life and Annuities Division and to send a note over the NAIC e-mail to the commissioners alerting them to this survey.

2. Charitable Gift Annuities

The working group reconvened Feb. 27, 1997, to discuss the draft of the Charitable Gift Annuities Model Act (Attachment Two-C1). Mr. Fickes asked Michael Batte (N.M.) to review the draft with the working group. Mr. Max commented on Section 2. He asked if there is a need in Subsection A(1) to link the charitable deduction for federal tax purposes to the definition of a charitable gift annuity. Rick Morse (N.Y.) suggested that the availability of a charitable donation confirms the legitimacy of the organization under the Internal Revenue Code. He said it would be very easy to set up a "charity" that might not be legitimate. Roger Strauss (Iowa) suggested that the draft remain as it is, and, if this language is inappropriate, interested parties will tell the working group.

Tom Foley (N.D.) asked if the working group intends to make the model as broad as possible to cover anything that would look or act like a charitable gift annuity. Mr. Fickes responded that he was in favor of making the language broad to give more power to the insurance department. Mr. Batte said that most states have laws that address annuities, and the purpose of this model is to create less restrictive requirements for charities that wish to provide annuities. He said that it was most important to define the category appropriately.

Mr. Batte asked if any of the working group members had a comment on Section 4, Surplus and Reserves. Richard Bean (Calif.) commented that in 1993 California added specific requirements for charities for commissioners to consider, such as fairness, honesty, integrity, etc. He said that the California law does not have a surplus requirement because the purpose of a charitable organization is to spend its money for its charitable purpose. He noted that the draft leaves it up to each state to insert a dollar amount for the reserves and pointed out that the charitable gift industry had indicated an interest in states adopting consistent numbers for a surplus requirement.

Mr. Strauss commented on Subsection B(1). He asked if the language of Paragraph (1) should say "greater of" instead of "either." Mr. Batte said this language allowed each charity to choose the standard that it wished to use, thereby giving charities more flexibility. Mr. Max said that the Maryland regulation had originally required Subparagraph (a), the Standard Valuation Law, but the industry comments led the Maryland drafters to change to the standard required in Subparagraph (b). The small charities commented that they could not afford the cost of an actuary to calculate the requirement for the Standard Valuation Law. Mr. Batte said that was the reason for including the alternatives. Mr. Bean commented that the California law had always included a provision more similar to Subparagraph (a) with a requirement to set reserves based on the 1983 Individual Annuity Mortality Table and 6% interest. Mr. Bean suggested it was simpler to use one table and to specify it in the law, rather than to offer alternatives, which tend to confuse people. Mr. Foley asked what the down side would be if the reserves were inadequate or too high. Mr. Batte responded that if the reserves were set too high, the money would not be available to use now. If the reserves were deficient, funds might not be available to provide the annuity. He said that initially charities were in the habit of taking the money they received and investing it. After the individual died, the money that had not been paid out in an annuity was available to spend. Now the American Council of Gift Annuities has recommended reserves and the charities are not always waiting to spend the excess assets. Mr. Foley opined that setting the reserves correctly is important and suggested that charitable organizations should be subject to the same degree of actuarial scrutiny as the department used for insurers' annuities. Mr. Strauss pointed out that the American Council of Gift Annuities could change its rates periodically, and they might become inadequate. The working group members agreed to delete Subparagraph (b) from the draft. Mr. Fickes noted that representatives from the American Council of Gift Annuities would attend the next working group meeting and would be available to comment on this section.

The next comments received were on Section 6, Annual Reports. Mr. Batte noted that earlier comments received had indicated an advantage to having reports due on the same day in all states. Mr. Max said the requirement in Maryland was to file an annual report 90 days after the end of the charity's fiscal year. Mr. Bean noted that the California statute provided 120 days for the annual report. Mr. Fickes suggested putting in a 90-day reporting requirement, with an option for that date to be extended by the commissioner. Ted Becker (Texas) suggested a change in Subsection B(5)(c). He said the words "insure solvency" might make the commissioner to blame if an insolvency of the charity occurred. The working group agreed that language was too strong and substituted the language "evaluate solvency."

Having no further business, the working group adjourned the conference call at 11:15 a.m.

ATTACHMENT TWO-C1

Charitable Gift Annuities Model Act
Draft: 2/27/97

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]; or

~~(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)(b)~~ 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. The report is due ninety (90) days after the close of the charity's fiscal year or at a later date approved by the commissioner.

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~~ Evaluate 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].

C. The requirements 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 THREE

Replacement Issues Subgroup
Orlando, Florida
March 17, 1997

The Replacement Issues Subgroup of the Life Disclosure (A) Working Group met in the Grand E Room of the Omni Rosen Hotel in Orlando, Fla., at 3 p.m. on March 17, 1997. Paul DeAngelo (N.J.) chaired the meeting. The following subgroup members were present: Sara M. Begley (Ariz.); Richard Rogers and Mike Hessler (Ill.); Rosanne Mead (Iowa); Lester Dunlap (La.); Cindy Martin (Mass.); Frederick P. Schumpe and Cynthia M. Amann (Mo.); Rick Morse and Martin F. Carus (N.Y.); Angela Ford (N.C.); Kip May (Ohio); Joel Ario (Ore.); and Ted Becker (Texas).

1. Adopt Minutes of Feb. 18, 1997, Conference Call

Joel Ario (Ore.) moved and Rick Morse (N.Y.) seconded a motion to adopt the minutes of the conference call of Feb. 18, 1997 (Attachment Three-B). The motion passed.

2. Discuss Survey of Insurers

Paul DeAngelo (N.J.) noted that over the last two weeks, members of the working group had received a large compilation of information from the American Council of Life Insurance (ACLI), and at this working group meeting the members received more detailed information about the contents of that document. He asked for three volunteers from the working group to review the information more closely and make a recommendation as to whether the information will meet the working group's need for information. Missouri, Iowa and Louisiana offered to serve in this capacity. Mr. DeAngelo asked how much time the group would need to complete its task and the volunteers agreed that six weeks would be an appropriate timeframe. Lester Dunlap (La.) suggested that the working group have a conference call after that review was completed. Mr. DeAngelo agreed that it would be appropriate to schedule a conference call in six weeks or so.

3. Discuss Various Recommendations to Address Replacements

Mr. DeAngelo asked the working group members to look at a list of proposed drafting initiatives that he had prepared (Attachment Three-A). He said the charge to the working group initially included amending the life insurance replacements regulation and his list included some of the potential amendments that might be necessary. He said many of these were recommendations from the National Association of Life Underwriters (NALU) and the ACLI. Mr. DeAngelo stated his conviction that agents compensation was a key factor in addressing the problems with replacements. He said that many companies have a procedure stating that, if the replacement is internal, the producer will not get a commission on the amount being replaced. To circumvent that procedure, agents do not disclose the sale is a replacement so they would get their full commission. At least one company has stated to Mr. DeAngelo once its procedures changed so that a full commission was paid, the problem of not reporting replacements disappeared. One possible solution suggested by Mr. DeAngelo was that, if the replacements in a year did not exceed a certain percentage, the agent would receive the full commission, but once an agent exceeded that threshold, the commission would only be paid on the amount above the replacement. If the company discovered an undisclosed replacement, no commission would be paid on the sale. Cindy Martin (Mass.) agreed that was one approach to consider, but suggested there are probably others. She gave as examples the procedures in the securities industry, the New York replacements regulation being considered, and other alternatives. Richard Rogers (Ill.) said he did not want to go on record with a pronouncement about discouraging replacements and suggested that it was inappropriate to change compensation only for that reason. Mr. DeAngelo said his goal was to find a way to encourage disclosure of the fact that the sale is a replacement. He was not ready to say that all replacements were bad. Mr. DeAngelo noted that if the working group intended to deal with the agent compensation structure on all sales, it might be beyond the scope of this working group. Mr. DeAngelo stated that the working group's primary responsibility is to make changes to the replacement regulation, but it could also make recommendations to the Life Insurance (A) Committee about other areas that needed review, such as agent compensation. Angela Ford (N.C.) suggested the working group could get some valuable insights from individuals who served on the Prudential Multistate Examination Task Force. Mr. DeAngelo responded that several members of this working group were also task force members and they seem to be in some agreement that the agent compensation structure was a major cause of the problems that resulted in the task force's creation.

Scott Cipinko (National Alliance of Life Companies—NALC) expressed concern over the focus on replacements. He said that companies were coming up with new and innovative policies and expressed the opinion that regulators should not take away an agent's incentive to sell them by removing the commission. Marty Carus (N.Y.) opined the issue here is inappropriate replacements. He said his overriding concern was about inappropriate replacements and suggested the group not focus on merely trying to identify the replacements. Mr. DeAngelo responded that the task force found many instances where the requirements for replacement had not been met. Disclosure that a sale is a replacement triggers certain disclosures so the policyholder can make his or her own determination of whether the replacement is appropriate. Mr. Carus suggested that regulators should work to create an environment where it is not to the company's advantage to replace policies.

Ms. Martin asked if it was Mr. DeAngelo's intent that members of the working group draft provisions to address issues in the list that is Attachment Three-A. Mr. Rogers opined that the working group does not yet know what the underlying problem is that needs to be solved. He suggested taking a step back to see where we are. Mr. DeAngelo responded that he felt confident that the underlying problem is that replacements are not being reported. Mr. Rogers responded that he was not ready to conclude that replacement is bad. He said there was a time earlier in his regulatory career where there were many orphan policies that should have been replaced, but were not. Mr. Ario said he believed compensation is part of the problem and would

like to hear a discussion of what can realistically be done to address this problem. Mr. Rogers responded that he would like to slow the process down. He said the Prudential Task Force had identified some things the working group would need to review and suggested preparing a white paper to discuss the problems before beginning to draft a regulation.

Mr. Carus suggested that the working group members evaluate some replacements and see if they had been a good idea. He said a random sample would confirm or deny whether there was a problem with the replacements. Mr. Rogers responded that he would like to see what caused the replacements. He opined that if the working group tried to solve a problem and that was not really the underlying problem, nothing had been gained. Ms. Martin suggested this working group's charge was to look at replacements that were not a good idea. Mr. Morse said that suitability standards for all sales were needed and then, after it has been determined whether the sale was appropriate, it would be easier to determine if replacement by another policy is also appropriate. Mr. DeAngelo expressed discomfort with the idea of regulators deciding for consumers what is suitable.

Mr. DeAngelo asked the working group how it wished to proceed. Mr. Rogers suggested holding hearings and then writing a white paper to identify the problems. Companies and consumers could tell the regulators what they thought should be done. Mr. Ario suggested beginning by drafting some proposals and also getting comments on these at a hearing. He said proposals on the table would focus the discussion. Don Koch (Alaska) agreed that it does make sense to come to some consensus on how to approach the problem. Mr. DeAngelo cautioned that, as the working group was holding hearings, it was doing nothing to help people with a replacement problem. He encouraged the working group to start drafting on the areas upon which there was agreement and, at the same time, to hold hearings. He noted the working group already had some recommendations from NALU and ACLI. Mr. Rogers suggested asking the A Committee for permission to hold hearings on the issue. Mr. DeAngelo suggested the working group could accomplish both tasks: draft in areas upon which there is some agreement and hold hearings on the other issues.

Mr. DeAngelo encouraged the working group to consider beginning the drafting process on the two problems that he had seen in the two years of the Multistate Examination Task Force. He said those two issues were replacements that were not reported and policy values being used without the policyowner's knowledge and consent. Mr. Dunlap and Rosanne Mead (Iowa) agreed that it would be appropriate to start drafting now rather than to lose more time. Mr. Ario suggested drafting with the items from number one and number three and leaving items two, four, and five for discussion at a hearing before proceeding. Ms. Ford said she would like to know what companies with churning and replacement problems have done to resolve those problems. She suggested the hearing would be an appropriate forum to hear from these companies. Mr. DeAngelo noted that that had been one of the goals of the survey being discussed.

Marybeth Stevens (ACLI) reminded the working group that the sales illustration regulation and the Insurance Marketplace Standard Association (IMSA) self-assessment program would solve many of these problems. She cautioned the working group against spending a great deal of time drafting provisions and then having the companies suggest that these were not appropriate.

Mr. Ario moved and Cindy Amann (Mo.) seconded a motion to invite comments by interested parties on the items in number one and three of Attachment Three-A by May 1. In response to these comments, the working group will begin drafting on issues upon which there is some agreement for discussion at the Summer National Meeting. The working group will decide later whether to hold a hearing at the Summer National Meeting. Ms. Mead suggested adding a "free-look/cooling-off period" as one of the topics for discussion under number one. Mr. Ario accepted this as a friendly amendment. The motion passed.

Mr. DeAngelo asked the working group members to submit suggestions to him by the end of April and he would prepare a draft model regulation for working group consideration.

4. Discuss 1998 Charges

The working group members discussed the charge to recommend changes to the Life Insurance (A) Committee on the Life Insurance Replacements Model Regulation and Life Insurance Advertising Model Regulation and to develop new model language to deal with issues of suitability, agent compensation and using policy values for financing. Mr. Morse suggested that the provision on life insurance advertising be coordinated with the group working on sales illustrations. With that change, Mr. Morse moved and Ms. Amann seconded a motion to recommend the charge to the Life Insurance (A) Committee.

Ms. Ford moved and Mr. Morse seconded a motion to adjourn. The motion passed.

Having no further business, the Replacement Issues Subgroup adjourned at 4:45 p.m.

ATTACHMENT THREE-A

Proposed Subgroup Drafting Initiatives

1. Amendments to Life Insurance Replacement Regulation
 - a. Eliminate exemption for internal replacements
 - b. Provide credit for suicide and incontestability periods
 - c. Compensation requirements
 - d. Eliminate comparison forms
 - e. Revise notice

- f. Incorporate internal replacement controls (suitability)
 - g. Reporting of agent replacement volume
 - h. Reporting of agent replacement violations
 - i. Applicability to annuities and variable policies
2. Amendment to Life Insurance Advertising Regulation
 - a. Address requirement for illustrating non-guaranteed elements and current levels
 3. New Model Regulation on Use of Policy Values (Financing)
 4. New Model Suitability Regulation
 5. New Model Law on Agent Compensation
 - a. New business
 - b. Orphan policies
 - c. Replacements

ATTACHMENT THREE-B

Replacement Issues Subgroup of the Life Disclosure (A) Working Group Conference Call February 18, 1997

The Replacement Issues Subgroup of the Life Disclosure (A) Working Group met by conference call on Feb. 18, 1997. Paul DeAngelo (N.J.) chaired the meeting. The following working group members participated: Paul Hogan and Erin Klug (Ariz.); Mike Hessler (Ill.); Jo Oldson (Iowa); Lester Dunlap (La.); Fred Schumpe (Mo.); Rick Morse (N.Y.); and Ted Becker and Bill Goodman (Texas).

Paul DeAngelo (N.J.) discussed the survey that the subgroup planned to send to insurers to determine their replacement practices. He summarized the working group's activity over the past six months and the working group's efforts to protect the identity of companies participating. He said American Council of Life Insurance (ACLI) members had expressed grave concerns because of the possible class action lawsuits that would seek to discover information companies compiled for the survey. Mr. DeAngelo revised the survey in response to the concerns expressed, but the ACLI still feels it will be detrimental to its members to participate. Mr. DeAngelo said the ACLI had given him a set of materials to answer some of the questions on the survey.

Mr. DeAngelo outlined three options the subgroup should consider during the conference call: (1) go ahead with the survey as it currently exists; (2) use the power of the insurance commissioner to require insurers to respond to the survey; or (3) look at the ACLI submission and see if it provides enough information for the subgroup. Paul Hogan (Ariz.) asked whether the materials provided by the ACLI responded to the revised survey or the original survey the subgroup had considered. Mr. DeAngelo responded that the materials responded mostly to the historical aspects of the original survey and did not contain much current information on monitoring of agents by companies. Mr. DeAngelo said the 1,000 or more pages of material provided would be difficult for everyone to review and he asked the ACLI to put the information into a more useful format for the subgroup. He suggested the subgroup members could then review the materials and decide whether the information they needed was included or whether they should go ahead with the survey. Ted Becker (Texas) agreed this was a good plan if it still allowed the subgroup to meet its charge. Mr. DeAngelo asked the ACLI to provide the information to the subgroup members before the Spring National Meeting. Marybeth Stevens (ACLI) agreed to do this. Erin Klug (Ariz.) moved that the ACLI material be analyzed in coordination with the original subgroup survey and a decision on the survey made at the Spring National Meeting. Rick Morse (N.Y.) seconded the motion and it passed. Ms. Stevens clarified that the ACLI would not analyze the data, but point out relevant information to the subgroup so it could make its own analysis. Mr. DeAngelo reiterated that the subgroup would not set aside the survey with finality, but would see if the ACLI information provides enough answers to the survey questions. He said the survey exercise had been fruitful because now the subgroup had a great deal more information that had not been available to it before.

Mr. DeAngelo reminded the subgroup members that at the Winter National Meeting he had provided them with some suggestions of areas on which to focus attention. He had not received significant feedback from the subgroup members and asked them to submit comments to him so that these issues could also be discussed at the Spring National Meeting.

Having no further business the subgroup adjourned at 2:30 p.m.

ATTACHMENT FOUR

Synthetic GIC Working Group
Orlando, Florida
March 17, 1997

The Synthetic GIC Working Group of the Life Insurance (A) Committee met in the Grand D Room of the Omni Rosen Hotel in Orlando, Fla., at 8 a.m. on March 17, 1997. Rick Morse (N.Y.) chaired the meeting. The following working group members were present: Jack Gies (Conn.); Clark Simcock (D.C.); Larry Gorski (Ill.); and Lynda Klebold (N.J.).

1. Discuss Draft of Synthetic Guaranteed Investment Contract (GIC) Model Regulation

Brian Haendiges (Ætna) gave an overview of activity of the technical resource advisors. He said the last time the working group met he had given an outline of what the group planned to accomplish, and he was pleased to announce that the technical resource advisors had made significant progress. He said the group included a good cross-section of types of companies, geographical distribution and size of company, and the group contained a good balance of lawyers and actuaries and areas of expertise. The technical resource advisors had organized themselves into a core group and then a wider group that served as a sounding board after the core group's discussions. Mr. Haendiges said the group met on Feb. 12, 1997, by conference call to discuss the comments the working group had received on the draft released at the 1996 Fall National Meeting. He said the technical resource advisors expected to have a revised draft for working group consideration before the 1997 Summer National Meeting and said the draft would be annotated to include reasons for any changes they might recommend. Mr. Haendiges expressed an intention to have final recommendations by the end of 1997. Mr. Morse said it was his goal to have the regulation final by the 1997 Fall National Meeting so that the NAIC could adopt it in December 1997. Larry Gorski (Ill.) agreed this was an aggressive schedule, but thought it could be done.

Mr. Haendiges said it would also be appropriate to provide a general informational program for members of the NAIC. Mr. Morse agreed this would be helpful and expressed the opinion that an appropriate time to do this would be after the NAIC adopted the regulation.

Mr. Haendiges said the first issue the technical resource advisors had discussed was what types of things were in the scope of the model. He noted that some states appear to have the basic regulatory authority to adopt this regulation, whereas other states may need a statutory authority provision. Mr. Morse said he had looked at that issue when he began drafting the regulation and realized that the best approach was to look at the nature and characteristics of synthetic guaranteed investment contract (GIC) and various traditional group annuity products, especially the need to properly evaluate the pension plan and its need to meet plan benefit requirements. As such, a conclusion could be justified that a synthetic GIC is substantially similar to a group annuity. Another approach would be use of ancillary authority. However, some states may not be able to use either the "substantially similar" or the "ancillary" approach. Thus, some states might need a brief law to give them the authority to adopt a regulation and suggested the technical resource advisors draft language to give authority if needed. Mr. Haendiges agreed to take on that task and opined that the draft would probably be only four to five lines in length. Lynda Klebold (N.J.) said she requested an attorney general opinion in New Jersey and had been told that the products could be treated as separate account GICs.

In respect to the scope of the present draft, Mr. Morse noted that some commentators from the industry would like to expand the regulation specifically to include municipal obligations. In light of the existing NAIC Financial Guaranty Model Act, which specifically authorizes municipal obligations to be underwritten by property/casualty insurers, addressing this issue in the synthetic GIC regulation may delay the adoption of the NAIC Synthetic GIC Model Regulation.

Mr. Haendiges said the technical resource advisors felt that some issues were outside the scope of their project and gave the example of risk-based capital treatment, annual statement and guaranty fund assessments. He expected his technical resource advisors might comment on these issues even though they decided it was not within the scope of their activity. Mr. Gorski noted that he would not want to see other products that were functionally the same as synthetic GICs not covered by the reserving requirements. He suggested that if a product looks like a synthetic GIC and acts like a synthetic GIC, it should have the same reserving requirements as a synthetic GIC. Mr. Morse agreed with a functional approach rather than a status approach.

Mr. Haendiges said the technical resource advisors plan to have a day-and-a-half session in April 1997 to go through the draft section by section and prepare language for a revised model regulation.

Ms. Klebold said she had been thinking of requesting prototypes of forms to match the types of products being offered. She said a series of forms rather than one form with lots of brackets would make her more comfortable. Otherwise she did not know what she was approving. She suggested companies needed to be more creative in designing their contracts.

2. Discuss 1998 Charges

Mr. Morse said it was his hope that the Synthetic GIC Working Group would not need a charge for 1998. He said he expected to have the project completed before the end of the year and thought it would be reasonable to ask for discharge of the Synthetic GIC Working Group after reporting the model up in September.

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

Viatical Settlements Working Group
Orlando, Florida
March 15, 1997

The Viatical Settlements Working Group of the Life Insurance (A) Committee met in the Junior Ballroom G Room of the Omni Rosen in Orlando, Fla., at 1 p.m. on March 15, 1997. Lester Dunlap (La.) chaired the meeting. The following working group members or their representatives were present: Linda Brunette (Alaska); Ron Kotowski (Ill.); Rick Diamond (Maine); Tom Foley (N.D.); Rick Morse (N.Y.); Gary Chartier (Okla.); Joe Ario (Ore.); Ted Becker (Texas); and Troy Pritchett (Utah).

1. Adopt Minutes of Jan. 30, 1997, Conference Call

It was moved and seconded to adopt the minutes of the Jan. 30, 1997, conference call of the working group. The motion passed. (Attachment Five-A).

2. Discuss Disclosure of Tax Implications

Lester Dunlap (La.) drew the attention of the working group members to the revised disclosure statement (Attachment Five-A2). Holly Roth (Viaticus) said she did not receive any additional comments from the working group or the interested parties. Mr. Dunlap said he thought the revised version addressed the concerns David Landay (National Viator Reps, Inc.) expressed during the conference call. Mr. Dunlap asked for input from the working group members about what to do with the information prepared. Drew Backstand (Viaticare Financial Service) suggested sharing the material with the two viatical trade associations for distribution to their members. The working group agreed to send the information to the trade associations and request their comments, and then to consider distribution to trade associations, insurance departments and other appropriate venues. Mr. Dunlap also suggested sending the submission from Mr. Landay with the other disclosure documents to receive comments from the trade associations.

Tom Foley (N.D.) asked if it is clear whether an individual with life expectancy of more than two years should expect to pay taxes on the amount viaticated. Mr. Backstand said that it is expected that if an individual has longer than two years to live the distribution will be taxable but it is not clear. He said that the Internal Revenue Service (IRS) is drafting regulations for distribution of Form 1099s and it is his understanding that the viatical settlement provider will be required to send a Form 1099 if the individual has more than two years life expectancy. He suggested the draft disclosure document should say that the tax ramifications beyond two years are not clear. Ms. Roth also pointed out that there is some confusion as to whether an individual can viaticate a policy if he or she can expect to live longer than two years and said it would be helpful to clarify this in any information provided by state insurance departments. Mr. Dunlap said this would be a good item for discussion when the working group revised the models. Mr. Foley said that he was more familiar with the provisions for long-term care insurance in the Health Insurance Portability and Availability Act of 1996 and in his opinion it was not clear that long-term care policies that did not meet provisions of the Act would be taxable. He doubted if it was any clearer for the viatical settlement provisions. He asked that the disclosure statement include language to say that a policy viatication that did not meet the requirements set out in the disclosure statement would "likely" be taxable.

Doug Head (Medical Escrow Society) offered the two viatical trade associations to get together and prepare an informational booklet for the working group's consideration. He noted that it is difficult for viators to call insurance departments and get information about which viatical settlement providers are licensed in the state. He said that state insurance departments need to be aware of this difficulty. He also pointed out that some insurance companies go so slowly in processing the information needed that people get tired of the process and quit trying to viaticate their policies. Mr. Dunlap agreed to include this consideration in the drafting of revisions to the viatical settlements model act and regulation.

3. Discuss Certification Form for Doctor

Mr. Foley introduced the discussion of a certification form by pointing out that a viator will know whether his viatical settlement is tax free if he has in hand a physician's statement that his life expectancy does not exceed 24 months. He had suggested at the prior conference call the development of a specific format to make this procedure easier. He said there had been some concern expressed that doctors would not feel comfortable doing this type of form. Ms. Roth pointed out that it would be needed by the viator to establish the tax-free treatment of the viatical settlement, but viatical settlement providers would probably not need that information in order to make an offer. She said Viaticus does not use physicians in its underwriting process and asked that the viatical settlement provider not be put into the position of providing the physician statement. Mr. Foley asked the members of the working group if they were in agreement that the viator would need this information before viaticating the policy. The working group members agreed that information about tax treatment and whether this settlement would be tax free were important. Mr. Backstand said that many people interested in viaticating their policy could get the certificate filled out by their own treating physician. He said that his company used consulting physicians, but did not necessarily want to put them in the position of preparing the certification. Mr. Foley pointed out that there was some merit in not having the viatical settlement provider's consultant prepare the statement. He suggested that this issue be considered further when drafting revisions to the Viatical Settlements Model Act and Regulation. Ron Kotowski (Ill.) pointed out that the real purpose of the certification was to assure tax-free treatment. If the viatical settlement company says that the individual will not get the tax break without a certificate, then it is up to the viator to get that information. He suggested that perhaps a standard format was not necessary. Rick Morse (N.Y.) said the certificate would put the burden of proof on the IRS to show that the viatical settlement was not tax free. He said it was unlikely that the IRS would challenge an individual who had the form. Barbara Stucki (American Association of Retired Persons—AARP) said that she had received information that the IRS was very

concerned about the possibility of fraud in these transactions. She said an individual could very well be left holding the bag if he did not have documentation that his life expectancy was less than 24 months. She said this put the burden on the consumer to get a form and said that a filled-out form showed a good faith effort.

4. Identify Areas for Amendment in the Viatical Settlements Model Act and Regulation

Mr. Dunlap asked for suggestions from the working group on the mechanics of drafting a revised model act and regulation. He said that it would be a tedious process to go through the draft section by section and identify the amendments desired. Mr. Foley suggested that a small group of drafters meet and prepare a draft before the Summer National Meeting for discussion by the working group. He suggested that this group could identify specific issues that needed discussion and that would help focus the discussion at the Summer National Meeting. Mr. Head said that the trade associations had done some drafting of models and would have a revised draft within the next month for working group consideration. Mr. Dunlap said that those who were interested in being part of this small drafting group would hold an interim meeting to draft a revised model and share it with the members of the working group in time to allow review before the Summer National Meeting.

5. Pricing Issues

Mr. Foley said that the pricing structure typically used in a viatical settlement was that the price quoted consisted of a dollar amount in exchange for assigning the policy. If the individual lived a short period of time, the company made more money than they had anticipated; if the individual lived longer, the company lost money. He said there was no participation of the viator in the risk. He asked if there was an alternative method of pricing that would offer participation in that risk. He suggested investigating a loan process so that, if the individual lived a short period of time, his beneficiary would receive some of the proceeds. Mr. Backstand described a transaction his company had participated in that followed along those lines and said the company hoped to soon make one of its pricing options a loan on the face value. He said this method of pricing would make viatical settlements available to individuals with a longer life expectancy.

6. Discuss 1998 Charges

Mr. Dunlap asked if the working group is interested in adding to the 1998 charge the issue of investments in viatical settlements. Mr. Backstand said the Securities and Exchange Commission is still involved in a case that might be appealed to the U.S. Supreme Court. This case raises the issue of investment in an undivided pool of viatical settlements. Ms. Roth said her company also agreed that there is a need to use institutional funds rather than soliciting funds from individuals. She thought it would be a great step forward for the working group to write the model in such a way that it stopped other types of arrangements. Mr. Morse suggested the working group look at the public policy issue of insurable interest and wagering on human life, rather than just relying on state law. He said New York had dealt with this issue in its act by putting in the statute a provision that a viatical settlement provider could only assign a policy to another licensed viatical settlement provider. He suggested that the working group seriously consider writing a provision in the revised model act that would eliminate assignment to other than licensed entities. Mr. Backstand said that if the viatical settlement industry gets large enough, it will offer securities through investment bankers and that would appeal to institutional investors.

Having no further business, the Viatical Settlements Working Group adjourned at 2:40 p.m.

ATTACHMENT FIVE-A

Viatical Settlements Working Group Conference Call January 30, 1997

The Viatical Settlements Working Group of the Life Insurance (A) Committee met by conference call at 1 p.m. on Jan. 30, 1997. Lester Dunlap (La.) chaired the meeting. The following working group members participated: Michael Bownes (Ala.); May Gabor for Don Koch (Alaska); Ron Kotowski (Ill.); Marilyn Burch (Kan.); Jim Schneider (Maine); Ted Hamby for Tom Jacks (N.C.); Tom Foley (N.D.); Rick Morse (N.Y.); Gary Chartier for Commissioner John Crawford (Okla.); Lewis Littlehales for Joel Ario (Ore.); and Beth Hill for Rhonda Myron (Texas).

1. Disclosure of Tax Ramifications of Viatical Settlements

Lester Dunlap (La.) announced that the purpose of the conference call was to discuss the disclosure form that had been drafted prior to the 1996 Winter National Meeting. Mr. Dunlap said the working group received two comments on the disclosure form: A letter from Holly Roth (Viaticus) contained a redraft that he found to be an improvement over the original document, and a letter from David Landay (National Viator Reps., Inc.) pointing out that sensitivity is needed in dealing with a terminally ill individual. Mr. Landay suggested that it was inappropriate to dwell on the life span and tax consequences in a disclosure statement. Jeffrey Barnes (National Viator Reps., Inc.) expressed concern that the disclosure statement focused on the life expectancy of an individual, which would force the viator to face his shortened life span. Mr. Barnes said it was important to minimize the amount of stress being faced by the viator and prolonged meditation on death and taxes was detrimental to his health. He suggested the viatical company just provide a reminder that the viator should consult his tax advisor. Ron Kotowski (Ill.) asked if individuals who viaticate their policies are all terminally or chronically ill. Mr. Barnes responded that was true because there was no way to sell a policy without a shortened life expectancy. Mr. Kotowski asked what percentage would not qualify for tax-free treatment under the new federal provisions. Mr. Barnes responded that his experience with respect to AIDS

patients indicated 35% of them would fall outside the favorable tax treatment. Mr. Kotowski said he looked at the disclosure statement as a positive document that would give the news that the viatical settlement would now be tax free, and he asked why the viatical settlement industry had worked for implementation of the law and now did not want to discuss it. Gary Gasper (attorney) said he had lobbied for a provision that the settlement be tax free in all cases. Congress felt it needed to draw a line, and the lobbyists had pushed for a five-year tax-free line or a disease that might shorten life expectancy. Mr. Gasper said he saw the issue as whether the working group wanted to advocate a disclosure statement at all.

Mr. Dunlap suggested the working group discuss the format of the disclosure statement and then decide whether to include it as a part of the NAIC Viatical Settlements Model Regulation. He suggested to Ms. Roth that her document needed to be de-personalized so it would refer not to "you" but rather "a person who is viaticating a policy." Ms. Roth agreed to make the suggested changes and said it was her conviction that it was important the viator know up front whether or not the distribution was going to be taxable. Jim Schneider (Maine) asked if the Internal Revenue Service (IRS) had a responsibility to tell the viator whether it would be taxable. Mr. Gasper responded that the IRS would not even know about the transaction if the viatical settlement provider determined that it would not be taxable because no Form 1099 would be provided to the IRS.

2. Doctor's Certification

Tom Foley (N.D.) focused on the certification of a doctor that is required. He suggested designing a certificate that the doctor would be able to use in helping determine whether the viatical settlement was eligible for tax-free treatment. He agreed that it was important to talk about tax-free treatment before an individual viaticated a policy. Mr. Dunlap pointed out this would be helpful information for the insurance department to have available to help viators work through their decisions. Mr. Landay asked the working group again why it felt a need to do more than to advise an individual that there were tax implications. He pointed out the provision in the model regulation that says the viatical settlement provider must tell the individual to check the rules on Medicaid entitlements, and suggested the language on tax treatment be as vague as that. Mr. Schneider pointed out that many people do not have a tax advisor so that advice would not be very helpful. Mr. Foley suggested that a certification for the physician could be included in the model or formally adopted in some way and that document could refer to the tax law. Mr. Barnes pointed out that a doctor would then become a tax advisor, and might not be willing to fill that role. Mr. Gasper agreed the certification had to say the individual was either terminally or chronically ill, and had to reference the 24 months that was in the tax law. The working group agreed to develop a sample certification to use with the disclosure statement, and Ms. Roth agreed to prepare a first draft (Attachment Five-A1).

3. Informational Brochure

Mr. Dunlap suggested that the working group consider development of an informational brochure on viatical settlements. He said the insurance department could serve as an unbiased source of information, and the booklet could incorporate some tax information as well. Mr. Schneider said he had written a booklet for the Maine Insurance Department and would be interested in seeing copies of what else was available, and also requested comments on what he had prepared. Rick Morse (N.Y.) said he could provide copies of brochures submitted to the New York department. Mr. Dunlap asked that copies of the materials and the revised draft of the disclosure document (Attachment Five-A2) be submitted to Carolyn Johnson (NAIC/SSO) by Feb. 24 for distribution to the working group members.

4. Actuarial Study

The working group discussed completion of an actuarial study to determine reasonable minimum payouts. Mr. Foley agreed to continue work on this project.

5. Amendments to NAIC Viatical Settlements Model Act and Regulation

Mr. Dunlap asked working group members and interested parties to submit comments about any amendments to the models that might be necessitated by the passage of the Health Insurance Portability and Availability Act of 1996 (Kassebaum/Kennedy). He asked interested parties to specifically identify the changes by reference to the model section.

Having no further business, the Viatical Settlements Working Group adjourned at 2:15 p.m.

ATTACHMENT FIVE-A1

Sample Doctor's Certification

Date

Re: Viatical Settlement Provider/Viator I.D. [Drafting note: I used Viator I.D. versus Viator name to protect confidentiality]

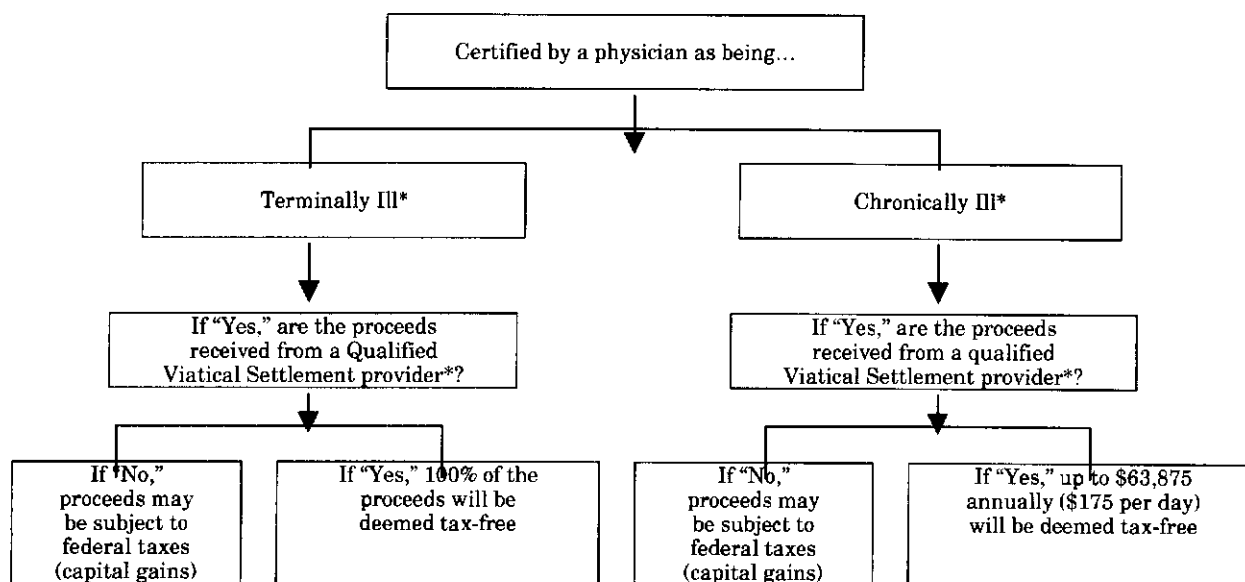
Dear Viatical Settlement Provider:

[insert physician's name/credentials/affiliation] has reviewed [insert source of information (e.g., insured's medical records, case synopsis, etc.)]. It is probable that the Viator will not survive more than 24 months. The Viator [insert what the decision is based on (e.g., clinical experience, work experience, statistical system, etc.)]

Sincerely,

Physician's Name

ATTACHMENT FIVE-A2

FEDERAL TAX DISCLOSURE
FLOWCHART

This disclosure does not constitute tax advice.
Consult a tax advisor for a determination of the tax ramifications.

*These are defined terms. Please see attached Federal Tax Disclosure Statement for additional information.

FEDERAL TAX DISCLOSURE STATEMENT
(Federal Tax Ramifications of Viatical Settlement Proceeds)

Effective Jan. 1, 1997, life insurance payments received as the result of a viatical settlement are not included in taxable income if certain requirements are met. Generally, tax-free treatment is available for proceeds received on the life of an individual who is either "terminally ill" or "chronically ill." This disclosure does not constitute tax advice. You should consult your tax advisor for a determination of the tax ramifications of your own situation.

I. DEFINITIONS

"Chronically ill" means:

- a.) Being unable to perform at least two activities of daily living (i.e., eating, toileting, transferring, bathing, dressing or continence);
- b.) Requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment; or

c.) Having a level of disability similar to that described in (a) above as determined by the Secretary of Health and Human Services.

"Qualified Viatical Settlement Provider" means an entity:

- a.) Licensed in your state as a "viatical settlement provider", or
- b.) If your state does not require licensing, meeting certain requirements pertaining to general rules and disclosure contained in Sections 8 and 9 of the National Association of Insurance Commissioners (NAIC) Model Viatical Settlement Act.

"Terminally ill" means having an illness or sickness which can reasonably be expected to result in death in 24 months or less.

II. TERMINALLY ILL INDIVIDUALS

Generally, the full amount of life insurance payments received on the life of an individual who is terminally ill is tax-free if the following two requirements are met:

- a.) The insured individual has been certified by a physician as being terminally ill; and
- b.) The proceeds are received from a qualified viatical settlement provider.

If the insured individual has not received a proper certification or if the proceeds are received from someone other than a qualified viatical settlement provider, the proceeds may be subject to federal income tax.

III. CHRONICALLY ILL INDIVIDUALS

Generally, certain limited amounts of life insurance proceeds received on the life of an individual who is chronically ill are tax-free if the following three requirements are met:

- a.) The insured individual has been certified by a licensed health care practitioner as being chronically ill;
- b.) The proceeds are received from a qualified viatical settlement provider; and
- c.) If the proceeds are received as a lump sum or periodic payments, the tax-free amount is limited to \$63,875 annually. If the proceeds are received as daily payments the tax-free amount is limited to \$175 per day. Both amounts are indexed after 1997. Amounts received in excess of these limits may be subject to Federal income tax. Additional rules apply in the unusual case where the amounts are received in a reimbursement/indemnity arrangement for long-term care expenses.

If the insured individual has not received a proper certification or if the proceeds are received from someone other than a qualified viatical settlement provider, the proceeds may be subject to federal income tax as a capital gain.

ATTACHMENT SIX

Life Disclosure Working Group
Orlando, Florida
March 15 and March 18, 1997

The Life Disclosure Working Group of the Life Insurance (A) Committee met in the Junior Ballroom G Room of the Omni Rosen Hotel in Orlando, Fla., at 10 a.m. on March 15, 1997, and reconvened in the Grand A Room of the Omni Rosen Hotel in Orlando, Fla., at 10:30 a.m. on March 18, 1997. Rick Morse (N.Y.) chaired the meeting. The following working group members were present: Tom Foley (N.D.), Vice-Chair; Don Koch (Alaska), Roger Strauss (Iowa); Lester Dunlap (La.); Paul DeAngelo (N.J.); Jerry Fickes (N.M.); Louis Belo (N.C.); Ted Becker (Texas); and Troy Pritchett (Utah).

1. Discuss 1998 Charges

Rick Morse (N.Y.) said that the working group was charged with developing regulations in three areas: non-variable annuities, variable life insurance, and equity-indexed products. He said he hoped that the work could be handled within the working group, but, if not, subgroups could work on each issue. No additional suggestions for charges were received.

2. Annuity Disclosure Provisions

Barbara Lautzenheiser (Lautzenheiser & Associates) summarized the work that had been done by the technical resource advisors. She said that they recommended concentrating on a disclosure document because of the differences of company practices in comparisons to life insurance. She said the disclosure document being suggested by the technical resource advisors did not go into great detail so it could be used for all types of annuities.

Mr. Morse said the working group will need to consider when an interest rate quote might trigger a full illustration. Mr. Foley asked the members of the audience whether an illustration was ever used with a "plain vanilla annuity." Linda Lanam (Life of Virginia) said that the technical resource advisors discovered some differences company by company. She said that her company did not have software for annuity illustrations. She also noted that the annual reports typically used by annuity companies show accumulations but do not project forward. She noted the consumer problems being dealt with by most companies had to do with misunderstandings in the application of surrender charges. Charlotte Liptak (Transamerica) said that her company did have illustration capacity for some types of "plain vanilla" annuities, but use of the illustration was optional for an agent and

she did not know how widely the illustrations were used. Tom Foley (N.D.) said that the working group members would need to decide what was a "plain vanilla annuity" if they wanted to eliminate illustrations for "plain vanilla annuities."

Steve Frankel (Northwestern Mutual) said he would like to introduce the concept of "expected renewal." He thought it would help a consumer to see what the rate would be after the guarantee period was over. Elizabeth Sutherland (TIAA-CREF) said her company provided an illustration on every sale it made. She said the purpose of the illustration was not necessarily for the sales process, but to serve as a counseling tool. The company also provides an updated illustration each year. She suggested that it was appropriate when sales were made for retirement purposes to focus on the annuitized value rather than the accumulation value. Jerry Fickes (N.M.) reinforced the idea that an illustration should be a tool to help individuals understand what they were buying. He noted that this was a problem he had seen with life insurance illustrations, and he thought that the illustration helped remind people later of what they had purchased. Paul DeAngelo (N.J.) suggested that not very many consumers understand an illustration. He wondered whether the illustration would help the consumer or would protect the agent that sold it. He expressed grave concern about using illustrations for annuity sales, but suggested a simple disclosure document was useful so that the person purchasing the annuity would understand what he was purchasing. Mr. Morse said he did not think it was inherently wrong to have a document that protected the agent and noted that people often hear what they want to hear. He expected that in the future the insurance industry will begin to emphasize the life income of an annuity more and more because it gives them a competitive edge over other financial products.

John Hartnedy (Ark.) suggested that regulators tend to get a biased view because people do not call the insurance department to say how nice their illustration was. The only people who complain to the department have not been satisfied. Scott Cipinko (National Alliance of Life Companies—NALC) said each consumer did not have the same needs and suggested it would not serve consumers well to force or prohibit illustrations. He recommended leaving it up to a consumer to decide whether an illustration is helpful but to require a disclosure document. Larry Gorski (Ill.) expressed concern that when a company says no illustration is used, not everyone is thinking of an illustration in the same way. He suggested that advertising containing numbers or a graph showing the impact of interest on a product is really an illustration. George Coleman (Prudential) agreed that when non-guaranteed elements over a period of years are shown, that is an illustration. If a company wants to talk about interest, it should provide an illustration following a specified format.

Mr. Foley suggested that two-tiered annuities, equity-indexed annuities, and life and annuity combination products need an illustration. The rest seem to only need disclosure. He opined that it was not necessary for an insurer to decide on a policy form basis as the life insurance illustrations regulation does. He also suggested that one of the problems with disclosure is that the disclosures use a great deal of "insurance-eze" that is not understandable by the typical purchaser. Linda Klebold (N.J.) suggested that a standardized format for the periodic reports was important.

Mr. Morse summarized several issues that had been discussed during the prior hour: (1) whether to require an illustration; and (2) whether to develop a three-level approach with mandatory disclosure, or (3) an option of a generic numeric summary or a full individualized personal illustration. He suggested that the decision on which level to use could be made on an applicant-by-applicant basis. Mr. Morse asked for a volunteer to begin drafting a regulation to use to facilitate discussion. Ms. Lanam offered to begin drafting for the working group's consideration. Mr. Morse suggested discussing the draft at an interim meeting of the Life Disclosure Working Group in connection with the illustration symposium being held in Washington, D.C., April 28-29.

Mr. Foley suggested that it was important to specify in the disclosure document that it be written in more understandable English. Mr. DeAngelo agreed that the document would serve no purpose otherwise. Ms. Lanam suggested the difficulty would be in writing a regulation to describe that concept. She said that most companies use the same terms in the disclosure as contained in the policy language. Roger Stauss (Iowa) said he envisioned the disclosure document to be only two or three pages in length, and Ms. Lanam agreed that was likely.

3. Equity-Indexed Products

Mr. Foley provided to the working group members with an overview of disclosure guidelines he was developing for equity-indexed products (Attachment Six-A). He said that because more than 40 states had been approving equity-indexed products, companies do not seem to think there are any special disclosures needed, but Mr. Foley suggested that the products were difficult to understand so disclosure is very important. Mr. Morse noted that it would be well to avoid a problem similar to that in the mid-1980s when interest rates were high. He hoped that the same type of problem would not occur with equity-indexed products because of the high stock market. Mr. Foley said that his filing guidelines contained information that would be required to be disclosed, and noted that Mr. Gorski was developing requirements for reserve information to be provided in Illinois before products were approved. He said that, based on the number of states that had called him, he would anticipate other states following with similar requirements.

In response to a request from the working group, Ms. Liptak provided materials from 10 companies that were marketing various types of equity-indexed product. She said most of the illustrations provided were currently in use, but a few were drafts being developed. She described the main features of each illustration or brochure to members of the working group.

John Booth (American Council of Life Insurance—ACLI) suggested it would be helpful to hold a seminar to help people know more about this type of product. He offered the assistance of the ACLI in finding speakers. Mr. Morse agreed that it was important to think in terms of educating regulators, but he was also interested in talking about how companies trained their agents in this complicated product. He opined that it was necessary to also educate the distribution forces. Mr. Fickes moved, and Don Koch (Alaska) seconded a motion to request permission from the Life Insurance (A) Committee to schedule a symposium as soon as possible on the issue of equity-indexed products. Mr. Foley reinforced the idea that it was important to do this as quickly as possible and suggested the target audience should be rate and filing staff of the insurance departments. Mr.

Koch suggested it might be useful to present the symposium twice: at the NAIC Summer National Meeting in Chicago, and at a separate location, perhaps in Kansas City in early May. The working group passed the motion to request authority to put on a symposium on equity-indexed products. Mr. Fickes noted that each time the regulators looked at this product, they saw more issues. He said the Annuities Working Group discussed the efforts of the Life and Health Actuarial (Technical) Task Force, the Life Disclosure Working Group, and also discussed guaranty fund issues. He wondered who was going to discuss reinsurance issues and questions on investments of insurers. He opined that these were things that regulators needed to learn more about.

Mr. Gorski said that the American Academy of Actuaries (AAA) has a task force on equity-indexed products and is looking at many of these issues. He said one of the questions that had come before the group were whether to illustrate on a hypothetical basis, a historical basis, or on current rates. He said it would be helpful to share Mr. Foley's ideas with the AAA group, although he emphasized that he was in no way suggesting that Mr. Foley curtail his own efforts in North Dakota. Mr. Gorski said the AAA task force is committed to a fast-track effort so it can make recommendations to the NAIC at the Summer National Meeting in Chicago. Mr. Morse asked for clarification as to whether the AAA was considering recommending that an illustration for equity-indexed products be mandated. Mr. Gorski responded that the group had not yet dealt with that issue, but felt it was important to get across the point that the individual may receive only the guaranteed value. Mr. Morse suggested that the AAA task force may come up with a proposal that looks a great deal like that prepared by Mr. Foley. He suggested this is a very urgent issue because the stock market is at historic highs, and insurance companies need to get across the concept of the risk being taken in the purchase of this product. Mr. Gorski noted that Illinois is reviewing the materials used in the sale of equity-indexed products and is rejecting 80% of the advertising material presented. Mr. DeAngelo asked about the material that was in the 20% category. Mr. Gorski said that he reviewed the material to make sure that it did not leave a buyer with an expectation of a return that is inappropriate. He noted that an advertisement or illustration that focuses on recent experience is inappropriate. He opined that a good illustration shows performance under representative scenarios and an inaccurate presentation of the build up of the account value is not appropriate. He also noted that he looks to see if the participation rate is shown accurately. If the company can change the product design by changing the participation rate, the advertising should not emphasize the results showing a high participation rate. Hugh Alexander (Alexander & Crabtree) said that the Society of Financial Examiners (SOFE) has scheduled a seminar for the NAIC Fall National Meeting in Washington, D.C., and suggested that it might be possible to include some information on equity-indexed products at that meeting.

Mr. Foley said it seemed to him that the advertising material was more critical for an equity-indexed product than for many others. He questioned whether many departments had the ability to closely review advertising materials to determine whether they were misleading. Mr. Gorski also noted that, in his department, a special effort had been made to guard against inconsistent analysis between staff members in this new area. He described a process where the members of the staff charged with reviewing the material got together to review and discuss the filing. Lester Dunlap (La.) pointed out that states with a limited number of staff would benefit greatly from having written standards that would give them evaluation assistance.

Mr. Fickes asked if the life illustration that had been recently adopted would cover the equity-indexed life products. He also suggested that regulators be careful not to imply that the equity-indexed product is bad. Mr. Morse responded that, if he had given that impression, he apologized, because that was not his intent. He said New York had been approving similar products since the early 1980s and some of those products had been very successful. Mr. Koch suggested that it would be useful for the complaints database maintained by the NAIC to set up a separate category for equity-indexed products so that it was easier to track those complaints. Mr. Cipinko asked how the guidelines suggested by Mr. Foley would be used. He asked if this would rise to the level of a model and questioned if it would be reviewed in an NAIC forum. Mr. Foley responded that he had been asked by some other states if he had guidelines, and expected to share these with other states as he developed them. He suggested that eventually they might be included in a model, but that was not his immediate intent. Mr. Morse noted that, at the Summer National Meeting, the working group will see what the AAA has accomplished and then decide what the next step will be. He expressed a need to have working group progress on the issue of equity-indexed products. Mr. Cipinko questioned why time was of the essence on this product and said that implies there are problems. Mr. Gorski said that the need for specific guidelines does not necessarily imply any problems, but may be positive—the regulators are eager to allow this type of product but don't have the standards in place. Mr. DeAngelo said this may be a very good product, but regulators need to be sure it is being marketed well. He noted that regulators would probably not see any complaints for several years in any event. Mr. Foley moved, and Mr. Koch seconded, a motion that the outline developed by Mr. Foley be considered by the working group as the beginning of a discussion for the basis of equity-indexed products. The motion was adopted. The working group requested comments on the outline by April 16, 1997, so that they could be discussed at a conference call in early May. Mr. Foley emphasized that comments to him for the North Dakota guidelines would need to be made within a week.

4. Implementation of Life Insurance Illustrations Model Regulation

Mr. Morse noted that New York is hoping to have the Life Insurance Illustrations Model Regulation in place effective Jan. 1, 1998. He said that New York was hampered in its move for quick adoption because it adopted a version of the Life Disclosure Model Regulation by statute and needs the legislature to make changes to avoid inconsistencies before the model illustrations regulation can be adopted. Mr. Foley said that he would like to hear from states that are not working on the adoption of the life insurance illustrations regulation to know why. Mr. Morse agreed it would be helpful for the working group members so that they would know if some changes were necessary to encourage adoption. Ted Becker (Texas) said his state was considering the third draft of a regulation that is somewhat different from the model. He opined that the NAIC model did not include enough information on expense allocation for universal life policies. He pointed out that the same type of detail was needed for other types of policies so that an individual could compare policies to some extent. Mr. Morse responded that he understood the illustrations model was a consensus document, so that it might not contain everything that everyone wanted. Mr. Foley said that the working group envisions allocating an hour or more at each meeting during 1997 to discuss implementation issues.

Mr. Foley said that states that had the regulation already in place had discussed Internet marketing. Mr. Strauss said that Iowa had reviewed some of the materials that are being provided by Internet marketers to compare term policies. Mr. Strauss opined that what is displayed on the Internet should be subject to the Life Insurance Illustrations Model Regulation if a state has adopted it. When he saw the illustrations, he asked himself two questions: 1) Are these subject to the regulation, and 2) do they meet its requirements? Mr. Foley said one firm marketed on the Internet and when the illustrations were first reviewed, they included nonguaranteed elements without providing the full requirements of the illustration regulation. He said the good news was the most recent review of the company's illustrations indicated that the company was using guarantees only, so the requirements of the illustration regulation did not apply. He cautioned, however, that many other term-quoting agencies are in business on the Internet and might be in violation. He asked how to get this information across to the public. He suggested one method was for the NAIC press office to make this material available, and for the trade associations to alert their membership.

Mr. Morse said staff had prepared an additional paragraph to the Question-and-Answer document to expand on Question No. 6.3 and he opined that would clarify the issue of internet marketing. Mr. Koch suggested that the trade associations could put Question 6.3, as well as Question 4.12, out to their members and that would help disseminate the information. Mr. Koch moved, and Mr. DeAngelo seconded a motion to adopt the additional Question-and-Answer paragraph (Attachment Six-B) and to include it in the document. The motion passed. George Coleman (Prudential) cautioned that the illustrations regulation is still relatively new, so more issues will probably crop up. He asked the regulators to keep an open mind to use of something less than a full basic illustration in certain situations.

Wendy Cooper (Equitable Life) said a third party had produced materials that Equitable's agents wanted to use. She said they were not specific to the company's products and asked for guidance from the working group on their use. She agreed to send copies to Carolyn Johnson (NAIC/SSO) for distribution to the working group.

Mr. Koch moved and Mr. Fickes seconded, a motion that the meeting be adjourned. The motion passed. Having no further business, the Life Disclosure Working Group adjourned at 12:30 p.m.

ATTACHMENT SIX-A

INDEXED PRODUCTS - DISCLOSURE GUIDELINES

The nature of indexed products requires disclosure to the applicant/contract owner that, as clearly as possible, provides useful, understandable information for decision purposes. These products have significantly more parameters than variable products which have major disclosure requirements.

The following are to be used in developing marketing, advertising, sales or any information that is provided to an applicant for these products.

1. Each applicant must be provided the illustrations described below and illustrated as attached. No other financial projections may be used in conjunction with the implementation of the contract.
2. Four illustrations must be provided with each one being on a separate page and in at least 14 point type.
3. The illustration attached exhibits the format to be used for each of the four illustrations. Each illustration will have an appropriate heading.
4. The first illustration shows the minimal values available to the policyowner at each illustrated year.
5. The next three use the same format and show, respectively, the worse result, the average result and the best result. These are described below.
6. The annual earnings rate shown is based on the value available to the policyowner at the end of the year shown. This is a compound rate.
7. The account value shown is the lesser of the death benefit and the annuitization determinant.
8. A term description section is required to be provided with the illustrations. This describes all value-determining aspects of the contract, all in consumer-friendly language and format.

DETERMINATION OF ILLUSTRATED VALUES

The monthly value of the equity index used is determined for the last 30 years - 360 values. The company determines for the product to be illustrated the annual earnings rate for each seven year period from this history - 276 rates. This determination must be based on the guaranteed value for all aspects of the product. For example, the guaranteed participation rate must be used unless not available, then the current participation rate minus 50 percentage points must be used.

The 276 earnings rates are ranked from low to high. The mean of the 10 lowest is used for the "lowest" (L) illustration, the mean of the middle 10 is used for the "average" (A) illustration and the mean of the 10 highest is used for the "highest" (H) illustration. The L, A and H annual earnings rates are placed in the year 7 value for the annual earnings rate in the respective

illustrations. An actual seven year period of values that yields this annual earnings rate is given in the INDEX VALUE column. The remaining entries are made. The heading for each L, A, and H illustration must describe it.

The 30 years and 10 samples are open to review. The seven years shown is intended to be one period unless the period is less, then show enough periods to provide 7 years total.

Included are samples for the guaranteed illustration and the H illustration. The format of the A and L illustrations are similar to that for H.

The basic premise used to develop these illustrations was twofold: simplicity and product neutrality. It is deemed important that the applicant have a real opportunity to understand what is being shown. The illustrations need to have few numbers, a lot of white space and a logical flow.

It is critical that the illustration be product design neutral. We do not want to favor a given design, so please review this proposal especially from this perspective.

GUARANTEED VALUES

The values shown on this page are the MINIMUM values available at the time shown.

Your Payment		\$10,000		
Years Since Payment	Account Value	Value If Surrender	Annual Earnings Rate	
0	\$10,000	\$9,000	*	
1	10,000	9,270	*	
2	10,000	9,548	*	
3	10,000	9,835	*	
4	10,000	10,130	0.32	
5	10,000	10,433	0.85	
6	10,000	10,746	1.21	
7	10,000	11,069	1.46	

* The annual earnings rate is negative if the value available is less than the amount paid.

HISTORICAL 30-YEAR AVERAGE CASE

This illustration shows the average performance of this product if it had been purchased at any time in the last 30 years. Actual month-end S&P 500 closing values have been used to model this illustration. The time period shown is when this average performance would have occurred. The average of the 10 single terms that are the average over this period was 5.43% annual compound growth.

Your Payment		\$10,000			
Date	S&P 500 Value	Index Interest	Account Value	Surrender Value	Annual Earnings Rate
May '86	300.0		\$10,000	\$9,000	*
May '87	304.0	\$107	10,107	9,334	*
May '88	288.0	0	10,107	9,360	*
May '89	378.0	2,389	12,476	11,789	5.63
May '90	390.0	116	12,592	12,089	4.86
May '91	458.0	1,890	14,482	12,990	4.46
May '92	444.0	0	14,482	13,998	5.77
May '93	443.0	0	14,482	14,482	5.43

* The annual earnings rate is negative if the value available is less than the amount paid.

ATTACHMENT SIX-B

Questions and Answers Affecting Internet Marketing

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.

4.12 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.

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.

Possible revisions to 6.3:

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

Any effort to sell a particular policy would require the agent or broker to provide the illustration required by the model regulation. Section 4H defines an illustration as "a presentation or depiction that includes nonguaranteed elements of a policy of life insurance over a period of years." If nonguaranteed elements were included in the side-by-side comparison, then the provisions of the regulation must be met. Section 11F(1) requires that an officer of the company certify that the illustration formats meet the requirements of the regulation. Therefore, it is entirely inappropriate to show the nonguaranteed premiums in any manner other than as part of a basic illustration and, if useful, a supplemental illustration.

ATTACHMENT SEVEN

1998 Suggested Charges for Life Insurance (A) Committee

The mission of the Life Insurance (A) Committee is to consider issues relating to life insurance and annuities, review new life insurance products and establish priorities of the Life and Health Actuarial (Technical) Task Force.

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. Complete by Winter National Meeting. Anticipate no extra cost.
2. Review other NAIC models for potential conflicts with the Life Insurance Illustrations Model Regulation. Revise as needed. Identify areas for change and begin amendment process by Winter National Meeting. Consider disclosure issues related to advertising model rules. Approximate cost will be \$3,000.
3. Establish model requirements for policy illustrations or ledger information disclosed or made available to consumers of variable annuities by the Fall National Meeting, subject to coordination with regulatory initiatives of the Securities and Exchange Commission and the National Association of Securities Dealers. Approximate cost will be \$6000.
4. Review various types of annuities and suggest to the parent committee where resolution if necessary should be sought. This is an on-going charge. Approximate cost will be \$1,000.
5. Complete amendments to the Viatical Settlements Model Act and Model Regulation by Summer National Meeting. Approximate cost will be \$2,400.
6. Make recommendations for changes to Life Insurance Replacements Model Regulation and Life Insurance Advertising Model Regulation. Consider replacement issues related to advertising and coordinate with group working on disclosure issues. Develop new model language to deal with issues of suitability, agent compensation and using policy values for financing. Complete by Fall National Meeting. Approximate cost will be \$3,500.

ATTACHMENT EIGHT

Life Insurance (A) Committee Conference Call January 22, 1997

The Life Insurance (A) Committee met by conference call at 9 a.m. on Jan. 22, 1997. A quorum was present and Terri Vaughan (Iowa) chaired the meeting. The following members participated: Larry Hinton (D.C.) on behalf of Patrick E. Kelly (D.C.); Lester Dunlap (La.) on behalf of James H. Brown (La.); Robert C. Macullar (Mass.) on behalf of Linda Ruthardt (Mass.); Dwight K. Bartlett III (Md.); Tom Foley (N.D.) on behalf of Glenn Pomeroy (N.D.); and Rick Morse (N.Y.) on behalf of Greg Serio (N.Y.).

Rick Morse (N.Y.) summarized the initial draft of the letter to the U.S. Department of Labor (DOL). This letter was prepared in response to the DOL Request for Information on general account issues raised as a result of the *Harris Trust* case. Mr. Morse said a new federal law required an insurer with plans subject to the Employee Retirement Income Security Act (ERISA) to treat class participants keeping in mind all of its obligations to policyholders. The DOL is required to issue regulations to implement that new law before the end of 1997. Mr. Morse said the question before the DOL was how to delineate to insurance companies the element of discretion they have when considering plan assets. He said it was key that the DOL recognize that insurers are required to exercise some discretionary judgment. He suggested the U.S. Supreme Court has recognized an abuse of discretion analysis based on all relevant facts and a deference to the judgment of the fiduciary. Steve Kraus (American Council of Life Insurance—ACLI) disagreed with Mr. Morse. He said that, unfortunately, that is not what the new law says. He said it divides insurer's obligations into two time periods. The one of concern now deals with contracts issued to employee benefit plans up to the end of 1998. Mr. Kraus said that, in his opinion, if a plan is not a guaranteed benefit contract, it will be subject to ERISA rules in direct conflict with the insurance law. After 1998 this will require the general account to be administered exclusively for the benefit of those beneficiaries. Until that time the insurer can take into account the interests of other policyholders.

Mr. Morse clarified that the charge to the A Committee was to address questions related to handling of the general account prior to the end of 1998. He suggested that there is adequate authority under the insurance law at this time, and the standards should be the same as are currently in place.

Tom Foley (N.D.) asked what the intent was in drafting this letter. He said the draft draws conclusions and asked how this was possible when the NAIC has not yet formed a working group to address these issues. He asked if the NAIC would have sufficient time to respond to the DOL on the issues. Commissioner Vaughan responded that the Request for Information asks questions about how insurance is being regulated, and the purpose of the letter is to provide information that the DOL will have available as it moves toward the development of regulations. Commissioner Dwight K. Bartlett III (Md.) opined that the draft letter goes beyond providing information. He said this document is speaking for 51 jurisdictions. Mr. Foley agreed that some of the verbiage in the letter is premature. Mr. Morse responded that the NAIC has already spoken in the past in more general terms and suggested it is necessary to put some meat in this letter. He said the DOL will be drafting regulations soon so there is not much time to talk general philosophy. Commissioner Vaughan said there is not time to build consensus before the Jan. 24, 1997, deadline for providing comments. She suggested the letter point out issues and note the ways states deal with these issues. She said the conference call discussion illustrated the difficulty in making recommendations at this time. She asked Mr. Morse to refocus the letter to identify issues and to offer the NAIC's assistance in developing a solution.

Commissioner Vaughan asked the Committee to go through the letter paragraph by paragraph suggesting changes to the draft. Mr. Kraus suggested the use of the term "employee benefit plan" throughout for consistency. He pointed out a particular sentence that only applies to plans up until 1998 and Mr. Morse responded that the entire letter only applies to plans to the end of 1998. Commissioner Vaughan asked Mr. Morse to make this clearer in the letter. The Committee identified several paragraphs or sentences for deletion as pertaining to solutions that had not yet been discussed by the Committee. Other sections were turned into a discussion of the issues rather than a specific position. Commissioner Vaughan suggested that the letter emphasize insurance regulators' expertise and make an offer to assist the DOL. She asked Mr. Morse to revise the letter by the morning of Jan. 23 and asked Carolyn Johnson (NAIC/SSO) to fax it to all of the Committee members that day. She asked Committee members who had comments to call Ms. Johnson by the end of the day and the letter would be revised in response to those comments and prepared for the DOL by the deadline (Attachment Eight-A).

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

ATTACHMENT EIGHT-A

To: Ms. Lyssa E. Hall, Office of Exemption Determinations, Pension and Welfare Benefits Administration, U.S. Department of Labor
 From: Therese M. Vaughan, Iowa Commissioner of Insurance, Chair of the NAIC Life Insurance (A) Committee
 Date: Jan. 24, 1997
 Re: Response to DOL Request for Information on General Account Issues Raised by *Harris Trust Case*

The National Association of Insurance Commissioners (NAIC) is an organization representing the insurance regulators of the 50 states, the District of Columbia and four territories. The NAIC appreciates this opportunity to provide comments in response to the Request for Information published in the *Federal Register* on Nov. 25, 1996.

Pursuant to Section 1460, the Small Business Job Protection Act of 1996 (Public Law 104-188), the Department of Labor is required to issue regulations applicable to general account policies issued on or before Dec. 31, 1998, for the benefit of employee benefit plans to the extent that the policy is not a guaranteed benefit policy. The legislation requires, among other things, that an insurer manage its general account taking into consideration all obligations supported by the general account.

While an exhaustive analysis of the insurance laws of the 50 states is not possible in the short time span to respond, the attached Exhibit A is the NAIC Policy Statement on Financial Regulation and Accreditation Standards. Currently, 48 states and the District of Columbia are accredited by the NAIC under these standards. Also, attached as Exhibit B, is a list of NAIC model laws and regulations dealing with both financial condition and consumer interests that have some impact on products sold to employee benefit plans.

Section 1460 of Public Law 104-188 reaffirms the responsibility of the states to monitor an insurer's financial well-being under accounting practices mandated by state insurance laws assuring the ability of an insurer to meet all obligations to all of its policyholders. A non-differentiated pool of assets, owned by the insurer, is the basic strength of an insurer's financial stability which provides the necessary diversity in investments best suited for the liability characteristics that the insurer has assumed. Congress recognized this fundamental fact in enacting Section 401(c)(3)(D) of the Employee Retirement Income Security Act of 1974 (ERISA) as part of Public Law 104-188. State insurance laws require an insurer to treat all of its policyholders in a fair and equitable manner. These laws also prohibit insurers from engaging in practices that would result in unfair discrimination among policyholders. The states enforce these requirements through review of annual statements filed by insurers and periodic financial and market conduct examinations.

In respect to allocation of expenses and investment income, principles of impartiality should be controlling. There are many state court decisions that address issues pertaining to the ascertainment and allocation of dividends to various classifications of policyholders based upon their contribution to divisible surplus. The same principles of equity have application in this situation. Furthermore, under the contribution to surplus theory, state courts have placed limits on the degree of discretion that an insurer has in ascertainment and distribution of divisible surplus. An insurer cannot act in a manner that would be deemed an

abuse of discretion. Several states have laws or regulations specifically addressing allocation of expenses and investment income based on principle of equity and fairness.

In view of the U.S. Supreme Court decision in *John Hancock Mutual Life Ins. Co. v. Harris Trust & Savings Bank* and Section 1460 of Public Law 104-188, the Department of Labor must address all types of insurance contracts used as a funding vehicle for employee benefit plans, such as, individual life policies, individual annuity contracts, group life policies, allocated and unallocated group annuities, and perhaps, certain health policies or health benefit arrangements. While most of these types of contracts do not impose on plan participants and beneficiaries a shift in investment risk as analyzed by the Supreme Court, the NAIC is concerned that the *Harris Trust* decision may be cited for the proposition that any non-guaranteed benefit or non-guaranteed element of these products will not afford that portion of the policy with an exemption under the "guaranteed benefit policy" language of Section 401(b)(2) of ERISA. Since the federal courts have bifurcated a group annuity contract into its guaranteed and non-guaranteed components, there is a concern that most general account products sold today to employee benefit plans will be subject to all of the requirements of ERISA unless the Department of Labor takes appropriate steps.

Careful thought must be given to such items as disclosure, market value adjustment, allocation of investment income and expenses, experience rating, allocation of dividends, transfers from the general account, elimination of surrender and withdrawal charges, the need to establish a definition for a guaranteed benefit policy in light of the various products made available to employee benefit plans, and insurance company transactions with its subsidiaries involving plan assets.

The NAIC, through its various committees, task forces and working groups, provides a forum for insurance regulators to share ideas and information; discuss and debate issues; and reach solutions by consensus to protect consumers and the financial solvency of the insurance industry. Currently, the NAIC is working on a new standard nonforfeiture law and several disclosure/sales illustration regulations to improve consumer protection. Often the work of the NAIC has to take into consideration the impact of federal laws covering such subjects as taxation, securities and employee benefits.

Given the overlap between the states' regulatory schemes and your rules under development, the NAIC would be prepared to create a working group to work with you on our common areas of concern.

EXHIBIT A

NAIC Policy Statement on Financial Regulation Standards

Introduction

The safety and soundness of insurance companies operating in the United States is a prime objective of state insurance regulators. In many respects non-domiciliary states rely and depend to a great extent on domiciliary insurance departments to effectively monitor and regulate their domestic companies. To ensure that these concerns and objectives are met, an effective financial surveillance and regulation structure and system is needed. While everyone can agree that this is critical, to date no one has yet defined what constitutes an effective structure and system for financial surveillance and regulation. While the NAIC has done a great deal to foster uniformity and sound regulation through various model laws and regulations and standardized financial reporting formats and instructions as well as the development of a variety of manuals and other tools to assist state insurance departments, a comprehensive pronouncement on all functions and procedures relating to financial regulation has not been done. The objective of the NAIC Financial Regulation Standards and Accreditation Subcommittee is to establish standards for the NAIC and state insurance departments in this important area.

It is believed that establishing standards for financial regulation will have the following positive results:

- (1) Strengthen state insurance departments through self-evaluation and improvement to meet the prescribed standards.
- (2) Demonstrate to, and obtain from, state administrations and legislative bodies the support and resources needed to maintain an effective system of financial surveillance and regulation.
- (3) Create a national standard for financial regulation which will improve and strengthen the state regulatory system of insurance and the safety and soundness of insurance companies.
- (4) A standard established by the NAIC will, if attained, ensure that each jurisdiction is monitoring and regulating domestic companies operating in other jurisdictions on an admitted or non-admitted basis or as a risk retention group.
- (5) Improve the efficiency of state regulation by eliminating duplicative procedures and activities and unnecessary state-by-state variations.

The standards recognize the realities of the diverse circumstances of state insurance departments. Standards for financial regulation have been divided into three major categories—(1) laws and regulations; (2) regulatory practices and procedures; and (3) organizational and personnel practices.

A. Laws and Regulations

1. Examination Authority

The department should have authority to examine companies whenever it is deemed necessary. Such authority should include complete access to the company's books and records and, if necessary, the records of any affiliated company, agent or managing general agent. This authority should extend not only to inspect books and records but also to examine officers, employees and agents of the company under oath when deemed necessary with respect to transactions directly or indirectly related to the company under examination. The NAIC Model Law on Examinations or substantially similar provisions shall be part of state law.

2. Capital and Surplus Requirement

The department should have the ability to require that insurers have and maintain a minimum level of capital and surplus to transact business. The department should have the authority to require additional capital and surplus based upon the type, volume and nature of insurance business transacted.

3. NAIC Accounting Practices and Procedures

The department should require that all companies reporting to the department file the appropriate NAIC annual statement blank which should be prepared in accordance with the NAIC's instructions handbook and follow those accounting procedures and practices prescribed by the NAIC *Accounting Practices and Procedures Manual*.

4. Corrective Action

State law should contain the NAIC's Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition or a substantially similar provision which authorizes the department to order a company to take necessary corrective action or cease and desist certain practices which, if not corrected, could place the company in a hazardous financial condition.

5. Valuation of Investments

The department should require that securities owned by insurance companies be valued in accordance with those standards promulgated by the NAIC Securities Valuation Office. Other invested assets should be required to be valued in accordance with the procedures promulgated by the NAIC Financial Condition (EX4) Subcommittee.

6. Holding Company Systems

State law should contain the NAIC Model Insurance Holding Company System Regulatory Act or an act substantially similar and the department should have adopted the NAIC's model regulation relating to this law.

7. Risk Limitation

State law should prescribe the maximum net amount of risk to be retained by a property and liability company for an individual risk-based upon the company's capital and surplus which should be no larger than 10% of the company's capital and surplus.

8. Investment Regulations

State statute should require a diversified investment portfolio for all domestic insurers both as to type and issue and include a requirement for liquidity. Foreign companies should be required to substantially comply with these provisions.

9. Admitted Assets

State statute should describe those assets which may be admitted, authorized or allowed as assets in the statutory financial statement of insurers.

10. Liabilities and Reserves

State statute should prescribe minimum standards for the establishment of liabilities and reserves resulting from insurance contracts issued by an insurer; including life reserves, active life reserves and unearned premium reserves, and liabilities for claims and losses unpaid and incurred but not reported claims. The NAIC Standard Valuation Law and Actuarial Opinion and Memorandum Regulation or substantially similar provisions shall be in place.

Note: Requirements for the Standard Valuation Law are effective July 1, 1997.

11. Reinsurance Ceded

State law should contain the NAIC Model Law on Credit for Reinsurance, the NAIC Credit for Reinsurance Model Regulation and the 1992 NAIC Life and Health Reinsurance Agreement Model Regulation or substantially similar laws.

Note: Requirements for the Credit for Reinsurance Regulation and the 1992 version of the Life and Health Reinsurance Agreements Model Regulation are effective July 1, 1997. The 1985 version of the latter model will suffice until that date.

12. CPA Audits

State statute or regulation should contain a requirement for annual audits of domestic insurance companies by independent certified public accountants, based on the December 1990 version of the NAIC Model Rule Requiring Annual Audited Financial Reports.

Note: The requirement for the 1990 version of the regulation is effective July 1, 1997.

13. Actuarial Opinion

State statute or regulation should contain a requirement for an opinion on loss and loss adjustment expense reserves by a qualified actuary or specialist on an annual basis for all domestic property and casualty insurance companies.

14. Receivership

State law should set forth a receivership scheme for the administration, by the insurance commissioner, of insurance companies found to be insolvent as set forth in the NAIC Insurers Rehabilitation and Liquidation Model Act.

15. Guaranty Funds

State law should provide for a statutory mechanism, such as that contained in the NAIC's model acts on the subject, to ensure the payment of policyholders obligations subject to appropriate restrictions and limitations when a company is deemed insolvent. Sections 3A and 5H of the Life and Health Insurance Guaranty Association Model Act or substantial similar provisions should be included.

Note: Requirements for the specific life and health guaranty association provisions are effective July 1, 1997.

16. IRIS

State statute should contain a provision similar to the NAIC model act requiring domestic insurance companies to participate in the NAIC Insurance Regulatory Information System (IRIS).

17. Risk Retention Act

State law should contain a provision similar to the NAIC Model Risk Retention Act for the regulation of risk retention groups and purchasing groups.

18. Producer Controlled Insurers

State statute should contain the NAIC Model Law for Business Transacted with Producer Controlled Property/Casualty Insurer Act or a similar provision.

19. Managing General Agents Act

State law shall contain a provision similar to the NAIC Managing General Agents Act.

Note: Either the 1990 version or the 1993 version meets the requirements for accreditation.

20. Reinsurance Intermediaries Act

State law shall contain a provision similar to the NAIC Reinsurance Intermediary Model Act.

Note: Either the 1990 version or the 1993 version meets the requirements for accreditation.

21. Diskette Filings

State statute or regulation shall mandate diskette filings, including quarterly statements, for all companies; except states may exempt from this requirement those companies that operate only in their state of domicile.

Note: This requirement is effective July 1, 1997.

22. Risk-Based Capital

The Risk-Based Capital (RBC) Model Act or provisions substantially similar shall be included in state laws or regulations.

Note: The requirement is effective July 1, 1997.

23. Disclosure of Material Transactions

State law shall contain the Disclosure of Material Transactions Model Act or provisions substantially similar.

Note: This requirement is effective July 1, 1997.

B. Regulatory Practices and Procedures

1. Financial Analysis

(a) The department should have a sufficient staff of financial analysts with the capacity to effectively review the financial statements as well as other information and data to discern potential and actual financial problems of domestic insurance companies.

(b) The department should have an intra-department communication and reporting system that assures that all relevant information and data received by the department which may assist in the financial analysis process is directed to the financial analysis staff.

(c) The internal financial analysis process should provide for levels of review and reporting.

(d) The financial analysis procedure should be priority-based to ensure that potential problem companies are reviewed promptly. Such a prioritization scheme should utilize the NAIC Insurance Regulatory Information System or a state's own system, or both.

2. Financial Examinations

(a) The department should have the resources to examine all domestic companies on a periodic basis which is commensurate with the financial strengths and position of the insurer.

(b) The department's examination staff should consist of a variety of specialists with training or experience in the following areas or otherwise have available qualified specialists which will permit the department to effectively examine any insurer: computer audit specialist, reinsurance specialist, life and health company examiners, property and liability company examiners, life and health actuarial examiners, property and liability actuarial examiners and property and liability claims examiners.

(c) The department's procedures for examinations shall provide for supervisory review within the department of examination work papers and reports to ensure that the examination procedures and findings are appropriate and complete and that the examination was conducted in an efficient and timely manner.

(d) The department's policy and procedures for examinations should follow those that are set forth in the NAIC *Examiners Handbook*.

Note: Beginning July 1, 1997, the revised *Financial Condition Examiners Handbook* is required.

(e) In scheduling financial examinations the department should follow those procedures set forth in the NAIC *Examiners Handbook* and this schedule system should provide for the periodic examination of all domestic companies on a timely basis. This system should accord priority to companies which are having adverse financial trends or otherwise demonstrate a need for examination such as determinations of the NAIC IRIS examiner team.

(f) The department's procedures require that all examination reports which contain material adverse findings be promptly presented to the commissioner or his or her designee for a determination and implementation of appropriate regulatory action.

(g) The department's reports of examination should be prepared in accordance with the format adopted by the NAIC and should be sent to other states in which the company transacts business in a timely fashion.

3. Other

(a) The Department should generally follow and observe the procedures set forth in the NAIC *Troubled Insurance Company Handbook*.

(b) State statute should allow for the sharing of otherwise confidential information, administrative or judicial orders, or other action with other state regulatory officials providing that those officials are required, under their law, to maintain its confidentiality. The department should have an established written policy to cooperate and share all information with respect to domestic companies with other state regulators including committees established by the NAIC which may be reviewing and coordinating regulatory oversight and activities. This policy should also include cooperation and sharing information with respect to domestic companies subject to delinquency proceedings.

(c) The department should establish and implement procedures to insure that regulatory actions taken by the Department be reported to the NAIC Regulatory Information Retrieval System (RIRS), that investigative information

be reported to the NAIC Special Activities Database (SAD) and that summary information on complaints be reported to the NAIC Complaints Database Systems (CDS).

Note: Provisions for sharing of confidential information and participating in databases required July 1, 1997.

C. Organizational and Personnel Practices

1. The department should have a policy which requires the professional development of staff through job-related college courses, professional programs or other training programs which are funded by the department.
2. All financial regulation and surveillance activities are the responsibility of an individual who shall report to the commissioner or his designee.
3. The department's staff and contractual staff involved in financial regulation and surveillance should all be periodically evaluated by the department to ensure that job duties and responsibilities are being discharged in a satisfactory manner.
4. The department should establish minimum educational and experience requirements for all professional employees and contractual staff positions in the financial surveillance and regulation area which are commensurate with the duties and responsibilities of the position.
5. The department's pay structure for those positions involved with financial surveillance and regulation should be competitively based to attract and retain qualified personnel.
6. The department's funding should be sufficient to allow for the financial surveillance and regulation staff's participation as appropriate in the meetings and training sessions of the NAIC and meetings relating to the review, coordination and the development and implementation of action for troubled insurers.

EXHIBIT B

1. Risk-Based Capital Model Act
2. Model Asset Valuation Law
3. Investment in Medium Grade and Low Grade Investments Model Regulation
4. Standard Valuation Law
5. Standard Life Non-Forfeiture Law
6. Standard Annuity Non-Forfeiture Law
7. Life and Health Insurance Policy Simplification Model Act
8. Unfair Trade Practices Act
9. Market Conduct Record Retention Model Regulation
10. Insurance Holding Company System Regulatory Act
11. Insurance Holding Company System Model Regulation (with reporting forms)
12. Actuarial Opinion and Memorandum Regulation
13. Model Regulation Requiring Annual Audits of Financial Reports
14. Insurers Rehabilitation and Liquidation Model Act
15. Modified Guarantee Life Insurance Model Regulation