LIFE INSURANCE (A) COMMITTEE

Reference:
1996 Proc. 4th Qtr. 1006
1997 Proc. 1st Qtr. 659

Terri Vaughan, Chair—Iowa
Neil D. Levin, Vice Chair—N.Y.

CONTENTS

MINUTES

The Life Insurance (A) Committee met in the Continental C Room of the Chicago Hilton & Towers in Chicago, Ill., at 10 a.m. on June 11, 1997. A quorum was present and Terri Vaughan (Iowa) chaired the meeting. The following committee members or their representatives were present: Martin Carus representing Neil D. Levin, Vice Chair, (N.Y.); Clark Simcock representing Patrick E. Kelly (D.C.); Lester Dunlap representing James H. Brown (La.); Tom Foley representing Glenn Pomeroy (N. D.); Jerry Fickes representing Chris P. Krahling (N.M.); and Dan Keating representing John Crawford (Okla.).

1. Report of the Viatical Settlements Working Group

Lester Dunlap (La.) reported that the working group convened twice since the Spring National Meeting in furtherance of its charge. First, a small group of regulators met to draft revisions to the Viatical Settlements Model Act, considering proposals from the National Viatical Association, the Viatical Association of America and viatical settlement companies. That draft was sent to interested parties for review in advance of the Summer National Meeting, and during the Summer National Meeting the regulators heard comments for further revisions. Mr. Dunlap highlighted the major changes being suggested: (1) an expanded definition of "viatical settlement provider" includes those who solicit investors in response to a case in California where individual investors have apparently been scammed out of nearly $100 million; (2) information is being included in this draft to conform to the Health Insurance Portability and Availability Act (HIPAA); (3) the model has been expanded to include viatical settlement agents and brokers; (4) new and tougher provisions for revocation have been included, most of these provisions taken from various state laws; (5) the insurance department will have the authority to approve disclosure statements; (6) enhanced disclosure requirements have been included; and (7) a new section on insurance company practices in dealing with viatical settlement providers has been added.

Mr. Dunlap said the working group anticipates receiving further comments and will plan an interim drafting session or a series of conference calls to revise the model draft. He noted that the insurance industry is particularly interested in commenting on the requirements for insurers. It appears this project will be completed by the Winter National Meeting in compliance with the working group charge.

Mr. Dunlap moved and Jerry Fickes (N.M.) seconded a motion to receive the Viatical Settlements Working Group report. John States (State Farm) asked when comments would be due and Mr. Dunlap responded that comments should be forwarded to Carolyn Johnson (NAIC/SSO) by July 10. Commissioner Vaughan asked if these comments would be discussed at a conference call and Mr. Dunlap responded that he preferred a face-to-face meeting to draft and suggested an interim meeting in August. Commissioner Vaughan called for a vote and the motion to receive the report of the Viatical Settlements Working Group passed (Attachment One).

2. Report of Annuities Working Group

Mr. Fickes reported that the Annuities Working Group had discussed a survey of state laws on annuities to see what issues states think are important. He noted that the responses indicate states are very interested in the issue of equity-indexed annuities and noted that the Life Disclosure Working Group is already coordinating this issue. The survey indicated an interest on the part of states in the issues of suitability for the purchase of annuities and sales to senior citizens. Mr. Fickes said that the working group will ask states to give examples of problems and concerns they have in this area. The working group also discussed how the Insurance Marketplace Standards Association (IMSA) may address this issue and requested a presentation from IMSA at the Fall National Meeting.

The Annuities Working Group is developing a model on charitable gift annuities. After receiving input from the American Academy of Actuaries (AAA) in September, the working group expects to be ready to adopt the Charitable Gift Annuities Model Act.

Mr. Fickes moved and Martin Carus (N.Y.) seconded a motion to receive the Annuities Working Group report. The motion passed (Attachment Two).

3. Report of Life Disclosure Working Group

Tom Foley (N.D.) said the Life Disclosure Working first heard a report on the Generally Recognized Expense Table (GRET) for sales illustrations. He noted this had been developed for the Life Insurance Illustrations Model Regulation in 1996 and is being updated. Mr. Foley said that the working group spent a considerable amount of time discussing equity-indexed product disclosures and heard reports from the AAA, technical resource advisors and a North Dakota bulletin under development. The working group also discussed what will be included in a regulation on disclosure and illustrations for annuities. He said the Annuity Disclosure and Sales Illustrations Model Regulation attached to the working group minutes will be updated in response to the discussion and the working group expects to hold an interim meeting in August to discuss that revised draft. Mr. Foley said the AAA will work on issues related to self-support and lapse-supported illustrations. At this time the working group does not anticipate requiring an illustration for annuities, but if an illustration is used it must meet the requirements in the regulation. The working group plans to have the model ready to recommend for adoption by the Winter National Meeting.

Mr. Foley moved and Mr. Fickes seconded a motion to receive the Life Disclosure Working Group report. The motion passed (Attachment Three).

4. Report of Replacement Issues Working Group

Paul DeAngelo (N.J.) said the working group reviewed a draft of a new replacement regulation prepared by the chair that included the various suggestions on the table for discussion. The draft attempts to remove disincentives for agents not to report replacements. He said the document is intended to replace the current NAIC model on replacements of life insurance and annuities, but the version included in the working group's report does not show the changes from the prior version because they are so extensive. He noted that the new draft defines and regulates financed sales. A notice is included for all sales, not just replacements, so that replacement can more easily be identified. He asked that comments on the draft be forwarded to Ms. Johnson by Aug. 1 and an interim meeting will be held later in August to prepare a revised draft for the Fall National Meeting.

Mr. Fickes moved and Mr. Carus seconded a motion to receive the Replacement Issues Working Group report. The motion passed (Attachment Four).

5. Report of Synthetic GIC Working Group

Mr. Carus reported for Larry Gorski (Ill.), Chair. He said the technical resource advisors had prepared an alternative draft on synthetic guaranteed interest contracts (GICs) and most of the working group meeting was spent reviewing their recommendations, which are attached to the working group minutes. The section on reserving has been forwarded to the Life and Health Actuarial (Technical) Task Force for comment. The working group reviewed approximately 40% of the model during its meeting, and plans an interim conference call to continue the review. Mr. Carus said he did not believe the working group's project would be completed by the end of the year but should be completed by early 1998. He noted the working group has also requested an opinion of legal counsel on the responsibility of custodians.

Mr. Carus moved and Clark Simcock (D.C.) seconded a motion to receive the Synthetic GIC Working Group report. The motion passed (Attachment Five).

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

Mr. Foley reported that the task force spent a considerable amount of time discussing equity-indexed products and heard a report from the AAA. He noted that the AAA members had spent literally hundreds of hours on developing concepts of reserving and investment issues for the AAA report. The task force also discussed the issues surrounding the revised standard nonforfeiture law and expects to have an updated draft out within a month. Interim meetings related to actuarial issues will be held for a week in August. The Actuarial Opinion and Memorandum Regulation was discussed, and it was decided to put on hold the development of a central depository until criteria had been developed for Section 7 and Section 8 opinions under the Actuarial Opinion and Memorandum Regulation.

Mr. Foley noted that the report of the Life and Health Actuarial (Technical) Task Force included a recommendation to adopt a revised Actuarial Guideline XXXIII. Mr. Foley asked the Life Insurance (A) Committee to consider adoption of a further amendment to clarify the intent of the drafters (Attachment Six). Mr. Foley explained that a phase-in period has been granted for the reserves after the effective date of the Actuarial Guideline XXXIII, with one-third of the higher reserves to be required at the end of 1998, another one-third at the end of 1999, and the remaining one-third required at the end of the year 2000. Mr. Foley moved and Mr. Fickes seconded a motion to adopt the report of the Life and Health Actuarial (Technical) Task Force, including his suggested clarifying revision to Actuarial Guideline XXXIII. The motion passed.

Commissioner Vaughan asked if this would go straight to the Executive Committee or whether there needs to be a report to the Financial Condition (EX4) Subcommittee for changes to the blanks or other financial changes. Mr. Foley said it was his understanding that the report could go to the Executive Committee.

7. Discussed Charge to Comment on Department of Labor (DOL) Proposed Regulations

Commissioner Vaughan reported that the Executive Committee adopted a charge for the Life Insurance (A) Committee to "analyze the regulation proposed by the U.S. Department of Labor to set standards for insurance policies and contracts that will be deemed to be in compliance with the fiduciary standards of ERISA, coordinate with committees analyzing similar issues, and provide comment." She said the DOL regulations were expected out by the end of June so she would appoint a working group to work on this charge. She asked states that are interested in participating on this issue to call Ms. Johnson to indicate their interest.

Having no further business, the Life Insurance (A) Committee adjourned at 10:45 a.m.

ATTACHMENT ONE

Viatical Settlements Working Group
Chicago, Ill.
June 7, 1997

The Viatical Settlements Working Group of the Life Insurance (A) Committee met in the Continental A Room of the Chicago Hilton & Towers in Chicago, Ill., at 10 a.m. on June 7, 1997. Lester Dunlap (La.) chaired the meeting. The following working group members or their representatives were present: Ron Kotowski (Ill.); Rick Diamond (Maine); Tom Jacks (N.C.); Bill Lardy representing Tom Foley (N.D.); Monica Swink representing Gary Chartier (Okla.); and Ted Becker representing Rhonda Myron (Texas).

Lester Dunlap (La.) announced that some of the working group members met in Kansas City in May for one and a half days to create a draft of revisions to the Viatical Settlements Model Act (Attachment One-A). He said the draft incorporated provisions from some of the states, particularly New York, Illinois, Florida and Texas, and information from the viatical trade associations and from viatical companies. He said the purpose of this meeting was to go through the draft and identify areas that need more extensive discussion. He pointed the group to the goal of adoption of a revised Viatical Settlements Model Act by the end of 1997. Mr. Dunlap said after the issues had been identified time would be set aside between the Summer National Meeting and the Fall National Meeting to discuss these issues in detail. Doug Head (Medical Escrow Society) asked if the working group was interested in hearing suggestions for fine-tuning, or whether they wanted to hear the major issues. Mr. Dunlap responded that the group would focus on major issues, but if there was a minor point that could be dealt with quickly it should be brought up.

Section 2: Definitions

Mr. Dunlap said Subsection A had been added to address concerns over entities soliciting investments and outlined a controversial case in Louisiana were more than $400,000 had been solicited. He said this definition along with other portions of the model would specifically address these instances where no other entities has assumed jurisdiction over participants. Drew Backstrand (ViatiCare) said he understood the regulators' concern about those who were soliciting investors. He said the Viatical Association of America (VAA) had a concern that large investment companies would not want to get a viatical providers' license so would quit lending money to the viatical industry. He suggested the draft could be narrowed to only address the problems with individual investors. Mr. Dunlap agreed that the entire financing issue was one of the problems that would need to be addressed further.

Mr. Dunlap stated that the information in Subsection C was new language, most of which has been provided by Viaticus. Holly Roth (Viaticus) said she believed it was important to reference viatical settlement agents in the model act, but did not think it was appropriate to refer to an agent soliciting funds. Mr. Head agreed that having reference to an agent on the funding side opens a whole new area of less appropriate behavior.

With regard to Subsection D, Mr. Backstrand suggested the members of the working group review a draft that had been prepared by the VAA and the National Viatical Association (NVA), but had not been received by the members of the working group until after the drafting session. He suggested that there was helpful language for Subsection D, and also said that draft addressed loans, which was an option that was not considered in this draft.

The working group next reviewed Subsection F. Mr. Dunlap noted that this section also talks extensively about the funding issue. Mr. Head provided the working group with a draft dated June 4, 1997, prepared by the VAA Legislative Committee. He referred to Subsection F(3) of that draft which reads "any individual who has an immediate family or other close consensual or close personal relationship to the insured and who enters into no more than three agreements in a calendar year for the assignment, sale or transfer of a life insurance policy or certificate for any value that less than the expected death benefit; immediate family means parents mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, or children." Ron Kotowski (Ill.) questioned the benefit of the VAA suggested language. He noted that it defined immediate family but not "close personal relationship." Mr. Head responded that, since many of the sales are from the AIDS community, it would allow those in a personal relationship with an AIDS victim to fund the agreement. Mr. Kotowski asked why the VAA recommended three agreements. Mr. Head responded that providers have run into situations where an individual has more than one life insurance policy, and relatives or friends are interested in viaticating all of the policies. Mr. Dunlap asked if there were any comments about Subsection G, the definition of viator. John Mathews (Allstate Life) said the definition made the viator an individual. Later the term is used to refer to the owner of a life insurance policy. He asked how this would work if the owner was a business, such as the corporate owner of a group life insurance policy.

Mr. Backstrand said that one of the VAA members had suggested that a provision be included to say the model covered contracts that were entered into in the state by residents of the state.

Mr. Dunlap asked if there were any more comments on Section 2, and Mr. Head responded that the VAA Legislative Committee draft included more definitions such as "financing entity," "financing transaction" and "viatical settlement."

Section 3: License Agreements

Ms. Roth commented that the VAA Legislative Committee draft breaks out the appointment process and fees for each of the types of entities covered under Subsection B. Mr. Head said that he thought it important te state that appointments end upon revocation of a license.

Section 4: License Revocation

Mr. Dunlap pointed out that some provisions have been added to Section 4 from other state laws to strengthen the grounds for revocation. Mr. Backstrand said the VAA supported these wholeheartedly except for the provisions for the misdemeanor involving moral turpitude. He said that provision was too broad and would like to see it removed. Ms. Roth said that Paragraphs 5 and 6 were captured elsewhere in the model act. Mr. Head suggested the model should also include discretion to impose fines for these types of violations. Mr. Dunlap said this was actually covered in Section 13 as a violation of the Unfair Trade Practices Act, which will lead to fines. Mr. Kotowski pointed out a new Subsection B and C in the VAA Legislative Committee draft, and opined that the working group should give consideration to adding these provisions.

Section 5: Approval of Viatical Settlement Contracts and Disclosure Statements

Mr. Dunlap said that this section had been revised to include a filing requirement for disclosure statements. Ms. Roth responded that this was a good idea and suggested the language should be broadened to apply also to forms that might be used by brokers. She said the VAA Legislative Committee draft used the term "person" instead of "viatical settlement provider."

Section 6: Reporting Requirements

Mr. Head suggested that the term "licensee" was not appropriate in this location because a licensee includes the viatical settlement agent who works under another licensee. He also suggested merging the requirements of Section 6 and Section 7.

Section 7: Confidentiality

Mr. Dunlap noted that the suggestions made by the VAA were similar to those that were included in this draft.

Section 8: Examination

Mr. Dunlap said the last sentence added to Subsection C required maintenance of records for five years. Mr. Head suggested that this language be restricted to providers because agents and brokers may not be aware of the time of death of the viator. He also suggested three years was a more appropriate time limit. Mr. Backstrand asked the members of the working group to consider the VAA draft immunity provision.

Section 9: Disclosure

Patty Parachini (American Council of Life Insurance—ACLI) pointed out that if the working group changes the numbering by adding a section on confidentiality, this would become confusing under the Health Insurance Availability and Portability Act (HIPAA) because it refers te Sections 8 and 9 of the Viatical Settlements Model Act. Mr. Dunlap agreed this is important and the working group could follow the VAA draft suggestion of combining the reporting and confidentiality requirements. Ms. Roth suggested changing the language of Subsection E te provide a 15-day recession period for simplicity.

Mr. Mathews pointed out that in Subsection A and Subsection I the availability of policy loans from the life insurer should also be mentioned along with the other alternatives available under life insurance policies.

Section 10: General Rules

Mr. Head said Subsection C of the VAA draft added more specificity about how the recession process should work. He also said Subsection H had been added te include more specificity on tracking the health status of the viator, but this could be included instead in the model regulation. Mr. Backstrand encouraged the working group to consider the language for Subsection D from the VAA draft, including strengthened rules in regard te escrow agente. He also noted that the VAA draft made some revisions to the model law to match the typical laws on escrow agents found in the states.

Section 11: Insurance Company Practices

Mr. Mathews said that the ACLI task force members had not yet had an opportunity to review this provision but he was sure that they would want to comment. He said his company had serious objections because it appeared that the legislative intent was to transfer the costs involved in the transaction from the viatical settlement provider to the insurer. He said the viatical settlement provider should be required to provide proof it was licensed. Ms. Roth agreed that this was important language to add to the draft and pointed out that it was included in the VAA draft.

George Coleman (Prudential) objected to Subsections C and D as attempts to convert a non-assignable into an assignable policy and a non-convertible into a convertible policy. Mr. Dunlap noted that there had been other suggestions that had not been incorporated into this draft but some were included in an attempt to assure the same services that a company would provide to an individual be available to the viatical settlement provider acting in the place of the insured. Gary Choades (Viaticus) announced that the California legislature is considering a bill (AB 489) addressing these issues. The insurance industry and the viatical settlement industry in California have come to a general agreement on appropriate actions to be taken by the two industries.

Section 12: Authority to Promulgate Regulations

Mr. Head said that some state laws now require a very large bond and encouraged the working group to maintain the provision for "another mechanism for financial accountability." He asked also that the draft include a provision allowing an annuity or loan against the policy. Mr. Dunlap asked the interested parties that had commented at the meeting to put their comments in writing as soon as possible and said these issues would be addressed at an interim meeting or by a series of conference calls.

Having no further business, the Viatical Settlements Working Group adjourned at 11:35 a.m.

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ATTACHMENT ONE-A

VIATICAL SETTLEMENTS MODEL ACT
Draft: 5/15/97

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Section 1. Short Title

This Act may be cited as the Viatical Settlements Act.

Section 2. Definitions

A. "Participant" means an underwriter, placement agent, lender, purchaser of securities, credit enhancer or other participant (other than a viatical settlement provider) in a financing transaction.

Comment: This definition was suggested by Viaticus.

~~A~~ B. "Person" means a natural or artificial entity, including but not limited to, an individual~~s~~, partnership~~s~~, limited liability corporation, association~~s~~, trust~~s~~ or corporation~~s~~.

Comment: Limited liability corporations were inserted wherever forms for entities are listed.

C. "Viatical settlement agent" means a person who is an authorized agent of a licensed viatical settlement provider and is appointed by at least one viatical settlement provider, and any other representative of the agent, who acts or aids in any manner in the solicitation of a viatical settlement or in the solicitation of funding for viatical settlements on behalf of the viatical settlement provider. Viatical settlement agent shall not include

(1) An attorney, an accountant, a financial planner or any person exercising a power of attorney granted by a viator; or

(2) Any person who is retained to represent a viator and whose compensation is paid by or at the discretion of the viator regardless of whether the viatical settlement is consummated. A viatical settlement agent is deemed to represent only the viatical settlement provider.

Comment: Most of this language is taken from a suggestion from Viaticus. The agent appointment provision comes from the Illinois statute.

~~B~~ D. "Viatical settlement broker" means an individual, partnership, limited liability corporation, corporation or other entity ~~who or which for another~~ that on behalf of a viator and for a fee, commission or other valuable consideration, offers or advertises the availability of viatical settlements, introduces viators to viatical settlement providers, or offers or attempts to negotiate viatical settlements between a viator and one or more viatical settlement providers. Irrespective of the manner in which the viatical settlement broker is compensated, a viatical settlement broker is deemed to represent only the viator and owes a fiduciary duty to the viator to act according to the viator's instructions and in the best interest of the viator. ~~"Viatical settlement broker" does not include an attorney, accountant or financial planner retained to represent the viator whose compensation is not paid by the viatical settlement provider.~~ The term does not include an attorney, accountant or financial planner retained to represent the viator whose compensation is paid directly by or at the direction of the viator.

Comment: Most of the revisions are from a suggestion by the National Viatical Association (NVA). They clarify the language and the intent of the original model.

~~C~~ E. "Viatical settlement contract" means a written agreement entered into between a viatical settlement provider and a viator ~~person owning a life insurance policy or who owns or is covered under a group policy insuring the life of a person who has a catastrophic or life threatening illness or condition~~. The agreement shall establish the terms under which the viatical settlement provider will pay compensation or anything of value, which compensation or value is less than the expected death benefit of the insurance policy or certificate, in return for the viator's ~~policyowner's~~ assignment, transfer, sale, devise or bequest of the death benefit or ownership of the insurance policy or certificate of insurance to the viatical settlement provider.

Comment: These are National Viatical Association (NVA) suggestions. Using a defined term makes the definition more concise and accurate.

~~D~~ F. "Viatical settlement provider" means an individual, partnership, corporation or other entity that enters into a viatical settlement contract. ~~an agreement with a person owning a life insurance policy or who owns or is covered under a group policy insuring the life of a person who has a catastrophic or life threatening illness or condition, under the terms of which the viatical settlement provider pays compensation or anything of value, which compensation or value is less than the expected death benefit of the insurance policy or certificate, in return for the policyowner's assignment, transfer, sale, devise or bequest of the death benefit or ownership of the insurance policy or certificate to the viatical settlement provider.~~ Viatical settlement provider also means an entity that obtains financing from a participant for the purchase, acquisition, transfer or other assignment of one or more viatical settlement contracts, viaticated policies or interests therein (including, without limitation, any secured or unsecured financing, any securitization transaction or any securities offering that either is registered or exempt from registration under federal and applicable state securities law) or otherwise sells, assigns, transfers, pledges, hypothecates or otherwise disposes of one or more viatical settlement contracts, viaticated policies or interests therein. Viatical settlement provider does not include:

(1) A bank, savings bank, savings and loan association, credit union or other licensed lending institution that takes an assignment of a life insurance policy as collateral for a loan;

(2) The issuer of a life insurance policy providing accelerated benefits under Section [refer to law or regulation implementing the Accelerated Benefits Model Regulation or similar provision]; or

(3) A natural person who enters into no more than one agreement in a calendar year for the transfer of life insurance policies for any value less than the expected death benefit.

Comment: Most of the changes were suggested by the NVA. Using the defined term makes the definition more concise and accurate. Most of the language on financing entities comes from a Viaticus suggestion.

~~E~~ G. "Viator" means ~~the owner of a life insurance policy insuring the life of~~ a ~~person~~ an individual with a catastrophic, ~~or~~ life-threatening or chronic illness or condition~~or the certificateholder who enters into an agreement under which the viatical settlement provider will pay compensation or anything of value, which compensation or value is less than the expected death benefit of the insurance policy or certificate, in return for the viator's assignment, transfer, sale, devise or bequest of the death benefit or ownership of the insurance policy or certificate to the viatical settlement provider~~ who is the owner of an individual life insurance policy or the certificate holder under a group policy insuring that person's life who enters or seeks to enter into a viatical settlement contract or an oral or written contract or agreement with a viatical settlement provider.

Comment: At the suggestion of the NVA, this was reworded to clarify that the language applies both to the policy owner and certificate holder of a group policy. Chronic illness was added in response to the invitation to set standards contained in the Health Insurance Portability and Availability Act of 1996 (HIPAA).

Section 3. License Requirements

A. ~~No individual, partnership, corporation or other entity may act~~ A person shall not operate as a viatical settlement provider, viatical settlement agent or viatical settlement broker ~~or enter into or solicit a viatical settlement contract~~ without first having obtained a license from the commissioner.

Comment: Standards for viatical settlement agents and brokers have been added throughout the model. A member of states have included this in their Acts. A technical change was made to use the defined term "person."

Drafting Note: Insert the title of the chief insurance regulatory official wherever the term "commissioner" appears.

B. Application for a viatical settlement provider, viatical settlement agent or viatical settlement broker license shall be made to the commissioner by the applicant on a form prescribed by the commissioner, and these applications shall be accompanied by ~~a~~ fees ~~of$[insert amounts]~~ as specified in Section [insert appropriate section].

Comment: Most states list fees for all types of licenses in one statute or regulation. This change introduces a reference to that location.

C. Licenses may be renewed from year to year on the anniversary date upon payment of ~~the~~ annual renewal fees as specified in Section [insert appropriate section] ~~of $[insert amounts]~~. Failure to pay the fees by the renewal date results in expiration ~~within the terms prescribed shall result in the automatic revocation~~ of the license.

Comment: In most states licenses expire if not renewed.

D. The applicant shall provide ~~such~~ information ~~as the commissioner may require~~ on forms ~~prepared~~ required by the commissioner. The commissioner shall have authority, at any time, to require the applicant to fully disclose the identity of all stockholders, partners, officers and employees, and the commissioner may, in the exercise of the commissioner's discretion, refuse to issue a license in the name of any firm, partnership or corporation if not satisfied that any officer, employee, stockholder or partner thereof who may materially influence the applicant's conduct meets the standards of this Act.

E. A license issued to a partnership, corporation, limited liability corporation, or other entity authorizes all members, officers and designated employees to act as viatical settlement providers or brokers under the license, and all those persons shall ~~must~~ be named in the application and any supplements to the application.

F. Upon the filing of an application and the payment of the license fee, the commissioner shall make an investigation of each applicant and may issue a license if the commissioner finds that the applicant:

(1) Has provided a detailed plan of operation; ~~and~~

(2) Is competent and trustworthy and intends to act in good faith in the capacity involved by the license applied for; ~~and~~

(3) Has a good business reputation and has had experience, training or education so as to be qualified in the business for which the license is applied for; and

(4) If a corporation, ~~is a corporation incorporated under the laws of this state or a foreign corporation authorized to transact business in this state.~~ provides a certificate of good standing from the state of its incorporation.

Comment: The revised Paragraph (4) is from the NVA.

G. The commissioner shall not issue ~~any~~ license to ~~any~~ nonresident applicant operating in the state, unless a written designation of an agent for service of process is filed and maintained with the commissioner or the applicant has filed with the commissioner, the applicant's written irrevocable consent that any action against the applicant may be commenced against the applicant by service of process on the Commissioner of Insurance.

Section 4. License Revocation

A. The commissioner may ~~shall have the right to~~ suspend, revoke or refuse to renew the license of ~~any~~ viatical settlement provider, viatical settlement agent or viatical settlement broker if the commissioner finds that:

(1) There was any material misrepresentation in the application for the license;

Comment: Suggested by the NVA to clarify the original intent.

(2) The holder of the license or any officer, partner or key management personnel has been convicted ~~guilty~~ of fraudulent or dishonest practices, is subject to a final administrative action or is otherwise shown to be untrustworthy or incompetent ~~to act as a viatical settlement provider~~;

Comment: Several states have this language.

(3) The viatical settlement provider ~~licensee~~ demonstrates a pattern of unreasonable payments to viators ~~policyowners~~; ~~or~~

(4) ~~The licensee has been convicted of a felony or any misdemeanor of which criminal fraud is an element; or~~ The licensee has been found guilty of, or has pleaded guilty or *nolo contendere* to, a felony, or a misdemeanor involving fraud or moral turpitude, regardless of whether a judgment of conviction has been enter by the court;

(5) The viatical settlement provider has issued viatical settlement contracts that have not been approved pursuant to this Act;

(6) The viatical settlement provider has failed to honor contractual obligations related to the business of viatical settlement contracts;

(7) The licensee no longer meets the requirements for initial licensure;

Comment: The language of Paragraphs (4) to (7) is taken from the Florida law.

(8) The viatical settlement provider has sold, assigned, transferred or pledged a viaticated policy to a person other than a viatical settlement provider licensed in this state or in a state with a similar law; or

Comment: The language is reworded from a suggestion made by Viaticus.

~~(5)~~ (9) The licensee has violated any of the provision of this Act.

B. Before the commissioner shall deny a license application or suspend, revoke or refuse to renew the license of a viatical settlement provider, the commissioner shall conduct a hearing in accordance with [cite the state's administrative procedure act].

Section 5. Approval of Viatical Settlements Contracts and Disclosure Statements

~~No~~ A viatical settlement provider ~~may~~ shall not use ~~any~~ viatical settlement contract or disclosure statement form in this state with a viator unless it has been filed with and approved by the commissioner. Any viatical settlement contract form or disclosure statement filed with the commissioner shall be deemed approved if it has not been disapproved within sixty (60) days of the filing. The commissioner shall disapprove a viatical settlement contract form if, in the commissioner's opinion, the contract or provisions contained therein are unreasonable, contrary to the interests of the public, or otherwise misleading or unfair to the viator. ~~policyowner.~~

Comment: Viaticus suggested adding approval requirement for disclosures. New York and Texas require brochure with disclosures to be filed with department.

Section 6. Reporting Requirements

Each licensee shall file with the commissioner on or before March 1 of each year an annual statement containing such information as the commissioner by rule may prescribe.

Section 7. Confidentiality

A. A licensee shall not submit to the commissioner any information that identifies a viator except with the express written permission of the viator, the viator's estate or the viator's representative.

B. Subject to applicable law, a viatical settlement provider, viatical settlement agent, viatical settlement broker, insurance company, insurance agent, insurance broker, information bureau, rating agency or company, or any other person with actual knowledge of a viator's identity, shall not disclose that identity to any other person unless the disclosure:

(1) Is necessary to effect a viatical settlement between the viator and a viatical settlement provider and the viator has provided prior written consent to the disclosure;

(2) Is provided in response to an investigation by the commissioner or any other governmental officer or agency; or

(3) Is a term of or condition to the transfer of a viaticated policy by one viatical settlement provider to another viatical settlement provider.

Comment: The NVA, Viatical Association of America (VAA) and Viaticus all suggested provisions for confidentiality be included. Most of this language was suggested by the NVA and Viaticus.

Section ~~7~~ 8. Examination

A. The commissioner may, when the commissioner deems it reasonably necessary to protect the interests of the public, examine the business and affairs of any licensee or applicant for a license. The commissioner shall have the authority to order any licensee or applicant to produce any records, books, files or other information reasonably necessary to ascertain whether the licensee or applicant is acting or has acted in violation of the law or otherwise contrary to the interests of the public. The expenses incurred in conducting any examination shall be paid by the licensee or applicant.

B. Names and individual identification data for all viators shall be considered private and confidential information and shall not be disclosed by the commissioner, unless required by law.

C. Records of all transactions of viatical settlement contracts shall be maintained by the licensee and shall be available to the commissioner for inspection during reasonable business hours. A licensee shall maintain records of each viatical settlement until five (5) years after the death of a viator.

Comment: The VAA suggested setting a time limit for retention of records. Their five-year suggestion was included.

Section ~~8~~ 9. Disclosure

A viatical settlement provider, viatical settlement agent or viatical settlement broker shall disclose the following information to the viator prior to ~~no later than~~ the date the viatical settlement contract is signed by all parties:

Comment: The drafters felt the protection offered by the disclosure was only meaningful if provided prior to the date the contract is signed.

A. Possible alternatives to viatical settlement contracts for individuals ~~persons~~ with catastrophic, ~~or~~ life threatening or chronic illnesses, including, any ~~but not limited to,~~ accelerated death benefits offered under the viator's ~~by the issuer of the~~ life insurance policy;

B. ~~The fact that some~~ Some or all of the proceeds of the viatical settlement may be free from federal income tax and from state franchise and income taxes, and that assistance should be sought from a ~~personal~~ professional tax advisor;

Comment: Viaticus suggested rewording this subsection in light of the changes to tax law included in HIPAA.

C. ~~The fact that the~~ Proceeds of the viatical settlement could be subject to the claims of creditors;

D. ~~The fact that r~~Receipt of the proceeds of a viatical settlement may adversely effect the viator's ~~recipients'~~ eligibility for Medicaid or other government benefits or entitlements, and that advice should be obtained from the appropriate government agencies;

E. The viator's ~~policyowner's~~ right to rescind a viatical settlement contract within thirty (30) days of the date it is executed by all parties or fifteen (15) days after ~~of~~ the receipt of the viatical settlement proceeds by the viator, whichever is sooner ~~less~~. as provided in Section ~~9C~~ 10C; ~~and~~

F. The date by which the funds will be available to the viator; ~~and the source of the funds.~~

Comment: NVA and Viaticus suggested deleting this phrase and the drafters agreed it was probably not information necessary to a viator.

G. The affiliation, if any, between the viatical settlement provider and the issuer of an insurance policy to be viaticated;

H. If an insurance policy to be viaticated has been issued as a joint policy or involves family riders or any coverage of a life other than the insured under the policy to be viaticated, the viator must be informed of the possible loss of coverage on the other lives and be advised to consult with his or her insurance producer or the company issuing the policy for advice on the proposed viatication; and

I. A description of any policy benefits other than death benefits and nonforfeiture values in the policy to be viaticated that may be of value, such as additional purchase benefits, waiver of premium benefits, accidental death benefits or conversion features. The viatical settlement provider shall also disclose its interest in the benefits and any options available to the viator for additional compensation or contractual reservation to the viator of policy options or other rights.

Comment: Subsection G to I are from Illinois law.

Section ~~9~~ 10. General Rules

A. A viatical settlement provider entering into a viatical settlement contract with an~~y person~~ individual with a catastrophic, ~~or~~ life threatening or chronic illness or condition shall first obtain:

(1) A written statement from a licensed attending physician that the individual ~~person~~ is of sound mind and under no constraint or undue influence; and

(2) A witnessed document in which the individual ~~person~~ consents to the viatical settlement contract, acknowledges ~~the~~ that he or she has a catastrophic~~,~~ ~~or~~ life threatening or chronic illness or condition, represents that he or she has a full and complete understanding of the viatical settlement contract, that he or she has a full and complete understanding of the benefits of the life insurance policy, consents to the releases of his or her medical records, and acknowledges that he or she has entered into the viatical settlement contract freely and voluntarily.

B. All medical information solicited or obtained by any licensee shall be subject to the applicable provision of state law relating to confidentiality of medical information.

C. All viatical settlement contracts entered into in this state shall ~~contain an~~ provide the viator with an unconditional ~~refund provision~~ right to rescind the contract for ~~of~~ at least thirty (30) days from the date ~~of~~ the contract was executed, or fifteen (15) days from ~~of~~ the receipt of the viatical settlement proceeds, whichever is less. If the insured dies during the rescission period, the contract shall be deemed to have been rescinded, subject to repayment to the viatical settlement provider of any viatical settlement proceeds.

Comment: New York and Illinois law contains an automatic rescission if the insured dies during that period, which is incorporated in this subsection.

D. ~~Immediately upon receipt from the viator of documents to effect the transfer of the insurance policy, t~~The viatical settlement provider shall pay the proceeds of the viatical settlement to an escrow or trust account managed by a trustee or escrow agent ~~in a bank approved by the commissioner,~~ independent of the parties to the contract ~~pending acknowledgment of the transfer by the issuer of the policy~~. Immediately upon receipt from the viator of documents to effect the transfer of the insurance policy, ~~T~~the trustee or escrow agent shall ~~be required to~~ transfer the proceeds ~~due~~ to the viator ~~immediately upon receipt of acknowledgment of the transfer from the insurer~~.

Comment: Kenneth Klein, American Life Resources, suggested changes to provide greater protection to the viator in connection with the escrow account. One suggestion was to alter the order of actions taken.

E. Failure to tender the viatical settlement by the date disclosed to the viator renders the contract null and void.

F. Contacts for the purpose of determining the health status of the viator by the viatical settlement provider after the viatical settlement has occurred should be limited to once every three (3) months for viators with a life expectancy of more than one year, and to no more than one per month for viators with a life expectancy of one year or less. The provider or broker shall explain the procedure for these contacts at the time the viatical settlement contract is entered into. The limitations set forth in this subsection shall not apply to any contacts with an insured under a viaticated policy for reasons other than determining the insured's health status.

Comment: All but the last sentence of this is currently included in the Viatical Settlements Model Regulation. Viaticus suggested moving it here and adding the last sentence.

Section 11. Insurance Company Practices

Comment: A recurring complaint from the viatical industry has been the inability to get timely confirmation from insurers of the conditions of the life insurance policy being considered for viatication. The following language is similar to that suggested by Viaticus and in place in Vermont, Illinois and other states.

Drafting Note: These provisions may be included instead in the sections of the insurance code governing life insurers.

An insurer licensed to transact insurance business in this state shall comply with the following requirements:

A. The insurer shall provide information requested on the status of a viator's insurance policy or certificate within ten (10) business days following the receipt of the following documents by the insurer or its agent:

(1) An instruction executed by the viator requiring the insurer to release specified information regarding the policy or certificate to a named viatical settlement provider, viatical settlement agent or viatical settlement broker; and

(2) A request in writing from the named viatical settlement provider, viatical settlement agent or viatical settlement broker for the information.

B. The insurer of a group life insurance policy shall deliver a conversion policy to the individual within ten (10) business days following the receipt by the insurer, or an agent of the insurer, of a written request from the certificate holder for a conversion of the certificate to an individual life insurance policy for purposes of facilitating a viatical settlement.

C. A certificate holder shall not be prohibited from assigning rights or benefits under the certificate to a viatical settlement provider or from converting the certificate to an individual life insurance policy subject to the requirements of [insert section of law containing conversion and assignment standards].

D. A life insurance policy or certificate issued or delivered in this state shall in no way restrict the owner of the policy or the certificateholder from making an assignment of rights under the policy for consideration, an assignment of the rights only as a gift and without consideration, an assignment of rights only to a limited class of persons, or an assignment of rights only to an individual.

Comment: The VAA suggested adding a provision to protect a viator's right to assign the policy.

Drafting Note: If state law already contains a provision similar to Subsection D, this subsection need not be included.

Section ~~10~~ 12. Authority to Promulgate ~~Standards~~ Regulations

The commissioner shall have the authority to:

A. Promulgate regulations implementing this Act; ~~and~~

B. Establish standards for evaluating reasonableness of payments under viatical settlement contracts. This authority includes, but is not limited to, regulation of discount rates used to determine the amount paid in exchange for assignment, transfer, sale, devise or bequest of a benefit under a life insurance policy; ~~and~~

C. Establish appropriate licensing requirements, ~~and~~ fees and standards for continued licensure for providers, agents and brokers; and

Drafting Note: Fees need not be mentioned if the fee is set by statute.

D. Require a bond or other mechanism for financial accountability.

Section ~~11~~ 13. Unfair Trade Practices

A violation of this Act shall be considered an unfair trade practice under Sections [insert reference to state's Unfair Trade Practices Act] subject to the penalties contained in that Aact.

Section ~~12~~ 14. Effective Date

This Act shall take effect on [insert date]. A ~~No~~ viatical settlement provider, viatical settlement agent or viatical settlement broker transacting business in this state may continue to do so pending approval or disapproval of the provider, agent or broker's application for a license as long as the application is filed with the commissioner by [insert date]. ~~after [insert date] unless it is in compliance with this Act.~~

Comment: Viaticus suggested adding language to allow persons already doing business in the state to continue for a period of time while the license application is being reviewed. This is the practice being followed in most states already.

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ATTACHMENT TWO

Annuities Working Group
Chicago, Illinois
June 8, 1997

The Annuities Working Group of the Life Insurance (A) Committee met in the Continental C Room of the Chicago Hilton & Towers in Chicago, Ill., at 9 a.m. on June 8, 1997. Jerry Fickes, (N.M.) chaired the meeting. The following working group members or their representatives were present: John Hartnedy (Ark.); Sheldon Summers representing Woody Girion (Calif.); Roger Strauss (Iowa); Tom Foley (N.D.); and Ted Becker (Texas).

1. Survey of State Laws on Annuities

Carolyn Johnson (NAIC/SSO) summarized the results of the survey of states on annuities. Ms. Johnson said that 44 states responded to the survey and highlighted some of the most interesting results (Attachment Two-A). She said the areas that received the greatest number of comments were an interest in model laws on equity-indexed contracts, suitability requirements and sales to seniors. Mr. Fickes asked Tom Foley (N.D.) to talk about what the NAIC is already doing on equity-indexed annuities. Mr. Foley responded that on June 10, 1997, the Life Disclosure Working Group is discussing annuity disclosure and illustrations. He said that Rick Morse (N.Y.) took the life insurance illustrations regulation, added annuity disclosures as previously discussed by the working group, and created a new model law for the consideration and discussion of the working group. Some of the questions that Mr. Foley anticipates will be discussed during the working group meeting are a definition of "sustainable rate," bow to disclose a company's intention for future rates and whether an interest rate can be shown without a full illustration. Mr. Foley noted the model would include provisions for equity-indexed annuities.

Mr. Fickes asked what the working group's response was to the interest in models for suitability and for seniors. Roger Strauss (Iowa) said it was important to finish the charitable gift annuities model act before starting another project. John Hartnedy (Ark.) said he thought a single annuity illustration law was better than having special provisions on suitability or special provisions for seniors and that it would be easier to develop future products if there was a single disclosure standard. Mr. Foley said determining suitability was very difficult. Considering the tax laws, there may be tax reasons to buy an annuity even though it might be considered unsuitable for other reasons. Mr. Hartnedy agreed that suitability was very much dependent upon whether a person understood a product and wanted it, than whether it was a suitable product for him. He said he hesitated as a regulator to make a determination without knowing from what risk the individual was trying to protect himself.

Paul DeAngelo (N.J.) gave an example of a recent action in New Jersey where an agent had been selling annuities to elderly people. He said it was difficult to make a case that annuities should not be sold to an 86-year-old individual. When compared to other investment vehicles, it may be appropriate. He suggested that if 23 states thought there needs to be special considerations for suitability, they should be asked what they had it mind or what problems they had come across. The working group members agreed this was a good idea. Mr. Fickes asked Ms. Johnson to request further information from the states concerned with the issues of suitability and sales to seniors.

Mr. Foley gave another example of a situation in North Dakota where an individual thought he was purchasing a single premium immediate annuity but found out lator that it was a flexible premium policy which allows for higher loadings and where he would need to pay more premiums to get the type of annuity he was expecting. Barbara Lautzenheiser (Lautzenheiser and Associates) said the new annuity disclosure standards being developed by the Life Disclosure (A) Working Group will show how the policy works and should prevent or reduce this type of abuse. Ted Becker (Texas) said the balancing language concept also discussed in the Life Disclosure Working Group would be helpful here. He said language explaining that the individual is given the right to pay higher premiums or will have to take a lower annuity would help to explain the type of policy being purchased. Ms. Lautzenheiser said a buyer's guide would also be helpful to explain the general concepts. Lester Dunlap (La.) reminded the working group that the Life Disclosure Working Group recently redrafted the buyer's guide for life insurance, and suggested that a revision of the annuity buyer's guide might address some of these problems. Dan Keating (Okla.) agreed that many of the problems could be addressed through disclosure but emphasized that often people need more education about the product. A buyer's guide is a good step in that direction.

Mr. Foley asked if the Insurance Marketplace Standards Association (IMSA) project is focusing on suitability issues. John Booth (American Council of Life Insurance—ACLI) said some of these issues were included in IMSA standards in the general proposal that customers should be treated as you would want to be treated yourself. William Geiger (Western Reserve Life) said the IMSA standards touch on suitability because a company commits itself to have a policy in place to help a person determine bis needs and objectives. Another IMSA standard is to be sure that agents are trained to help people identify their goals and objectives. He suggested these efforts would supplement what the NAIC is doing.

Scott Cipinko (National Alliance of Life Companies—NALC) suggested this was not a problem exclusive to seniors. He said a product line may or may or may not be sophisticated and a consumer may or may not be sophisticated. He said the only way to appropriately regulate this market is to provide disclosure adequate for someone to understand his purchase, no matter what his age. Mr. DeAngelo said some senior citizens are wise, but some are more vulnerable because they are lonely and appreciate the attention from someone who comes to sell them an annuity product. Mr. Cipinko opined that the states' advertising and market conduct laws already address all of the issues described at the working group meeting, but they just need to be enforced. Mr. DeAngelo responded that his goal is to prevent inappropriate sales not to cure them afterwards.

Mr. Fickes asked if a representative from ISMA could make a presentation to the Annuities Working Group at the NAIC Fall National Meeting to help them understand how this program would help address their concerns. Mr. Booth agreed to arrange that presentation. Mr. Fickes asked William Albus (National Association of Life Underwriters—NALU) if his organization would also like to make a presentation. Mr. Albus said he would check with his association. Mr. Cipinko agreed to work with the ACLI to prepare the presentation for the fall meeting in Washington, D.C.

2. <u>Charitable Gift Annuities</u>

Mr. Fickes said he had incorporated the comments the working group had received into the Charitable Gift Annuities Model Act draft (Attachment Two-B). Ms. Lautzenheiser said the American Academy of Actuaries (AAA) was interested in providing input on the reserving issue and had appointed Mike Pressley (Tillinghast) to coordinate response to this issue. Mr. Strauss said it appeared to him that the only outstanding issue was reserves and the working group would be ready to adopt this model as soon as it had heard from the AAA. Sheldon Summers (Calif.) said his state's law required segregation of the assets supporting the reserves. He suggested that the model add more conservatism to the investment section because many charities are smaller and thinly capitalized. Mr. Foley asked if any charities had been unable to pay on their charitable gift annuities. Mr. Fickes responded that the Planned Giving Association said that no charities had failed to pay on their annuities. Mr. Hartnedy opined that, if the working group followed Mr. Summers' suggestion, it needed to allow a commissioner to grant an exception because some charities are clearly well capitalized and able to make payments. Ms Lautzenheiser said that some charitable organization's agreements do not actually promise to pay and this would affect the reserves required. Mr. Keating pointed out the provision of Section 9B on the guarantee and suggested this would be helpful to the AAA.

Mr. Fickes asked Ms. Johnson to review the other comments received by the working group. Ms. Johnson noted that Life Investors Insurance Company suggested that the model act include a section on effective date and asked whether this model would cover existing agreements or just new agreements. The members of the working group agreed that the affect should be prospective and agreed to include such a provision. Then Ms. Johnson summarized a comment from Allen Keith (Keith Financial Planing) suggesting that Section 6B(1) referred to a financial statement of the organization but perhaps really meant a financial statement covering the segregated annuity fund. Mr. Hartnedy suggested that the language remain as is because the information on the financial condition of the whole organization would be helpful in seeing if it can fulfill its obligations. He noted that the model called for backing the annuity with the full faith and credit of the organization. Mr. Keith was concerned that the annual report would be on a form prescribed by the commissioners and that this would create various forms. Mr. Keith suggested that preparation of various reports with substantially identical information in different formats was unnecessarily burdensome. Mr. Fickes asked Ms. Johnson to expand the language on the annual report to deal with this problem.

Mr. Fickes announced that the American Council of Gift Annuities (ACGA) provided an alternative draft for a model that exempts charitable gift annuities from the insurance provisions. He asked if the working group would be interested in considering this alternative model. Mr. Strauss asked why such a model is needed. Mr. Hartnedy suggested that perhaps it could be useful to look at it since some states have an exemption from the insurance laws. Mr. Fickes asked if states need the working group's help in developing an exemption. The working group decided that it is not necessary to adopt an alternative model providing for an exemption.

Mr. Foley moved and Mr. Hartnedy seconded a motion to adjourn and the working group meeting was adjourned at 10:40 a.m.

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ATTACHMENT TWO-A

To: Annuities Working Group
From: Carolyn J. Johnson, CLU, NAIC Senior Counsel
Date: June 8, 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. Forty-four states responded.

The most interesting results of the survey for working group consideration include these thoughts of regulators:

- Twenty-nine states think the NAIC needs to develop a model law on equity-indexed contracts.
- Ten think no law defining annuities is needed, but 14 think a model should he developed.
- Ten states do not think they need a law on annuity and deposit fund disclosure. Five think the NAIC model needs revision.
- Eight do not think they need a law on two-tier annuities, but six think the model needs revision.
- Seven think the NAIC model variable annuity regulation needs to be revised, five would like to see the model on modified guaranteed annuities revised and five think the variable contract law should be revised.
- Twenty-two states would like to see a model detailing suitability requirements and 23 would like to see a model on sales to seniors.
- A dozen or more states expect to adopt the model on annuity illustrations as soon as it is completed.

Following is a summary of the state 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	3 Have law or reg in place 8 Apply model informally in state 2 Law or reg covers equity-indexed products too	1 Intend to adopt a law or reg 5 Intend to use model 1 Intend to use other language 11 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?	3 Have law or reg in place	9 Intend to adopt a law or reg 3 Do not need a law in this area 29 A model should be developed

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?	18 Have law in place defining annuities 15 Treated same as life insurance	1 Intend to adopt a law or reg 10 Do not need a law in this area 14 A model should be developed

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	5 Require delivery of buyer's guide 14 Disclosure standards in place 4 Apply model informally in state	4 Intend to adopt a law or reg 3 Intend to use model 1 Intend to use other language 10 Do not need a law in this area 5 Model needs revision (describe in comments section)

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	3 Prohibit sale of two-tier annuities ❒ Other regulation of two-tier annuities 7 Apply model informally in state 6 Require disclosure ❒ Require form from model ❒ Created our own disclosure form	4 Intend to adopt a law or reg 5 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)

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	27 Require separate account 33 Require filing of contracts 26 Standards for contracts 24 Require report to policyholder 5 Apply model informally in state	3 Intend to adopt a law or reg 2 Intend to use model ❒ Intend to use other language 5 Do not need a law in this area 7 Model needs revision (describe in comments section)

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	15 Have standards for market value adjusted annuities 24 Require filing of contracts 18 Requirements for contracts 16 Reserve standards 7 Apply model informally in state	2 Intend to adopt a law or reg 2 Intend to use model ❒ Intend to use other language 6 Do not need a law in this area 5 Model needs revision (describe in comments section)

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	28 Law sets standards for transacting variable contract business 28 Requirements for separate accounts	1 Intend to adopt a law or reg 3 Intend to use model ❒ Intend to use other language 6 Do not need a law in this area 5 Model needs revision (describe in comments section)

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	2 Intend to adopt a law or reg 7 Do not need a law in this area 22 A model should be developed

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	2 Intend to adopt a law or reg 5 Do not need a law in this area 23 A model should be developed

11. Illustrations of Annuity Products Model Regulation	Under Development	6 Have standards in place 8 Apply same standards as for life insurance	7 Intend to adopt a law or reg 12 Intend to use model ❒ Intend to use other language 5 Do not need a law in this area

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	33 Have requirements similar to model 7 Add comment to show how caps vary from model 17 Exclude some types of annuities, for example, 3 funding agreements 4 deposit funds 12 unallocated annuities 3 plans under § 401(k) 5 other (comment)	1 Model needs revision (describe in comments section)

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.

Capped at $2 million per contract.

13. Replacement of Life Insurance and Annuities Model Regulation	613-1	28 Replacement law applies to annuities 23 Require notice to existing insurer 14 Law or reg applies only to external replacements 18 Requires delivery of illustration or information to individual replacing	5 Intend to adopt a law or reg 2 Intend to use model 1 Intend to use other language 3 Do not need a law in this area 5 Model needs revision (describe in comments section)

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	38 Have nonforfeiture requirements similar to model ❐ Add comment to show how vary from model	❐ Intend to adopt a law or reg 4 Intend to use model ❐ Intend to use other language 1 Do not need a law in this area 5 Model needs revision (describe in comments section)

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.

Use model informally; limit surrender charges to 10 years.

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ATTACHMENT TWO-B

Charitable Gift Annuities Model Act
Draft: 6/9/97

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 annuity is less than the 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~~ issue an annuity and incur a financial obligation to guarantee annuity 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~~ donor or other annuitant 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) 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 file a report verified by at least two (2) principle officers with the commissioner covering the preceding ~~calendar~~ fiscal 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) Evaluate solvency;

(d) Respond to consumer complaints; and

(e) Conduct hearings to determine compliance with this Act.

C. A copy of a report containing the information required in Subsection B that has been filed in the state of domicile of the charitable organization will be deemed to satisfy the requirement of this section. The commissioner shall have the authority to request additional information.

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;~~ donor or other annuitant;

(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~~ Subsection A and B may be satisfied by an acknowledgment that is a part of the annuity agreement that is signed by the donor.

Section ~~11~~ 10. Other Applicable Code Provisions

~~1. Receivership Law~~

~~2. Hazardous Financial Condition~~

~~3. Unfair Trade Practices~~

~~4. Investments~~

These provisions of the insurance code apply to the transactions covered by this Act:

A. [insert citation to receivership law];

B. [insert citation to laws on hazardous financial condition];

C. [insert citation to laws governing unfair trade practices]; and

D. [insert citation to laws governing investments].

Section ~~10~~ 11. 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 12. Effective Date

This Act shall become effective [insert date] and shall apply to charitable gift annuities agreements entered into on or after the effective date.

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ATTACHMENT THREE

Life Disclosure Working Group
Chicago, Illinois
June 7 and 10, 1997

The Life Disclosure Working Group of the Life Insurance (A) Committee met in the Continental A Room of the Chicago Hilton & Towers in Chicago, Ill., at 8 a.m. on June 7, 1997, and at 4:30 p.m. on June 10. Tom Foley, (N.D.); chaired the meeting. The following working group members or their representatives were present: John Hartnedy (Ark.); Sheldon Summers (Calif.); Kevin McCarty representing Frank Dino (Fla.); Roger Strauss (Iowa); Lester Dunlap (La.); Paul DeAngelo (N.J.); Jerry Fickes (N.M.); Bill Carmello representing Rick Morse (N.Y.); and Ted Becker (Texas).

1. Report on Generally Recognized Expense Tables

Tim Harris (Milliman & Robertson), representing the Society of Actuaries (SOA), reported on the Generally Recognized Expense Table (GRET) that the SOA had developed. Mr. Harris said that in 1996 the Life Disclosure Working Group had asked the SOA to prepare a GRET to allow the use of marginal expenses in life insurance illustrations to the extent they were not lower than the expense levels in the GRET. To update that table the SOA surveyed 250 life insurance companies and used commercially available data. A few changes were made to address problems that had become apparent in the prior year's data. Mr. Harris said the GRET excludes companies with a high percentage of reinsurance and the "outliers"—companies that are extremely inefficient or efficient. He said the expense factors resulting from this new data were somewhat higher than those from the prior year. Mr. Harris asked that the report of the group be distributed by the Life Disclosure Working Group for comment and a final report will be prepared after the comments are incorporated. Jerry Fickes (N.M.) moved and John Hartnedy (Ark.) seconded a motion to expose the GRET (Attachment Three-A) for comment until the Fall National Meeting. The motion passed.

2. Adopt Minutes of April 30, 1997, Meeting

Roger Strauss (Iowa) moved and Paul DeAngelo (N.J.) seconded a motion to adopt the minutes of the April 30, 1997, meeting of the Life Disclosure Working Group. The motion passed (Attachment Three-E).

3. Discuss Equity-Indexed Products

Charlotte Liptak (Transamerica Occidental) reported that technical resource advisors held numerous conference calls and meetings to prepare a disclosure recommendation and buyer's guide for equity-indexed products. The May 23, 1997, report summarizes the consensus of the technical resource advisors on this issue (Attachment Three-B).

Ms. Liptak said the group focused on fixed deferred equity-indexed annuities, which they believe should come within the overall framework of the Annuity Illustrations Model Regulation. The group recommends that following layers of disclosure:

1. Buyer's guide. Ms. Liptak said the group is progressing on development of a buyer's guide that explains in more detail what an equity-indexed product is. She said more improvements to the document will be made as comments are received. She said the group anticipates this would be a helpful document used by insurance companies, agents and insurance departments to explain generally an equity-indexed product.

2. Narrative description of the particular product being marketed by the company. She indicated this would be similar to the outline of disclosure standards that have been prepared earlier by the Life Disclosure Working Group.

3. Narrative with non-personalized examples of how the company's product works. This would include an narrative and some numeric information with hypotheticals. It would not be personalized to the individual applicant. The recommended period for the document would be the term provided in the policy or five years, whichever is longer. The product-specific features would include minimum guarantees.

4. A full personalized illustration. Ms. Liptak suggested it was premature to discuss the specifics for this because the working group had not yet decided on fixed annuity disclosures in general.

Larry Gorski (Ill.) said one of the hallmarks of the report prepared by the American Academy of Actuaries (AAA) for the Life and Health Actuarial (Technical) Task Force was the concept of balancing information. He noted that the technical resource advisors suggested balancing information in the buyer's guide, but the disclosure document had no reference to balancing language. Mr. Foley suggested that Mr. Gorski explain to the audience what he meant by the term "balancing language." Mr. Gorski responded that the idea had come out of the AAA group as a result of Mr. Gorski's frustration with how best to handle numeric information in a disclosure. Mr. Gorski said the balancing language would require that, any time a statement was made about a positive aspect of the feature, the narrative needed also to tell the negative aspects of that same feature. Ms. Liptak responded that the information included in the technical resource advisors' report was consistent with the AAA report, but at the time the technical response advisors met, the AAA report had not yet been finalized.

Mr. Strauss asked if the technical resource advisors' proposal allowed the company the option to choose which of these layers of disclosure to use. Ms. Liptak responded that it would be up to the agent and, more importantly, the consumer to choose for a particular sale which level of disclosure would be most helpful. She noted that, if the company has all layers of disclosure available, the agent can use whichever is most appropriate in a situation.

Mr. Foley reiterated that the working group seemed to be developing a position on fixed annuity disclosures that provided more flexibility than was allowed for life insurance illustrations. He said now the working group was hearing how that might be structured. He noted that, in addition, the working group would soon hear more about the North Dakota approach.

Ted Becker (Texas) asked if the narrative-only document really included no numbers, such as the participation percentage. Mr. Liptak responded that the narrative anticipated no tables of values, but that there might be numbers for participation rate, guaranteed interest rate, etc. Mr. Becker responded that he was somewhat uncomfortable with that concept. Ms. Liptak responded that some of the technical resource advisors thought they could describe their companies' product design in words only, but others thought that some numeric material was necessary. She opined that allowing companies this choice was important. Mr. Gorski clarified that the narrative option was devoid of a tabular illustration, but not necessarily devoid of numbers.

Donna Claire (Claire Thinking, Inc.) reported that the AAA had prepared an extensive report for the Life and Health Actuarial (Technical) Task Force, part of which included recommendations on disclosure. That report is attached to the minutes of the Life and Health Actuarial (Technical) Task Force. Barbara Lautzenheiser (Lautzenheiser & Associates) amplified on the AAA report to the actuaries. She began by noting that the actuarial report suggests that one definition from the NAIC Advertising of Life Insurance Regulation be changed. The definition of nonguaranteed elements excludes indexed products, and for equity-indexed products, that exclusion is not appropriate. She noted that the goals and objectives are similar for disclosures of equity-indexed products as they are for all life insurance and annuities: make sure the consumer develops an understanding of what he is contemplating for purchase. Ms. Lautzenheiser described more fully the balancing language to which Mr. Gorski referred and said that the recommended disclosures helped to build appropriate expectations on the part of the consumer. She noted that the AAA report includes an annual report to the policyowner which was not mentioned in Ms. Liptak's report.

Steven Preston (Golden American Life Insurance Company) drew the working group's attention to disclosure recommendations that were not in the marketing section of the AAA report. He noted that the definition of nonguaranteed elements and the filing requirements provisions also pertained to disclosure. He said the AAA group spent a considerable amount of time discussing how to illustrate interest rates clearly. He said that using a level scenario will not show product differences; it is essential to show the volatility of this product so that the results are not misleading. He noted that the balancing language goes a long way to illustrating this. Mr. Gorski pointed out that the AAA report contrasts with that of the technical resource advisors in recommending guidance beyond the term recommended by the AAA. He said there are many similarities between the two reports, but that is a difference. Ms. Liptak agreed there were differences and explained that the technical resource advisors had chosen to recommend a one-term illustration to keep the narrative simple. She suggested that, if more than one term was desired, then a full illustration should be used. Mr. DeAngelo asked if the disclosure was intended to point out the interrelation between products or was product-specific. Ms. Lautzenheiser responded that the balancing language was intended to show the different results within one product depending on market conditions, rather than comparing different types of products. Mr. Becker asked about the use of the term "account value" in the AAA report. He asked how this would be handled if the policy defined the term differently. Ms. Lautzenheiser responded this was a good question because in the materials before the working group there were different terms used such as "account value" and "accumulated value." He suggested that it would be necessary to clarify this language, so the consumer was not confused.

Bruce Ferguson (American Council of Life Insurance—ACLI) said his organization had reviewed the work of the AAA and the technical resource advisors and saw the tension between the need for simplicity and specificity. He concluded it would be a challenge to balance those two needs.

Mr. Foley asked the working group members to review with him the proposed North Dakota bulletin that he expected to have in effect by the end of June 1997 (Attachment Three-C). He noted the bulletin would contrast somewhat with the prior presentations. Mr. Foley began by noting that the requirements in the bulletin were minimum requirements for equity-indexed products. He pointed out that all advertising for equity-indexed products would be filed with and approved by the insurance department and noted this was a departure from the general North Dakota procedure.

Disclosure for life insurance equity-indexed products will follow in general the requirements of the Life Insurance Illustrations Regulation in effect in North Dakota. Equity-indexed annuity disclosures have similar components to the Life Insurance Illustrations Regulation. The disclosure must begin with a narrative summary that is, in most ways, similar to that discussed by Ms. Liptak and Ms. Lautzenheiser. Mr. Foley emphasized that it needed to be real disclosure and challenged the industry to find innovative ways to get key concepts across. He applauded the concept of balancing language to clarify the key elements of the product being offered. The narrative summary required in North Dakota will include a hypothetical illustration that helps consumers understand how that company's product works. He noted that most marketing materials he has seen do use that type of illustration. It must include a minimum value illustration of the type attached as an appendix to the North Dakota bulletin.

Mr. Becker asked if the summary in the North Dakota requirements clarifies the amount of death benefit. Mr. Foley responded that for an annuity product the death benefit is not the primary focus of the purchaser. To keep the document simple, the company can leave out the death benefit. Mr. Foley opined that it would be nice if companies could find a consistent, simple way to show what the death benefit would be. Mr. Preston noted the tension between the requirement to demonstrate "all potential features," but still to keep the hypothetical simple. Mr. DeAngelo asked what steps a company might use to keep the hypothetical from becoming misleading. Ms. Liptak responded that would be difficult, but the technical resource advisors had come to the conclusion that building strict parameters would be difficult because new products are constantly being developed. Mr. Foley noted that he would personally review North Dakota filings for equity-indexed products and opined that a seasoned regulator needed to review these filings.

Mr. Foley next drew the attention of the regulators to the numeric summary portion of the North Dakota bulletin. He suggested that it is very important to make clear what the participation rate is and what that concept means. He pointed out Exhibit 2 to the North Dakota regulation showing historical performance for the last seven years for treasury bills, the Standard and Poor's 500 total return, including dividends, and a third column for how the particular design of equity-indexed product would have performed doing the last seven years. He noted the numeric summary also includes statements for the agent and applicant to sign, similar to the Life Insurance Illustrations Regulation.

The tabular detail section may show whatever a company desires as long as it is not misleading. Mr. Foley noted the North Dakota proposal is more definitive than what the technical resource advisors are currently proposing.

Mr. DeAngelo suggested adding to the list of disclosures that the individual should be able to use it to compare products. Mr. Foley responded that if only the last term were compared, some types of products would do better than others, which might in itself be misleading. He recognized that the balance of simplicity makes the chance greater that in certain scenarios the results might be misleading. Mr. Becker asked if the surrender charge had to be included in the North Dakota illustrations. Mr. Foley responded that the value shown is the surrender value, so if there is a surrender charge it would be shown for as many years as it lasts.

Ms. Liptak asked about the requirement for department review of all advertising, which distinguished the North Dakota proposal from the others considered. Mr. Foley responded that there is such a potential for people being misled, that the department wants to see everything at this time. Ms. Liptak asked if the tabular detail was required in North Dakota and Mr. Foley responded in the affirmative. Ms. Liptak asked if that would make the document rather lengthy, but Mr. Foley responded that it could be completed within six pages. Ms. Liptak then asked if the numeric summary was intonded to cover the most recent period of time and Mr. Foley responded that was true and recognized that the current period might in itself be somewhat misleading. Ms. Liptak said she was concerned with the comparison to other financial instruments and suggested it compares apples and oranges. Mr. Foley said there was opportunity for a company to provide enough background information so that the consumer would understand the comparison.

Mr. Preston questioned whether the use of the Standard & Poor's 500 index in Mr. Foley's example implied that another index would be used if the equity-indexed product was based on a different index. Mr. Foley responded in the affirmative. Mr. Preston also requested information on whether the use of a hypothetical meant historical information. Mr. Foley responded that the hypothetical would probably not be based on recent historical experience because recent history would not allow the illustration to show the effect of a downturn on the equity-indexed product.

Having no further business, the Life Disclosure Working Group adjourned at 10 a.m. and reconvened in the Continental A Room of the Chicago Hilton & Towers in Chicago, Ill., at 4:30 p.m. on June 10, 1997.

Mr. Fickes offered an additional comment on equity-indexed products. He suggested that the attendees at the NAIC meetings are writing reports for each other. He asked how this information would be delivered to agents and consumers. He said the problems of the last few years were because consumers and agents did not understand the implications. Regulators should make sure people do not think they are buying into the stock market.

4. <u>Consider Issues Related to Life Insurance Illustrations Model Regulation</u>

Mr. Foley said the list of states that had adopted or are in the process of adopting the NAIC model regulation had grown and indicated that information was available on the NAIC Home Page.

Mr. Foley said that complaints that had been received about the Life Insurance Illustrations Regulation were mainly about the length of the illustrations. He asked if there was a way, consistent with the model, to make a generic narrative summary so that there is not so much to print, keeping in mind the model's requirements on pagination, etc. He asked companies to start thinking about how to reduce the number of pages to be printed. Mr. Strauss asked what made the illustration so long; whether it was the narrative or the tabular display. Mr. Foley responded that the working group had anticipated an illustration of five to seven pages and they are hearing that illustrations are running from 10 to 14 pages. He asked for input from the industry on the reason for this. Ms. Liptak said that the regulators and interested parties started with laudable goals, but added too many things that need to be disclosed with a resultant increase in the complexity of the life insurance illustration. Bill Koenig (Northwestern Mutual) said he was not sure how to solve the problem but he was sure that the regulators would get many suggestions on this issue. Mr. DeAngelo said he hoped that regulators would ask for sample documents when they heard this complaint. Mr. Foley asked those in attendance to submit comments on the issue so that the regulators could determine the appropriate course of action to reduce the problem.

5. Discuss Annuity Disclosure and Sales Illustrations Model Regulation Draft (Attachment Three-D)

Mr. Foley said that Rick Morse (N.Y.) had created the draft for annuity illustrations by taking the Life Insurance Illustrations Model Regulation and adding disclosure provisions. He suggested, rather than go through the draft section by section, that it would be more fruitful to pick the major topics included in the draft and reach consensus on them. Mr. Becker said that, if the working group planned any differences between the Life Insurance Illustrations Model Regulation and that for annuities, he would like to have a good reason for the difference articulated.

Linda Lanam (Life Insurance Company of Virginia) said that the technical resource advisors had suggested the inclusion in the regulation of a disclosure document, but hoped that they would not have to give the same information in the illustration as was suggested in the model draft. Bill Carmello (N.Y.) asked if there was a survey done on how many companies actually used annuity illustrations. Mr. Foley said there had been general consensus that the use of illustrations ranged from never to always.

One of the issues raised by Mr. Foley was a description of an individual who purchased an annuity with the intent of supplementing retirement income. He asked whether it is important to consider the surrender charges. Mr. Becker responded that it is always important to know about the surrender charges. Even if the individual is interested in income, if the annuity did not pay interest as anticipated, the individual would want to move on to another contract. He opined that is the consumer's only weapon when he thought he was not getting a fair deal. Mr. Foley agreed that the information on the declared rate for a deferred annuity is particularly important and hopes that consumers would have information before purchasing the annuity so that they understood what degree of reliance they should place relative to their expectations for future years. Mr. Foley said he had reviewed the disclosures that had been previously provided by technical resource advisors and noted that only one out of the dozen or more provided gave guidance about what the renewal rate might be. He asked the company representatives in attendance how they explained their current renewal rate. Roger Waird-Bauer (USAA) said that his company illustrated annuities and reflected what the assets might earn that were used to purchase the policies. He said the narrative information did not say anything more about how that interest rate was calculated because it was not necessary. Mr. Foley asked if that is all the consumer needed but Mr. Waird-Bauer responded that the information is not required. Mr. Carmello said that perhaps companies do not provide their strategy because they do not want to commit themselves. He said that most companies give a first-year bonus and do disclose that fact but do not disclose that the rates may drop as the surrender charge period ends and they shift to short-term assets. Jim Van Elson (Van Elson Consulting) said that, typically, the objective is either a constant spread or a first-year bonus and that is reflected in the illustration. Mr. Strauss asked if there was any benefit to showing a historical illustration of prior years' rates as part of the disclosure. Mr. Carmello opined that would give a more responsible illustration. Mr. Foley said that sounded like the life illustrations disciplined current scale. He said the requirement to make the illustration consistent with prior experience did not mean the same, but consistent with market experience as compared to the first-year rate. He asked if the first-year rate misled people as to what to expect in future years.

Mr. DeAngelo said it seemed to him that the working group had covered this ground at the April 30, 1997, meeting in the discussion of a "sustainable" rate. He said at that time the working group concluded it did not really want to require an illustration but rather a disclosure of what the individual might expect after the first year. He suggested that, if the rates historically dropped after the first year, the narrative should disclose that. Mr. Carmello wondered whether the working group needed something comparable to the disciplined current scale and the Actuarial Standard of Practice for the annuity illustration. Mr. DeAngelo suggested that the following language would help a consumer understand what to expect:

> While past practice is not necessarily what will happen in the future, typically the renewal rate on these contracts issued in past years has [dropped, remained the same, increased]. The actual renewal rate will be effected by the returns on company investments and the number of contracts that are surrendered and other factors.

Mr. Koenig said this was similar to the plan discussed in the Life and Health Actuarial Task Force's nonforfeiture project. He opined that if a relatively simple plan such as this could not be described, the insurer would be unable to describe a more complex plan for nonforfeiture purposes.

Mr. Foley asked the working group and interested parties to discuss when an illustration might be required. Mr. Carmello suggested the equity-indexed product may need an illustration on every sale. Mr. Strauss opined that, other than equity-indexed products, illustrations always should be optional. Ms. Lanam responded that the technical resource advisors had looked first at a requirement of disclosure for all sales and then tried to determine whether there might be a trigger for a full illustration, either for types of products or types of sales. She said they expected the regulation to say that any illustration provided would have to follow the requirements of the regulation, whether that illustration was required or voluntary. She asked the working group to consider the impact on insurance companies of too much disclosure, which might lead to class-action lawsuits. Mr. Carmello suggested that companies would still want to disclose that some of the first-year rate was a bonus. Ms. Lanam agreed, and said that is typically done in most of the companies.

Mr. Foley said that a small group of regulators would rewrite the model consistent with the discussion at the meeting and solicited suggestions for specific language. Ms. Lautzenheiser asked if the AAA Committee on Life Insurance should look at the issues of self-support and lapse support. Mr. Foley responded that the AAA needs to investigate the lapse support and self-support issues in the context of annuities. He suggested there may be certain crediting strategies that should be prohibited. Mr.

Carmello opined that there would be annuities that fail the self-support test. Mr. Foley asked if this generic charge to the AAA was sufficient, or whether more specifics would be needed. He said if the AAA group needed more specific information, he would provide it.

Mr. Foley agreed to distribute a revised model draft in July, with the intent to review this at an interim meeting in August. Ms. Lautzenheiser also agreed to bring to the August meeting information from the AAA group, which would begin the process of evaluation immediately.

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

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ATTACHMENT THREE-A

Society of Actuaries' Committee on Life Insurance Research
Report to the NAIC Life Disclosure Working Group

Life Insurance Illustrations
Generally Recognized Expense Table for 1998 Illustrations
June 7, 1997, Draft Report

The Society of Actuaries' Committee on Life Insurance Research (Committee) established a Project Oversight Group to develop or identify a table of expenses that would qualify as a Generally Recognized Expense Table (GRET) for the life insurance industry.

This GRET is to be relied upon by actuaries and insurance companies in their compliance with the NAIC Life Insurance Illustration Model Regulation (Model Reg) and the Actuarial Standard of Practice "Compliance with the NAIC Model Regulation on Life Insurance Sales Illustrations" (ASOP).

This table will represent the industry's expenses on a fully allocated basis. The use of this table, however, does not relieve actuaries and companies from the allocation of direct expenses in complying with the Model Reg and ASOP.

During the process of developing a Model Reg which both met the concerns of the regulators and still allowed the insurance industry to efficiently function, the issue of expenses became a sticking point.

A compromise position on the expense issue was proposed at the 1996 Snowbird, Utah, meeting among representatives from the NAIC, consumer organizations, the insurance industry and the Actuarial Standards Board (ASB). The proposed compromise was that the actuaries and the insurance industry would be allowed to use marginal expenses in complying with the self-supporting provision of the Model Reg to the extent that these marginal expenses (ME) were not less than those of the GRET. GRET expenses may be used if they are greater than the company's marginal expenses (Note: this is not clear from the Model Reg but is spelled out in the ASOP). The company's fully allocated expenses (FAE) may always be used regardless of their relationship to the GRET. Note that company direct sales costs are in addition to the GRET.

The following relationships result from this compromise using the acronyms previously defined and assuming that ME < FAE.

1)	If	GRET < ME < FAE	Then use	ME or FAE
2)	If	ME < GRET < FAE	Then use	GRET or FAE
3)	If	ME < FAE < GRET	Then use	GRET or FAE

The mission of the Project Oversight Group for 1997 was to:

- Address any questions that were previously raised regarding the GRET that had been previously developed.
- Determine the appropriate method for developing the 1998 GRET.
  - i) Timeliness of presentation of results to the NAIC and the industry.
  - ii) Resolution of any issues that were raised regarding last year's GRET.
- Interface with the NAIC and insurance industry representatives throughout this process.
- Present a proposed GRET to the NAIC for their approval before the June 1997 NAIC Meeting.
- Establish the set of expense factors that are appropriate for use as the 1998 GRET.

For 1997 the Project Oversight Group conducted a survey of the 250 largest life insurance companies in order te obtain the needed statutory data on a more timely basis and to also address questions that could not be answered directly by published information including expense adjustments for pour-in premiums on universal life, reinsurance and expense allocations within groups of companies and by lines of business within companies.

The responses to the survey were dismal and, therefore, once again, the Project Oversight Group focused on the One Source database which was used in the previous year's study. This is a database service which provides statutory data obtained from the NAIC. The database is updated on a monthly basis; however, there is a time lag of several months on the information included.

The Project Oversight Group had received several requests to consider developing a separate set of factors or some adjustment of universal life pour-in premiums and had hoped to obtain sufficient data from the surveys that were mailed out to the 250 life companies to address these requests. However, only 10 companies provided expenses data on the expenses related to this item and this data jumped around a bit. The Project Oversight Group felt that it was inappropriate to base any expense factors on data of this quantity and credibility.

The following NAIC annual statement fields were accessed in the One Source database.

NAIC Annual Statement References [1]			
Item	Acquisition	Maintenance	Aggregate
Policies	Exh of Life Ins.; l 2, col 3	Exh of Life Ins.; .5*(l 1, col 3 + l 20, col 3)	N/A
Units	Exh of Life Ins.; l 2, col 4	N/A	N/A
Premiums	Exh 1 Pt 1; col 3, l 9a + l 10a [2]	N/A	N/A
Expenses	N/A	N/A	P6; col 3, l 22 + l 23 [3]

[1]Group products to which the regulation is applicable were thought to be very similar in their expense elements to ordinary life. Therefore, no attempt was made to isolate the annual statement expenses attributable to group products marketed directly to individual members of a group.
[2]Single premiums were weighted using 6% after reduction for any dividends applied.
[3]Only the estimated life insurance component of FICA and unemployment tax was included. Premium taxes and other state and municipal taxes must be considered separately.

The group again used the Life Office Management Association's (LOMA) functional cost expense factors as seed expense factors used in one of the published expense studies based on One Source data. LOMA had provided new seed factors from their most recent expense study but the number of participants in the most recent study was lower than the previous year and contained a different mixture of companies by distribution system. Therefore, for consistency, the Project Oversight Group decided to continue using last year's seed expense factors. It is anticipated that next year's expense study will contain a higher number of participants and will provide a new set of seed expense factors.

The Project Oversight Group was still of the opinion that expense factors should not be shown separately by type of company ownership (stock vs. mutual) and should not be stratified by company size. The group again examined variations in expenses attributable to company distribution methods and decided that this refinement was appropriate. The Project Oversight Group did receive requests for additional definitions of distribution systems but was unable to consider such request due to the lack of available expense study data and the dismal responses on the expense survey that was sent out to the companies.

The Project Oversight Group again grouped expenses into the four categories of distribution systems: Branch Office, Direct Marketing, Home Service and All Other. Companies were placed in the appropriate category based on research performed by Conning and Co. and public information (e.g., Bests' Reports) for our analysis.

The expense factors were developed based on a review of the application of the LOMA seed expense factors to the 1996 statutory results of the 200 largest life insurance companies as measured by life insurance expenses. In order to lessen the effect of reinsurance on the factors, we removed companies where the life reinsurance commissions and allowances were at least 25% of the sum of life general expenses and life commissions on premiums and annuities. The Project Oversight Group continues to have some concern about the wide range of variation of expenses within the groups and to alleviate concerns over the effect of these variations removed the "outliers" from the study. Outliers were generally determined to be those companies that had expenses that were 50% or less or 250% or more than the expenses produced by the median factors applied to that company's units. The final sample represented approximately 80% of industry life insurance expenses. The expense factors were then derived by scaling the LOMA seed factors to cover the 50th percentile of the companies in each distribution system. This produced a set of expense factors which was generally higher than the average for the respective groups.

The tables of expense factors by distribution system are shown below.

BRANCH OFFICE		
	Acquisition	Maintenance
Per Policy	$65	$33
Per Unit	$1.15	
Percent of Premium	72%	

DIRECT MARKETING		
	Acquisition	Maintenance
Per Policy	$91	$46
Per Unit	$1.60	
Percent of Premium	50	

HOME SERVICE		
	Acquisition	Maintenance
Per Policy	$53	$27
Per Unit	$0.95	
Percent of Premium	29%	

ALL OTHER		
	Acquisition	Maintenance
Per Policy	$73	$37
Per Unit	$1.30	
Percent of Premium	40%	

Note the following in applying these expense factors:

- All of the expense factors are to be used and the results summed.
- Premiums for single premium products should be multiplied by 6% prior to the application of the percent of premium factor.
- These factors do not cover premium taxes, state and federal income taxes or commissions. All of these items must be considered in addition to the expenses generated by the GRET.

The factors by distribution system may be used by a company or division that meets the description of that distribution system. A company may use one set of GRET factors for a specific distribution system and another set of GRET factors for a separate distribution system but cannot mix GRET factors and the company's own, e.g., if a company chooses to use the GRET factors for their Home Service Division they cannot use fully allocated factors for their Direct Marketing Division.

General descriptions of the different distribution systems are shown below. It is expected that actuaries will apply professional judgement in determining distribution system categories.

Branch Office - A company or division which operates an agency building system featuring field management that are employees although their compensation may be largely based on production. The company provides significant employee benefits to field employees in addition to direct compensation.

Direct Marketing - A company or division that markets directly to the public through printed or other media. No direct field compensation is involved.

Home Service - A company or division that markets smaller insurance policies through an organization that resembles the Branch Office system in organizational and compensation structure but focuses on smaller policies and agent collections of premiums. Note that we have focused only on the ordinary life business of companies and have not considered industrial business.

Other - Companies or divisions other than those described above including those that market through Brokers and General Agents.

This Project Oversight Group included the following individuals:

Tim Harris - Milliman & Robertson (Chair)
Doug Knowling - Tillinghast - Towers Perrin
Zain Mohey-Deen - Society of Actuaries Staff
John Palmer - Society of Actuaries, Vice President
Mark Peavy - NAIC
Irwin Vanderhoof - Member of Society of Actuaries Committee on Life Insurance Research

We wish once again to thank Greg Story of LOMA for his organization's assistance in providing the seed expense factors that allow us to use an experience based set of seed factors. This provides a method of allocation by type of expense factor that is based on research.

Please contact any of the Project Oversight Group members at their yearbook address with any comments or concerns that you may have.

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ATTACHMENT THREE-B

To: Carolyn Johnson (NAIC/SSO)
From: Charlotte S. Liptak, Assistant General Counsel, Transamerica Occidental Life
Date: May 23, 1997
Re: Life Disclosure Working Group—Technical Resource Advisors – Report on Equity-Indexed Annuity Disclosure Issues

I am submitting the following report and comments to the Life Disclosure Working Group on behalf of the Equity-Indexed Annuity Subgroup of the Technical Resource Advisors. It may be helpful to know the make-up of the Equity-Indexed Annuities Subgroup to clarify that this report includes the participation of a broad spectrum of interested persons. Participants include: attorneys from insurance companies and private law firms; actuaries from insurance companies and consulting firms; representatives of the American Council of Life Insurance (ACLI) and the National Alliance of Life Companies (NALC); marketing and sales consultants; and insurance company compliance personnel.

Since our letter of April 16, 1997, and the meeting of the Working Group on April 30, 1997, numerous conference calls and meetings have occurred to discuss the viability and effectiveness of various disclosure concepts and their ramifications. This report contains a summary of the discussions and explains the rationale for the types of disclosure proposed by the Technical Resource Advisors. While we believe a review of the entire report is necessary, to aid in the Working Group's review, we have begun with an executive summary of our conclusions and recommendations. The executive summary is not intended to supersede or minimize the report as a whole. Please note again that the focus of our discussions and of this report is fixed (non-registered or non-variable) deferred equity-indexed annuities.

EXECUTIVE SUMMARY

Fixed equity-indexed annuities disclosure requirements should come within and follow the overall regulation of other fixed annuities as much as possible. However, there are a wide variety of equity-indexed annuities product designs currently on the market, and new product designs are being developed. Because of the variety of products and levels of complexity, different types of disclosure may be more appropriate for some than for others. Consumers have different needs, wants and levels of understanding, as well. While it is important that consumers have a good explanation of how equity-indexed annuities operate and realistic expectations concerning performance, it is clear that no one standardized method of disclosure can fulfill all disclosure needs for all product designs and for all consumers in a totally comprehensive and fair manner. Thus, the Technical Resource Advisors recommend that different "layers" and types of disclosure be permitted if we are to accomplish our stated goal; that is, to ensure that consumers are provided enough meaningful information to enable them to make informed choices in their annuity purchases.

The first layer of disclosure proposed by the Technical Resource Advisors would be a Buyer's Guide containing an overview of equity-indexed annuity products and unique features that make this product different from other fixed annuities. Rather than a required pieco delivered at a certain point in time, we envision the Buyer's Guide as a high-level educational piece that state insurance departments, insurance companies and producers could distribute to consumers that are not familiar with equity-indexed annuities products. The Buyer's Guide would help censumers familiarize themselves, to the extent they have a need to do so, with the kinds of choices available in different product designs and the trade-offs attached to different features that are available.

A discussion draft of a Buyer's Guide is attached for the Working Group's consideration. We would be happy to continue to assist the Working Group to refine and improve the Buyer's Guide.

The next layer of disclosure would be specific to the particular product or products being considered by the consumer. Three types of disclosure make up this layer. One of the three types of disclosure would be required with every equity-indexed annuities sale.

- Narrative only: This document would include disclosure required for traditional fixed annuities. The elements specific to the indexed features would be disclosed, including:
  - A statement that this product is an equity-indexed annuity.
  - Identification of the index.
  - Explanation of how the index affects the equity-indexed annuities.
  - Duration of the term during which indexed-based interest applies and the length of the renewal window.
  - A statement that this contract is not a purchase of securities or participation in the stock market.
  - Explanation of the minimum guaranteed value.
  - Explanation of the indexing method.
  - Explanation of any guaranteed and nonguaranteed rates, caps, floors or other index features.

- Narrative with nonpersonalized mathematical examples of how the particular product design works. This document would be short and include the required narrative disclosure along with some numeric/graphic display of how values are determined. The premium amounts used would be hypothetical and the examples would be required to show one term period or five years, whichever is longer. The examples would include product specific features that are discussed further in the body of this report. One of the examples would be required to show the minimum guarantees.

- Personalized illustration including narrative explanation. This document would include a narrative explanation section, including the concepts mentioned previously. The term "illustration," for purposes of this document, is used in the context of the Life Illustration Model Regulation. Because that section of the Annuity Disclosure Regulation has not yet been drafted, our discussion is very preliminary, with consensus that illustrations should be allowed, but not required, on a sale by sale basis, and some guidelines would be necessary.

FURTHER CONSIDERATION OF WORKING GROUP'S DISCUSSION DRAFT

The illustration proposal distributed by the Working Group at the Orlando meeting (the Orlando proposal) engendered much discussion, not only of the proposal's specific elements, but also of other alternatives and current disclosure practices. Because of that it was a good first step.

For purposes of our discussions and this report, we concluded that "illustration" means a full ledger type of personalized illustration, similar to that used in the context of the Life Illustration Model. It appears that such an illustration is contemplated by the Orlando proposal, with the addition of a section that would provide ranges of historically based annual earnings rates. While we appreciate that simplicity, understandability and product neutrality were goals of the Orlando proposal, we do not believe that those goals are achieved by using the methods summarized in that proposal.

First, we believe the Orlando proposal may favor certain product designs over others. For example, while the methodology fits an annual crediting, seven-year term design, it is not clear how other designs would work within that methodology. For instance, we could not determine how it would work for designs that use crediting at end of multi-year term, or an indexing method that uses an index with no historical experience or without significant historical experience.

In addition, the methodology proposed appears to lead consumers to the conclusion that the participation rate is the only differentiating factor they need to focus on among the different product designs. However, it also appears the method attempts to reflect differentials in product feature designs by "adjusting" the historical earnings rates of the index. We believe this is a potentially misleading oversimplification, because the various product features are interrelated and interdependent. Each consumer will place his or her own value on which features, or combinations of features, are more important for his or her own individual needs.

The required use of historically based earnings rates is of concern on two fronts:

1. It is dangerously close to variable product solicitation requirements under federal securities laws and regulations. The products we are discussing have been designed not to be variable or registered products, therefore, it is extremely important that insurers use solicitation methods that maintain that differentiation. Each insurer should judge the risks for itself with respect to the use of historical data in its solicitation process, rather than having a regulation force that risk upon them.

2. The display of historical rates of return, without disclaimer or explanation of the bases or assumptions from which they were derived, is simplicity at the expense of understandability. Certainly, there is a delicate balance between simplicity and understandability, which can be difficult to achieve. We believe that the primary goal should be understandability, and embedded within that is the concept that information be sufficiently clear and complete so as not to mislead. Thus, to provide rates of return without explaining how they were arrived at can mislead the consumer to believe that the rates shown were actual rates of return, or to believe that the rates shown are those likely to be achieved in the future. Considering the complicated methodology used to arrive at the rates displayed, finding a simple explanation understandable to all consumers is an extremely difficult, if not impossible, task. In addition, the explanation would bear no relationship to how the actual values of the product will be determined in the future. Thus, the usefulness of the information to most consumers is questionable.

Finally, we note that most companies currently offering this product do not use illustrations, as we defined illustration earlier. For those insurers that do have the capability to offer illustrations, it is usually not a required part of the solicitation process. Thus, unlike the backdrop for the life insurance illustration regulation, illustrations are <u>not</u> widely used and have <u>not</u> generated widespread claims of being misleading. Consequently, we see no basis for requiring this particular method of disclosure; while allowing illustrations may very well suit the particular needs of some consumers. Also, considering the diversity in product design and consumers needs and wants, it does not appear that there is a one-size-fits-all type of disclosure that can fairly and accurately present all product designs to all consumers. Rather, flexibility, within certain guidelines, is necessary to achieve the goal of consumer education and understandability.

EQUITY-INDEXED ANNUITIES SUBGROUP DISCUSSION OF ALTERNATIVES AND PROPOSAL

Further discussions led to reconsideration of the goals that we are trying to achieve. The main goal of our efforts appears to be the same as that of the Working Group, namely, to provide consumers with meaningful information so they can understand what their choices are and what they are buying. To this end, disclosure should be sufficiently simple, yet complete and balanced so that consumers have an understanding of how the product works and they are not surprised later by how a product performs. Thus, these goals are the same whether the product is an equity-indexed annuity or a more traditional annuity design. The specifics of how these goals are achieved will vary depending upon the complexity of the product and the needs of the particular consumer. While flexibility for disclosure is necessary, we agree that guidelines within which to operate are also necessary. To achieve our goals, the guidelines need to strike a balance between being general enough to apply to the product designs of today and tomorrow, and specific enough so they can easily be implemented.

As the Technical Resource Advisors discussed alternatives, it became clear that no one document could serve all purposes. Therefore, we propose the following layers of disclosure.

One layer of disclosure that could be useful for all consumers is a buyer's guide; a reference guide to equity-indexed annuities. This document would serve the purpose of educating the public about indexed annuity products generally and could be used by a consumer contemplating which product best meets his or her specific needs. The buyer's guide could be made available to consumers by state insurance departments, insurers and producers at their discretion. A discussion draft of a such a guide is included with this report.

The goal of the buyer's guide would be first to summarize the basics of annuities in general, and then to concentrate on the features or elements of equity-indexed annuities that make them indexed annuities, rather than some other type of fixed annuity. While brevity is an admirable goal, we concluded that being comprehensive may give more value te consumers. We attempted to include product descriptions and terms that are as generic as possible, so that the guide will not become dated too quickly. While the buyer's guide will probably require updating from time to time, so do buyer's guides used for other product lines, for example, life insurance, Medicare supplement or long-term care insurance. We also tried to emphasize the wide variety of product designs in a neutral way, to avoid showing preference toward any particular design. We included a section describing indexes generally, and the impact on performance of external factors such as increases and decreases in the stock or bond market.

We would like to emphasize that the draft document included is for discussion purposes only and is a work in progress. The Technical Resource Advisors has had only a short time to work on the draft and we believe that improvements are necessary. We would welcome the opportunity to assist the Working Group in refining the concept and ensuring that it is written in the most consumer-friendly way possible.

The second layer of disclosure would be a document that describes the particular product design being purchased by the consumer. This disclosure material would be required in all fixed equity-indexed annuities sales, and would take the form of at least one of three types. In other words, insurers could choose which type of disclosure to use, but they would be required to use at least one of the three. Again, it was determined that because of the diversity in product features and the varying levels of complexity, flexibility to choose the most appropriate type of disclosure would better serve the ultimate goals referenced above. Products use different indexing methods, different indexes (the Standard & Poor's 500 may be the most common now, but it is not the exclusive external reference), different measuring periods, different crediting methods and different guarantees. In developing the following proposed guidelines, we were very careful not to get too specific. Discussion of the "what ifs" abounded, and led us to the conclusion that general statements, followed with some examples in certain situations, was the most balanced approach. Too much specificity meant we could be excluding disclosure of features that should be disclosed, or promoting a disclosure mindset of form over substance; technical compliance rather tban meaningful information.

One type of disclosure would be a narrative-only document. The concepts to be discussed in this disclosure document would include all of the items listed in the draft Annuity Disclosure Model Regulation for traditional fixed annuities. Thus, specific equity-indexed annuities features would be described including: identification and explanation of the index; explanation of the indexing method; a statement as to the term during which indexed interest or credits apply and the length of the renewal window; an explanation of any guaranteed and nonguaranteed rates, caps, floors or other index features and their limits; an explanation of the minimum guaranteed value; a statement that the contract is not a purchase of securities or participation in the stock market. The narrative would discuss concepts that apply to all annuities, such as the ability to access benefits and values, any charges or fees that apply, and a disclosure that there may be tax consequences. The above is intentionally not an all-inclusive list. New equity-indexed annuities product designs continue to be developed and for each design, there may be additional features that would need to be disclosed pursuant to the general requirements set forth in the draft regulation.

A second type of disclosure would consist of the narrative detailed above, plus nonpersonalized mathematical examples of how the particular product design works. It is envisioned that this document would be no longer than three pages. The document would consist, in part, of a narrative portion covering the concepts discussed above for the narrative-only document. Another portion of this document would include a graphic or numeric display depicting how the end-of-term values are determined. The following guidelines would apply to the mathematical examples:

- The examples would be nonpersonalized—that is, not personal to any particular applicant.

- A generic, standard premium amount would be used (for example, $10,000 if the product is a single premium product. Allowance should be given for any contractual minimum or maximum premium amounts.)

- The examples would show a single term poriod or five years, whichever is longer. (Allowance shonld be made for contractual designs where the five year minimum may not be appropriate, i.e., contracts with term periods of two years in length.)

- The examples would assume no withdrawals, surrenders or loans are made before the end of the period shown. (The goal is to provide a simple snapshot of the basic contract mechanics. To the extent the consumer desires more personalized details, then the third type of disclosure may be more appropriate.)

- The examples would use caps, floors, participation rates and any other index features of the particular product design. Further study is recommended to determine if limits may be necessary in the depiction of such features.

- The examples would include a statement that the examples used do not represent actual performance of the contract and should not be considered a prediction of future performance.

- The examples would include at least three depictions of how the product works; one demonstrating the minimum guaranteed values (worst case scenario), and two others. The examples can be based on either hypothetical or historical index values. Further study is recommended to determine if limits would be appropriate when an insurer chooses to use either hypothetical or historical index values.

The third type of disclosure document would be a personalized illustration including a narrative explanation section that incorporates the concepts mentioned above for other types of disclosure. Again, for purposes of this report and discussion, illustration means a full, ledger type of illustration similar to that used in the context of the life illustration model. Our discussions on this type of disclosure are appropriately very preliminary, in that the illustration section of the Model Annuity Disclosure Regulation has not yet been drafted. Even so, we have been able to reach consensus on some basic points, including: illustrations should be allowed, but not required; illustrations should be allowed on a sale by sale basis; guidelines for illustrations should probably follow those that are developed for more traditional fixed annuities, with adjustments as necessary for elements of an equity-indexed annuity that are unique to the equity index features.

We look forward to working with the Working Group to continue to develop disclosure guidelines for equity-indexed annuities that will meet what we believe is our mutual goal of providing consumers with meaningful information that will enable them to make appropriate choices when purchasing annuities. We anticipate discussing these proposals with the Working Group further at the upcoming NAIC meeting in Chicago.

Buyer's Guide to Equity-Indexed Annuities
Draft

What Is An Annuity?

Since there are features of annuities which are common to all types, it is helpful to describe them in general. "Annuity" is defined as a series of payments made at regular intervals by an insurance company in return for premiums you have paid. The main reason to buy an annuity contract is to obtain an income, usually for retirement or other purposes. An annuity contract is not a life insurance policy or a health insurance policy. It is not a savings account or savings certificate, nor should it be bought for short-term purposes.

Annuity contracts may be classified in a number of ways. The most common are:

Immediate or deferred. Immediato annuity contracts provide income payments that start shortly after you pay the premium. Deferred annuity contracts provide income payments that start later, often many years later.

Single premium or flexible premium. Single premium contracts require you to pay the company only one premium. Installment premium contracts are designed for a series of premiums. Most are flexible premium contracts, allowing you to pay as much as you wish, whenever you wish, within specified limits. Others are scheduled premium contracts, which specify the size and frequency of your payments.

Individual or group. Individual contracts cover only one or two persons while group contracts cover a specified group of people.

Fixed, variable, or a combination of both. During the deferral or accumulation period of a fixed annuity contract, premiums (less any applicable charges) earn interest at rates set by the company. The amount of each annuity payment you receive is fixed when payments start. During the deferral period of a variable annuity, the value of the accumulated premiums (less any applicable charges) varies with the performance of a specified pool of investments. A combination annuity allows you to put part of your premium in a fixed annuity and part in a variable annuity. Annuity payments may be fixed or may vary with the performance of an investment pool.

Some states and local governments impose premium taxes on annuity sales. If applicable, premium taxes may be deducted from the premium or the accumulated value of your annuity when the tax is incurred by the insurer.

What Is an Equity-Indexed Annuity?

A fixed indexed annuity is an annuity with an interest rate which is linked to an external reference or index. The index might be a stock, bond or other index. One of the most commonly used indices is the Standard & Poor's 500 Composite Stock Price Index (the Standard & Poor's 500), which does not include dividends. The value of any index varies from day to day; it is not stable or predictable.

The index-linked interest creditod to an equity-indexed annuity is based on a formula that takes into account the changes in the index. The interest formula varies with different equity-indexed annuity products. It is very important that you understand how the interest formula works in your contract.

Some of the contract features that make up the formula that determines how index-linked interest is credited may include the following:

- indexing method used
- percentage of any increase in the index used (the participation rate)
- interest rate maximums and minimums (caps and floors)
- averaging

In addition to index-linked interest, the annuity also provides guaranteed values which are based on a guaranteed interest rate.

While an equity-indexed annuity may be immediate or deferred, this Buyer's Guide will address only deferred annuities. Also, this Buyer's Guide will address only fixed annuities and annuities which are not registered products. Registered products require the use of prospectuses.

Equity-Indexed Annuity Contract Features

The features are described as they currently appear in various product designs. Variations of these contract features may be developed in the future.

Term

The term or term period is the time during which increases in the index are measured. Terms are generally from one to 10 years in length, with six or seven years most common. Some products offer single terms while other products offer multiple terms. For contracts with multiple terms, at the end of each term there is generally a window, typically 30 days, during which you may withdraw your money without penalty.

Indexing Methods

There are several commonly used indexing methods: a) annual reset (ratcheting); b) point-to-point; and c) high-water mark.

Annual Reset

Index-linked interest, if any, is determined each year based on a comparison of the index value at the end of the contract year with the index value at the start of the contract year. Such interest is added to the contract each year during the term.

Point-to-point

Index-linked interest, if any, is determined based on a comparison of the index value at the start of a term of years with the index value at the end of that term. Interest is added to the contract at the end of the term.

High-Water Mark

Index-linked interest, if any, is detormined based on a comparison of the highest index value at some point during the term, usually an anniversary, with the index value at the beginning of the term. Interest is added to the contract at the end of the term.

Averaging

In some contracts, an average of index values rather than the actual index value on a specific date is used. The averaging may take place at the beginning, the end, or throughout the entire term of the annuity contract.

Participation Rate

The participation rate (sometimes called the "index factor") limits how much of the increase in the index will be used in the calculation of interest. For example, if the calculated rate of index change is 9% and the participation rate is 80%, the percentage credited to the contract will be 7.2%. (9% times 80% = 7.2%) The company sets the participation rate at the start of the term and usually guarantees it for a specific period (from one year to the entire term). When that period is over, the company sets a new participation rate for the next period. Some contracts guarantee that the minimum participation rate will never be set lower than a specified minimum.

Cap Rate

The annuity may have a cap on the amount of interest credited. This is the maximum rate of interest that will be applied to the contract. In the example given above, if the contract has a 6.5% cap rate, 6.5%, and not 7.2%, would be credited to the contract. Not all contracts have a cap rate.

Floor on Index-linked Interest

The floor is the minimum index-linked interest rate that will be applied to the contract. As in the case of a cap, not all contracts have floors on index-linked interest rates; in any case, however, the contract will have a minimum guaranteed value.

Guaranteed Value

The guaranteed value is the minimum value in the contract. For example, in the case of a single premium contract, it will never be less than a certain amount, typically 90% of the premium paid plus interest earned at an annual rate of 3%, minus any withdrawals. This value is the minimum amount available during a term period for withdrawals, as well as for some annuitizations (see Annuity Income) and death benefits. The guaranteed value may be adjusted at the end of each term to reflect any index increases. If, at the end of a term, the guaranteed value is greater than the accumulated value, it becomes the contract value.

Accumulated Value

The accumulated value is the value of the interest credited to the contract, plus the premiums paid, less any withdrawals taken or premium taxes paid during the term.

Withdrawals Subject To A Withdrawal Charge

Withdrawals are permitted in equity-indexed annuities to varying degrees. Most equity-indexed annuity contracts allow you to withdraw all or part of your contract value if annuity income payments have not started. Your contract may or may not permit you to make partial withdrawals before the end of a term. If you withdraw all of your contract value, the contract terminates. If you withdraw all or part of your contract value before the end of the term, a withdrawal or surrender charge may or may not be applied to the accumulated value or the guaranteed value. Some contracts do not credit index-linked interest on amounts withdrawn or surrenders made before the end of a contract anniversary or term.

If applicable, a surrender charge is usually a percentage of the value of the annuity contract or the premiums paid. The percentage may be reduced or eliminated after the contract has been in force for a certain number of years. Sometimes the charge takes the form of a reduction in the interest rate credited under the contract.

Withdrawals Not Subject To A Withdrawal Charge

Some contracts have a limited "free withdrawal" provision, which allows for one or more withdrawals without withdrawal charges each year up to a specified percentage of the guaranteed or accumulated value. Withdrawals above that amount are subject to withdrawal charges. Most equity-indexed annuity contracts waive withdrawal charges on withdrawals made within a specified number of days at the beginning of each new term. Some contracts waive withdrawal charges if you are confined to a nursing home or diagnosed with a terminal illness. To the extent that amounts are withdrawn, you may forfeit any index-linked interest.

Equity-Indexed Annuity Contract Benefits

Annuity Income

One of the most important benefits of equity-indexed annuities is the right to use the accumulated value to provide future income payments. Income payments are usually made monthly, although other frequencies are available. The amount of the annuity payment is based on both the accumulated value and the contract's "benefit rate" when income payments begin. This benefit rate depends on your age and sex, and the form of annuity payment you have chosen.

Death Benefit

There is a variety of death benefits in equity-indexed annuities. All contracts provide a minimum death benefit equal to the guaranteed value. Some contracts provide that the death benefit will be equal to the total premiums paid, less withdrawals and premium taxes. Other contracts may provide the accumulated value. Still others may provide the accumulated value, including any index-linked interest payable to the date of death, treating the date of death as the end of the term.

Tax Deferral

Annuities permit the accumulation of interest on a federal income tax deferred basis.

Why Buy an Equity-Indexed Annuity?

Just as with other annuities, an important purpose for purchasing an equity-indexed annuity contract is to obtain an income, either immediate or deferred, usually for retirement or other purposes.

Equity-indexed annuities offer an alternative to traditional fixed-interest annuities or variable annuities. Like traditional fixed-interest annuities, and subject to particular contract terms, they provide guarantees of principal and minimum interest. And, because the interest credited is linked to changes in an index, which is a broad measure of fluctuations in the equity or bond markets, they offer an alternative to the more traditional means of crediting interest.

Interest crediting that is linked to an index, yet subject to minimum guarantees, may be attractive for conservative individuals who want to increase the growth potential on their retirement savings. The interest credited may or may not be compounded, based on the particular contract.

In providing protection against declines in the index, the most common guarantee is a guarantee that 90% of the premiums you pay will be accumulated at 3% interest annually. Some equity-indexed annuity contracts may provide more attractive guarantees.

An equity-indexed annuity may appeal, in addition to those seeking protection of principal, to individuals who are looking for:

- a product designed to offset the effects of inflation
- a product that adds diversity to their retirement savings portfolios

Please refer to the Equity-Indexed Annuity Benefits section for additional points.

Tradeoffs - Which Equity-Indexed Annuity May Be Right For You?

Like any other financial product, you must carefully consider your own personal situation and how you feel about the types of alternatives available to you. It may be possible that no single equity-indexed annuity design will have all of the features you find desirable. Therefore, it is important to have an understanding of the positives and negatives associated with some of the features available today so that you can make the decision that is right for you.

[Additional balancing language to be added.]

The following general information may be helpful:

Which equity indexing method is best for you?

Annual Reset

Because interest earned is "locked in" and the index is "reset" at the end of the year, future decreases in the index will not affect the interest you have already earned. Therefore, this type of annuity often may provide greater interest than other designs when the index fluctuates up and down frequently during the term of the annuity, but doesn't end up significantly higher or lower from where it was at the start of the term.

Some annual reset designs may limit the total amount of interest you might earn each year based on caps on interest and averaging. Also, in some cases, the participation rate may vary each year. On the other hand, this design is more likely than others to feature a withdrawal privilege.

In general, you may prefer an annual reset design if the following features are important to you:

- crediting and "locking in" of interest annually
- availability of withdrawal feature

Point-to-Point

Since changes in the index are measured between two points in time—the day you purchase the contract and the last day of a specified term—the full amount of interest is not credited until the end of the term, typically six or seven years.

A point-to-point design often may credit more interest than other designs if the index moves in a steadily upward direction during the term. Depending on the formula the company uses to measure changes in the index, a higher participation rate could result in more overall interest earned. You should consider this design only if you are sure you can leave your money in the annuity for the entire term, however, since there may be no withdrawal feature available.

In general, you may prefer a point-to-point design if the following features are important to you:

- higher participation rate or index factor
- potential opportunity for greater interest if the index moves up significantly at the end of the term

High Water Mark

Interest is calculated using the highest value of the index, usually on a contract anniversary, during the term. Although there is typically no withdrawal feature available, your contract may make a portion of your interest available to you before the end of the term through a vesting schedule.

The high water mark annuity design often may credit higher interest than other designs if the index reaches a high point early or in the middle of the contract's term, then drops off at the end of the term.

In general, you may prefer a high water mark design if the following features are important to you:

- calculation of interest on highest value of index during the term
- protection against a market decline toward the end of the term

Impact of other Product Features

Cap on Interest Earned

A cap limits the amount of interest you might earn each year. This may, however, be offset by other product features you may find desirable, such as annual interest crediting, the availability of partial withdrawals or a high water mark feature.

Averaging

Averaging at the beginning of a contract term generally protects you from purchasing the annuity at a high point—which would leave less opportunity for future increases in the index. Averaging at the end of the contract term protects you from potential severe declines in the index, which may negatively impact the amount of interest you might earn. Averaging may limit reductions in your annuity values if the index declines. However, it may also limit the amount of interest you earn when the index rises consistently.

Compound vs. Simple Interest

Some equity-indexed annuities provide simple interest within the term, where any interest earned is added to your original premium amount and does not compound. Other designs offer compound interest, where interest that has already been earned will also earn interest. In either case, however, over the life of the contract, the interest earned over multiple terms is generally compounded.

Participation Rate

The declared participation rate in any particular contract may or may not take into account whether rates are calculated on a simple or compounded basis or what form of averaging, if any, is used.

Final Points to Consider

It is not possible to predict the future course of an index. Therefore, you must decide for yourself what combination of features make the most sense to you. It is very important that you choose a product which you thoroughly understand. The purpose of this Buyer's Guide is to assist you with that process. Your agent can also help guide you. Remember that the quality of service you can expect from the company and the agent should also be an important factor in your decision to purchase any equity-indexed annuity contract.

Read the Contract

When you receive your indexed annuity contract, read it carefully. Ask the agent and insurance company for an explanation of anything you do not understand.

If you have a specific complaint or cannot get the answers you need from the agent or company, please contact your state insurance department.

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ATTACHMENT THREE-C

BULLETIN—INDEXED ANNUITY AND LIFE PRODUCTS
Draft, June 1997, North Dakota

Annuity and life insurance products whose values are based in any way on the developing value of a financial index or indices are addressed in this bulletin. Because of potential consumer misunderstandings, investment requirements, uncertainty concerning nonforfeiture values and unknown reserve requirements, the appropriate regulation of these products is only developing.

Minimum Requirements

This bulletin presents the insurance department's current minimum requirements that must be met before a filing of an indexed product will be considered for approval. Further, if there are any indexed products currently approved for sale in this state, then these requirements are henceforth placed on these products. It is expected that these requirements will be updated from time-to-time as need requires.

These requirements should be considered as minimums. Because of the intricate nature of indexed annuity and life insurance products, it is critical to completely perform all necessary functions connected with these products. At the same time, it is equally critical that "real" communication occur with all parties; that is, simplicity of presentation is also paramount.

Advertising

All advertising laws and regulations applicable to life or annuity products are specifically applicable to these products. As outlined later in this bulletin, all advertising material must be filed and approved for use in this state before an indexed product may be offered for sale. Further, any marketing, advertising or disclosure material developed for use with an indexed product after the initial approval must be filed and approved before use.

Life Insurance—Disclosure

The disclosure requirements for indexed life insurance products are given by N.D. Administrative Rules 45-04-01.1, Life Insurance Illustrations Model Regulation. All companies offering indexed life insurance products in North Dakota must file and have approved all material showing complete compliance with this regulation before offering the product for sale. Items include all required certifications, all possible illustrations and complete documentation of Actuarial Standard of Practice #24 compliance. This regulation has been in effect for all sales since Jan. 1, 1997. The following disclosure requirements are not applicable to life insurance products at this time.

Annuity—Disclosure

The disclosure requirements for indexed annuities will follow the same general format of the life insurance illustrations model. That is, requirements include a title page, a narrative summary, a numeric summary and tabular detail. All material must be presented in a format that is readily understandable by the reader; large print, copious blank spaces, simplified language, useful examples.

Narrative Summary

Key Components: this section of the disclosure document is to describe all the key components of the contract. These components include, but are not limited to, the index, the index calculation method, averaging or not, participation rate, caps, type of benefit and time receiving benefit. These descriptions must be simple, understandable, readily available to the typical reader and not misleading. Examples illustrating each concept may be helpful. The following examples are illustrative, although not required. Companies are encouraged to be innovative.

1. The index used in this contract is the XYZ index. This index has a value each day which is the stock price of three companies. Suppose the three companies are the same size and their stock prices are $1, $3 and $5. Then the XYZ index for that day would be $3 which is the average price. If the stock prices on the next day are $2, $4, and $6, then the XYZ index would be $4 for that day. The index represents the average value of the stock price for that day. Please note that the index value does not include any dividends paid.

2. Index credit is given to the contract based of the change in the XYZ index. The index value is determined at the beginning of the period. It is compared with a later value. Suppose the first value is 100 and the later value is 108. This later value is 8% larger than the beginning value. Now, suppose the first value is 100 and the later value is 95. No index credit would be given for this period because the value decreased.

3. Not all of the index credit is given to the contract. A portion of this value is given. This portion is called the participation rate. The participation for is contract IN THE FIRST YEAR is 75%. This means that 75% of the change in the index is given to the contract. Suppose the index changed 8%. Then 6% (.75x8) would be given to the contract.

Again, these examples are for illustrative purposes only. The critical concern is that every reasonable effort be made to provide meaningful, accessible information for the consumer.

Balancing language: all sections of the disclosure material must contain pro-and-con language. This language is intended to provide a balance view of the features of these products. This is especially important as a consumer expectation determinant. A few examples will illustrate.

1. Averaging of index values provides higher values during a period when index values are decreasing. The average of the values 5, 3 and 1 is 3. The average is higher than the ending value. It must be disclosed that averaging provides lower values during periods when the index is increasing. The average of the values 6, 8 and 10 is 8 which is lower than the ending value, 10.

2. The participation rate is determined by the company. The current rate, the guaranteed rate and the guaranteed period must be clearly explained. Also factors which may cause the rate to change must be disclosed. How the rate will be determined in subsequent periods must be shown.

Hypothetical: one of the two primary goals of these index annuity disclosure documents is to explain the internal workings of the contract. To that end, an illustration based on a hypothetical index pattern is to be included. The pattern must include movements of the index which will demonstrate all potential features of the product. Columns must be shown for the index values, the change in the index, the dollar affect of the change, the account value, the surrender value and the cumulative annual earnings rate. The resulting values can in no way be misleading.

Minimum Value Illustration: a purported key feature of these products is that they provide a floor of value; they guarantee principal. It is critical that the consumer know exactly what this means for the product under consideration. A minimum value illustration is to be provided which will simply and completely demonstrate "the floor." An example is shown in Exhibit 1 attached.

Numeric Summary

The second of the two primary goals of this disclosure material is to create a "correct" expectation for the applicant as they consider this product. Since the future of the financial markets is unknown, this expectation must be created based on past results and current knowledge.

Summary Table: this table is intended to provide a framework with which the applicant can view the product under consideration. Various accumulation instruments are available for the consumer. It is important that as accurate an expectation as possible be developed by the applicant. To that end, a comparison of actual results for various financial instruments is be given along with the results of the product under consideration. The indexed product values are found as follows:

1. The product design being disclosed is used. The index method, caps, averaging or not, and so forth are used. The initial participation rate is used for the period for which it is guaranteed. Beyond the guaranteed period for the participation rate, one-half (1/2) of the initial participation rate is used to calculate these values.

2. The period to use is one ending 12/31/96. So, for a seven year product, assume that it was issued 1/1/90. For other terms, please show at least seven years. So a three-year term would require three periods to be shown and assume that the policy was issued 1/1/88.

3. The value to be shown in the table is the cash surrender value at the end of the year.

4. The index to be used is the one purposed for the contract using values from the period indicated.

5. The premium is a single payment of $1,000.

The cash surrender values for the $1,000 single payment are to be included in the table along with results from two other financial instruments: one-year treasury bills (effective annual interest rates corresponding to discount rate-360 day year) and S&P composite index total returns. Annual increases for these instruments from 1985 through 1996 are given below.

YEAR	ONE-YEAR TB	S&P TOTAL RETURN
1985	8.60%	32.16%
1986	6.56	18.47
1987	6.86	5.23
1988	7.79	16.81
1989	8.73	31.49
1990	8.05	-3.17
1991	5.93	30.55
1992	3.91	7.67
1993	3.45	9.99
1994	5.36	1.31
1995	6.02	37.43
1996	5.59	23.07

The format and contents of this disclosure page are shown in Exhibit 2 attached.

STATEMENTS: on the same page as the summary table are statements to be signed by the applicant and company representative.

1. Applicant: "I have received a copy of this disclosure material and understand that results shown, other than the guaranteed minimum values, are not guarantees or are they promises. No one knows what the future equity values will be under this contract."

2. Representative: "I certify that this disclosure material has been presented to the applicant and a copy is provided. I have not made any promises about future equity values to be expected under this contract."

TABULAR DETAIL

This section is to continue the twin goals of showing minimum values and creating the most accurate expectation for the applicant of the equity portion as possible. Minimum values must be shown in reasonable proximity to equity values.

Presentations can be provided in any reasonable format with the intent being to show meaningful aspects of the contract in a manner which will be readily accessible to the applicant. A key review criteria will be the ease of understanding of the material by the typical applicant.

PRODUCT FILINGS

For each indexed life insurance and indexed annuity product, the following must be filed and approved before the product may be offered for sale in North Dakota. Each of these items must also be filed and approved for any "indexed" product which is currently approved for use in North Dakota.

1. For life insurance, compliance with NDAC 45-04-01.1, Life Insurance Illustration Model Regulation.

2. For annuities, the disclosure documents described in this bulletin.

3. All advertising and marketing material intended for use in conjunction with the sale of these products. Newly developed material must be approved before use. All assumptions underlying the development of this material must be provided.

4. Description of the hedging strategy that is going to be used and a description of the methods for determining the effectiveness of tbe strategy.

5. The methodology that will be used to calculate statutory reserves.

6. Description of the methodology that will be used to calculate the statutory value of any derivative instrument used in the investment strategy to support the product.

7. A statement as to how the product will be reported for risk-based capital purposes.

8. Additionally, please provide the annual report to the policyowner.

EXHIBIT 1
GUARANTEED VALUES

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

YOUR PAYMENT $1,000

YEARS SINCE PAYMENT	ACCOUNT VALUE	VALUE IF SURRENDER	ANNUAL EARNINGS RATE IF SURRENDER
0	$1,000	$900	*
1	1,000	927	*
2	1,000	955	*
3	1,000	984	*
4	1,013	1,013	0.32
5	1,043	1,043	0.85
6	1,075	1,075	1.21
7	1,107	1,107	1.46

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

EXHIBIT 2

Single Payment = $1,000 on Jan. 1, 1990

The one-year Treasury Bill rates are U.S. Government backed securities.

The S&P 500 Total Return represents the total return–price increase and dividends paid–for this collection of stocks.

The equity-indexed annuities surrender value is the value which would have developed had this purchase been made on the date indicated.

YEAR	1 YTB	SP TOTAL	equity-indexed annuities SURR VALUE
1990	$1,081	$968	*
1991	1,146	1,264	*
1992	1,189	1,361	*
1993	1,230	1,497	*
1994	1,296	1,517	*
1995	1,374	2,084	*
1996	1,451	2,566	*
**	5.46	14.30	*

* The surrender values and average annual earnings rate for the product
** The average annual earnings rate caveats that these are not guarantees or projections, etc.

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ATTACHMENT THREE-D

Annuity Disclosure and Sales Illustrations Model Regulation
Draft: 5/9/97

Table of Contents

Section 1. Purpose

The purpose of this regulation is to provide rules standards for the disclosure of certain minimum information about annuity contracts and to provide rules for annuity illustrations that will protect consumers and foster consumer education. The regulation specifies the minimum information which must be disclosed and the method for disclosing it in connection with the sale of annuity contracts. The regulation provides illustration formats, prescribes standards to be followed when illustrations are used, and specifies the disclosures that are required in connection with illustrations. The goals of this regulation are to ensure that purchasers of annuity contracts understand certain basic features of annuity contracts and to make illustrations more understandable. Insurers shall define terms used in the disclosure statement and illustration in language that facilitates the understanding by a typical person within the segment of the public to which the disclosure statement or illustration is directed.

Section 2. Authority

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

Section 3. Applicability and Scope

This regulation applies to all group and individual annuity contracts and certificates except:

A. Registered or non-registered variable annuities or other registered contracts;

B. Deferred and immediate annuities without non-guaranteed elements.

C. Annuities used to fund an employee pension benefit plan which is covered by ERISA, or a plan described by Sections 401(a), 401(k) or 457 of the Internal Revenue Code, or a governmental or church plan defined in Section 414 of the Internal Revenue Code, or a nonqualified deferred compensation arrangement not prohibited by ERISA. Notwithstanding the foregoing, a disclosure document will be required for annuities used to fund any such plan or arrangement for which fewer than 15 employees are eligible and where there is a direct solicitation of individual employees by an insurance agent. As used in this subsection, direct solicitation shall not include any meeting held by an insurance agent for the purpose of educating or enrolling employees.

D. Structured settlement annuities

Section 4. Definitions

For the purposes of this regulation:

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

B. "Contract owner" means the owner named in the annuity contract or certificate holder in the case of a group annuity contract.

C. "Currently payable scale" means a scale of non-guaranteed elements in effect for an annuity contract or certificate form as of the preparation date of the illustration or declared to become effective within the next sixty (60) days.

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

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

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

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

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

E. "Generic name" means a short title descriptive of the annuity contract being applied for or illustrated such as "single premium deferred annuity."

F. "Guaranteed elements" means the benefits, values, credits and charges under an annuity contract that are guaranteed and determined at issue.

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

(1) The disciplined current scale; or

(2) The currently payable scale.

H. "Illustration" means a presentation or depiction that includes non-guaranteed elements of a annuity contract over a period of years and that is one of the three (3) types defined below:

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

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

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

I. "Illustration actuary" means an actuary meeting the requirements of Section 11 who certifies to illustrations based on the standard of practice promulgated by the Actuarial Standards Board.

J. "Lapse-supported illustration" means an illustration of an annuity contract failing the test of self-supporting as defined in this regulation.

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

(a) Fully allocated expenses;

(b) Marginal expenses; and

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

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

L. "Non-guaranteed elements" means the benefits, values, credits and charges under an annuity contract that are not guaranteed or not determined at issue.

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

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

Section 5. Contracts to be Illustrated *(To Be Drafted)*

Section 6. General Rules and Prohibitions

A. At or prior to the taking of an application for any annuity contract subject to the regulation, the insurer, its producers or other authorized representative shall provide to the applicant a disclosure document which meets the requirements of Section 7 of this regulation.

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

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

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

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

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

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

(6) Provide an applicant with an incomplete illustration;

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

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

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

Section 7. Standards for Disclosure

The following information shall be contained in the disclosure document required to be provided under this regulation:

A. The generic name of the contract, the company product name, if different, and form number.

B. The insurer's name and address;

C. A description of the contract and its benefits, identifying it as an annuity, emphasizing its long-term nature and describing:

(1) The guaranteed and non-guaranteed elements of the contract, and their limitations, if any, and an explanation of how they operate;

(2) If a first specific rate is mentioned a statement of recent data history is required;

(3) The availability of periodic income (annuitization);

(4) The surrender charges if applicable, specifically their duration and how they are applied;

(5). Any other fees and charges, their limits and how they are applied;

(6) How values in the contract can be accessed;

(7) The death benefit, if available;

(8) A summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract;

(9) Impact of any rider, such as nursing home, or long-term care rider.

Section 8. Standards for Basic Illustrations

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

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

(2) Each page, including any explanatory notes or pages, shall be numbered and show its relationship to the total number of pages in the illustration (*e.g.,* the fourth page of a seven-page illustration shall be labeled "page 4 of 7 pages").

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

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

(5) The assumed payments on which the illustrated benefits and values are based shall be identified as premium outlay or contract premium, as applicable. For policies that do not require a specific contract premium, the illustrated payments shall be identified as premium outlay.

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

(7) Any non-guaranteed elements shall not be based on a scale more favorable to the contract owner than the insurer's illustrated scale at any duration. These elements shall be clearly labeled non-guaranteed.

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

(9) The account or accumulation value of a contract shall be identified by the name this value is given in the contract being illustrated and shown in close proximity to the corresponding value available upon surrender.

(10) The value available upon surrender shall be identified by the name this value is given in the contract being illustrated and shall be the amount available to the contract owner in a lump sum after deduction of surrender charges, contract loans and contract loan interest, as applicable.

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

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

(a) The benefits and values are not guaranteed;

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

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

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

(1) A brief description of the contract being illustrated, including a statement that it is a life insurance contract;

(2) A description of the contract and its features, riders or options, guaranteed or non-guaranteed, shown in the basic illustration and the impact they may have on the benefits and values of the contract;

(3) The availability of periodic income;

(4) The surrender charges, if applicable, specifically their duration and how they are applied;

(5) Any other fees and charges, their limits and how they are applied;

(6) How values in the contract can be accessed;

(7) The death benefit, if available;

(8) A summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract;

(9) Impact of any riders, such as long-term care or nursing home;

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

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

C. Numeric Summary.

(1) A basic illustration shall include a numeric summary of the accumulation value, cash surrender value and the premium outlay, as applicable. For a contract that provides for a contract premium, the values shall be based on the contract premium. This summary shall be shown for at least contract years five (5), ten (10) and twenty (20) and at age 65, as applicable, on the three bases shown below.

(a) Contract guarantees;

(b) Insurer's illustrated scale;

(c) Insurer's illustrated scale used but with the non-guaranteed elements reduced as follows:

(i) Dividends at fifty percent (50%) of the dividends contained in the illustrated scale used;

(ii) Non-guaranteed credited interest at rates that are the average of the guaranteed rates and the rates contained in the illustrated scale used; and

(iii) All non-guaranteed charges, including but not limited to, expense charges, at rates that are the average of the guaranteed rates and the rates contained in the illustrated scale used.

(2) In addition, the summary shall show, on three bases, the amount of monthly annuity income payable on a life annuity basis selected by an applicant. If none is selected, then the amount of monthly annuity income shall be shown on a life annuity with 10-year certain payments using the insurer's current single premium annuity purchase rate and the contract value using the insurer's illustrated sale; second, the insurer guaranteed annuity purchase rates and the guaranteed contract value using the contract guaranteed contract elements; and third, using factors midway between the current purchase rate and the illustrated scale for contract value and the guarantee annuity purchase rates and guarantee contract values.

D. Statements substantially similar to the following shall be included on the same page as the numeric summary and signed by the applicant, or the contract owner in the case of an illustration provided at time of delivery, as required in this regulation.

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

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

E. Tabular Detail.

(1) A basic illustration shall include the following for at least each contract year from one (1) to ten (10) and for every fifth contract year thereafter ending at the later of age 85, or the maximum annuitization age. In addition, the basic illustration shall show the amount of monthly annuity income based on the annuity option selected by the applicant, if an option is not selected, then on a life annuity with 10 year certain for annuitization ages 65 and 70, or if later, for the annuitization age in the 10th and 15th contract year, but, in no event later than age 90.

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

(b) The corresponding guaranteed accumulation and cash surrender value, as provided in the contract.

(2) For a contract that provides for a contract premium, the guaranteed accumulation and cash surrender value available shall correspond to the contract premium.

(3) Non-guaranteed elements may be shown if described in the contract. In the case of an illustration for a contract on which the insurer intends to credit terminal dividends, they may be shown if the insurer's current practice is to pay terminal dividends. If any non-guaranteed elements are shown they must be shown at the same durations as the corresponding guaranteed elements, if any. If no cash surrender value is available at any duration, a zero shall be displayed.

Section 9. Equity-Indexed Annuities *(To Be Drafted)*

Section 10. Standards for Supplemental Illustrations

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

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

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

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

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

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

Section 11. Delivery of Illustration and Record Retention

A. (1) If a basic illustration is used by an insurance producer or other authorized representative of the insurer in the sale of an annuity contract and the contract is applied for as illustrated, a copy of that illustration, signed in accordance with this regulation, shall be submitted to the insurer at the time of contract application. A copy also shall be provided to the applicant.

(2) If the contract is issued with an initial lower guarantee interest rate or rates than that illustrated, a revised basic illustration conforming to the contract as issued shall be sent with the contract. The revised illustration shall conform to the requirements of this regulation, shall be labeled "Revised Illustration" and shall be signed and dated by the applicant or contract owner and producer or other authorized representative of the insurer no later than the time the contract is delivered. A copy shall be provided to the insurer and the contract owner.

B. If no illustration is used by an insurance producer or other authorized representative in the sale of an annuity contract, the producer or representative shall certify to that effect in writing on a form provided by the insurer. On the same form the applicant shall acknowledge that no illustration was provided. This form shall be submitted to the insurer at the time of contract application.

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

D. A copy of the basic illustration and a revised basic illustration, if any, signed as applicable, along with any certification that either no illustration was used or that the contract was issued other than as illustrated, shall be retained by the insurer until three (3) years after the contract is no longer in force. A copy need not be retained if no contract is issued.

Section 12. Annual Report; Notice to Contract Owners

A. The insurer shall provide each contract owner with an annual report on the status of the contract that shall contain at least the following information:

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

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

(3) The total amounts that have been credited to the contract value during the current report period; and

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

B. If a sales illustration was used or is available for that annuity contract form, and the annual report does not include an in force illustration, it shall contain the following notice displayed prominently: "IMPORTANT CONTRACT OWNER NOTICE: You should consider requesting more detailed information about your contract to understand how it may perform in the future. You should not consider replacement of your contract or make changes without requesting a current illustration. You may annually request, without charge, such an illustration by calling [insurer's phone number], writing to [insurer's name] at [insurer's address] or contacting your agent. If you do not receive a current illustration of your contract within 30 days from your request, you should contact your state insurance department." The insurer may vary the sequential order of the methods for obtaining an in force illustration.

C. If a sales illustration was used or is available for that contract form, the annual report must contain a statement that upon the request of the contract owner, the insurer shall furnish an in force illustration of current and future benefits and values based on the insurer's present illustrated scale. This illustration shall comply with the requirements of Sections 6 and 8. No signature or other acknowledgment of receipt of this illustration shall be required.

D. If an adverse change in non-guaranteed elements that could affect the contract has been made by the insurer since the last annual report, the annual report shall contain a notice of that fact and the nature of the change prominently displayed.

Section 13. Annual Certifications

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

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

C. The illustration actuary shall:

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

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

(3) Not have been found by the commissioner, following appropriate notice and hearing to have:

(a) Violated any provision of, or any obligation imposed by, the insurance law or other law in the course of his or her dealings as an illustration actuary;

(b) Been found guilty of fraudulent or dishonest practices;

(c) Demonstrated his or her incompetence, lack of cooperation, or untrustworthiness to act as an illustration actuary; or

(d) Resigned or been removed as an illustration actuary within the past five (5) years as a result of acts or omissions indicated in any adverse report on examination or as a result of a failure to adhere to generally acceptable actuarial standards;

(4) Not fail to notify the commissioner of any action taken by a commissioner of another state similar to that under Paragraph (3) above;

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

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

(a) Fully allocated expenses;

(b) Marginal expenses; or

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

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

(a) Annually for all annuity contract forms for which illustrations are available; and

(b) Before a new annuity contract form is illustrated.

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

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

F. A responsible officer of the insurer, other than the illustration actuary, shall certify annually:

(1) That the illustration formats meet the requirements of this regulation and that the scales used in insurer-authorized illustrations are those scales certified by the illustration actuary; and

(2) That the company has provided its agents with information about the expense allocation method used by the company in its illustrations and disclosed as required in Subsection C(6) of this section.

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

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

Section 14. Penalties

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

Section 15. Separability

If any provision of this regulation or its application to any person or circumstance is for any reason held to be invalid by any court of law, the remainder of the regulation and its application to other persons or circumstances shall not be affected.

Section 16. Effective Date

This regulation shall become effective [or effective date set in regulation, whichever is later] and shall apply to policies sold on or after the effective date.

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ATTACHMENT THREE-E

Life Disclosure Working Group
Washington, D.C.
April 30, 1997

The Life Disclosure Working Group met at 8 a.m. on April 30, 1997, in Washington, D.C. Rick Morse (N.Y.) chaired the meeting. The following working group members were in attendance: Harold Phillips (Calif.); Roger Strauss (Iowa); Paul DeAngelo (N.J.); and Tom Foley (N.D.).

1. Disclosure Requirements

Rick Morse (N.Y.) announced that the agenda was to review the draft prepared by Linda Lanam (Life of Virginia) on disclosure, discuss what should be included in a full illustrations model, and then discuss equity-indexed products. William Fisher (MassMutual) suggested the model should exempt annuities used to fund retirement plans. He offered to provide more information to the working group. Tom Foley (N.D.) suggested leaving the language of the regulation open enough to allow the plan document to satisfy the disclosure requirements rather than including an exemption. Mr. Morse suggested the working group hold off on deciding this issue until more of the details of the regulation had been worked out. Roger Strauss (Iowa) asked if the philosophy of this regulation would be to require disclosure for all annuities and then have an optional full disclosure for certain types of annuities. Mr. Foley responded that the disclosure document is comparable to the narrative summary in the Life Insurance Illustrations Model Regulation.

Ms. Lanam highlighted the disclosure requirements included in her draft. She said that the provisions did not prohibit describing a guaranteed or nonguaranteed interest rate. She said the working group should discuss whether it wanted to call the nonguaranteed rate an anticipated rate, historical rate, etc. She pointed out that if the working group wanted to include an interest rate in the disclosure document, there were probably additional issues that needed to be considered. Mr. Morse said he thought the disclosure document would disclose the anticipated rate and suggested that there needs to be a mechanism to describe the first-year bonus. Ms. Lanam responded that if an interest rate is included in the disclosure document, there need to be standards for that disclosure. She said she was not concerned about the first-year rate because that was guaranteed but suggested that future rate disclosure without a discipline could cause problems. Mr. Morse expressed concerned that, without discussion of the anticipated renewal rate, there was the possibility of misunderstanding and the potential of lawsuits in the future. Ms. Lanam said that describing the possible renewal rate could lead to misunderstandings too. She suggested that, if the current rate was described, then future rates should be also.

Paul DeAngelo (N.J.) asked if it was necessary to disclose a numeric rate, or whether it could simply be a sentence that gives information such as "typically the renewal rate is lower," or "typically the renewal rate is 1% lower." Mr. Foley pointed out that some companies are playing games with the first-year interest rates and the working group needed to deal with how misleading this is. Mr. DeAngelo said consumers want to know what typically happens after the first year. They do not necessarily need a specific rate, but complaints about surrender charges are usually because consumers were disappointed with the interest rate after the first year. Ms. Lanam suggested that the working group recommend for the disclosure document that, if the first-year interest rate is mentioned, the disclosure must include the most recent renewal rate for that form. Ms. Lanam noted that the working group had earlier discussed a possible rule that if any rate was used, that a full illustration would be required.

Mr. Strauss suggested it would be appropriate to include a bail-out provision here. If the renewal rate declined more than "x" percent, waive the surrender charges for 60 days. Harold Phillips (Calif.) suggested that a higher first-year rate is inherently misleading. He suggested that regulators should prohibit that, but if it is allowed, excellent disclosure is needed. He said this included showing the interest rate that the company expected to credit each year. Mr. Foley said the working group had begun with the idea of requiring a full disclosure, but had moved to the position of identifying types of annuities that would require full illustrations. Three types that have been identified so far are equity-indexed products, two-tier annuities and annuities sold with a life insurance policy. Mr. Phillips asked why the working group was not requiring a full illustration with each annuity sale. Mr. DeAngelo responded that the working group did not want to require an illustration where none was currently being used. He also said that sometimes an illustration may do more harm than good, especially with an unsophisticated purchaser, who could be mislead by numeric displays. He said his office did not generally get complaints about the annuity value, but if an illustration is required the departments will begin to get complaints about the value. Mr. Phillips disagreed, saying that a purchaser will not comprehend until he sees the surrender charge included in the tabular display. Mr. Morse said another concern that led the working group to the decision not to require a full illustration was the great financial burden to the insurers. Originally the assumption had been that insurers typically used full illustrations, but when they found that the assumption was not correct, the working group stepped back and reviewed the types of complaints that were received.

Ron Nelson (Northwestern Mutual) said the anticipated rate is what can be paid in the current environment. He suggested that if the working group went with this concept, then a disciplined current scale would be needed. Barbara Lautzenheiser (Lautzenheiser & Associates), a member of the American Academy of Actuaries (AAA) Committee on Life Insurance, asked that if the decision is made to include some numbers in the disclosure document, the AAA committee be allowed to comment on what should be included in the illustration. She suggested focus groups would help the regulators to understand what the consumer drew from the disclosure document and the illustration. Ms. Lanam agreed that, if the regulators wanted to include rates in the disclosure document, actuarial input would be necessary so that the illustration did not end up using an artificially high rate.

Charlotte Liptak (Transamerica) said she thought of this disclosure document as being simply narrative. She expressed concern that getting too specific in the disclosure would encourage companies to design products around that disclosure. Mr. DeAngelo said it had never been his understanding that the disclosure would include numbers; if it did, then he would agree with Mr. Phillips that a full illustration should be required all the time. Ms. Lanam said she saw the disclosure as a preprinted document that could be distributed to each potential purchaser. Mr. Morse said a key decision for the working group was the trigger for a full illustration. He said he personally thought that quoting a rate was a good trigger. Ms. Lanam said her concept was that if a first-year rate was included in the disclosure, the actuarially determined sustainable current rate should also be mentioned. If the insurer wants to show that over a period of years, a full illustration would be required. Mr. Foley expressed the conviction that the working group needs a determination of a "sustainable rate." He agreed with the idea expressed by Mr. Strauss to include a bail-out provision. Mr. Strauss said one concern about life illustrations is that they are getting too long. He did not want to see the same thing happen with annuity illustrations. Mr. Phillips said the illustration should fit on one page even with some numbers.

Mr. Morse summarized three decisions the working group had to make: (1) decide whether to prohibit numeric information on the disclosure document; (2) give an option to use just numeric or combined; and (3) define a sustainable rate. Mr. Foley suggested the working group put off that decision until later. He said that after a discussion of equity-indexed products and two-tier annuities, the decision may be clearer.

The next question for discussion was whether to include ancillary benefits in the disclosure. For example, if an individual goes into a nursing home, the surrender charges would be waived. Mr. Phillips said that if those benefits are included in the contract they should be mentioned; not doing so would be a serious omission. Mr. Morse suggested adding a section to the disclosure requirements to "describe impact of any riders on the contract." Ms. Lautzenheiser said that, in terms of consumer education, describing riders that people were not purchasing would be confusing. Ms. Lanam responded that the information on riders could be given only to those who were considering purchase of that particular rider.

2. Other Sections for Annuity Illustrations Regulation

Mr. Morse reviewed the provisions of the Life Insurance Illustrations Model Regulation and reached consensus with the members of the working group on the major sections to be included in an annuity illustration regulation. He offered to use that information plus the disclosure draft prepared by Ms. Lanam to prepare an initial draft of an annuity illustration model regulation for working group consideration. Mr. Morse asked if the working group thought it was necessary to provide the same paper trail as in the life illustrations regulation; for example, are signatures of the agent and applicant necessary? John Mathews (Allstate) asked how the working group envisioned addressing the signature requirements with Internet sales and agents using a lap-top computer but no printer. Mr. Morse responded that many states will need to change their laws to allow any verification other than a signature. He opined that this was a much broader issue than annuities sales and said these issues are being handled in other committees of the NAIC.

When the working group discussed the details of the tabular display, Mr. Phillips suggested that, since annuities are generally sold at older ages, the group should consider allowing a company to combine the numeric summary and the tabular detail into one section. Mr. Morse agreed that it should be possible for an insurer to do a full illustration in three or four pages in the abbreviated disclosure format being discussed.

The working group discussed whether to include standards for an annual report. Mr. Morse said that the New York annuity law does require an annual report, and he suggested putting it in the first draft for discussion purposes.

Mr. Morse asked if an illustration actuary would be a necessary component of an annuity illustrations regulation. Ms. Lautzenheiser asked that the AAA be allowed to provide input on that issue before a decision was made. Mr. Foley agreed that was appropriate, since the working group does not yet know how many actuarial issues will be involved in this regulation. The working group recommended that Mr. Morse not include the actuarial certification and expense issues in the first draft but retain the certification of a company officer requirement.

Mr. Foley opined that a core decision needs to be the method for handling a sustainable interest rate. Mark Peavy (NAIC/SSO) suggested that it is not possible to do that without an actuarial standard of practice. Mr. Foley said that if the working group could reach a decision on this issue at the April meeting, it would give the AAA another six weeks to work, but if the working group could find a way to accomplish this goal in a less onerous manner, that should be explored. One possibility might be that if a company discloses the criteria used in arriving at its current interest rate, an actuarial standard of practice might not be necessary. Mr. Phillips said he did not see a way for this to work without the involvement of the AAA. Mr. DeAngelo suggested that the majority of consumers do not care how the company's calculation works, they just want to know how their policy will perform.

3. Equity-Indexed Products

Mr. Morse said he would not draft the section on equity-indexed products, but he said a separate section of the model to deal with equity-indexed products was appropriate. He noted that New York did not allow some of the policy designs being used in other states, so he needed to be educated. He suggested waiting to draft this section until nearer the end of the debate. Ms. Liptak said the AAA group on equity-indexed products is preparing information to provide the Life and Health Actuarial Task Force at the Summer National Meeting and that will be helpful to the Life Disclosure Working Group also.

Mr. Foley summarized the responses he had received to the disclosure document he distributed at the Spring National Meeting in Orlando. He reminded the group that he was developing guidelines to be used for filings in North Dakota, and he expected to incorporate the Illinois requirements on reserves. He said that he had received more than 30 written responses; about half agreed with his basic strategy of applying the policy design to the past 30 years of the index's history. A few who commented were vehemently opposed to his proposal and a few had suggestions for improvement. Mr. Foley said that North Dakota will promulgate something fairly close to his prior submission during May. He said he expected to require a numeric summary, a narrative and a tabular detail similar to the Life Insurance Illustrations Model Regulation. Mr. Foley said the descriptive materials he had in mind would reinforce how the product works and give the potential purchaser a better understanding of what the product values meant. He suggested that it was important that illustrations for equity-indexed products somehow show the probability of receiving a high or low return. Ms. Liptak asked what participation rato should be used in the illustration. Mr. Foley responded that if the participation rate is guaranteed, that should be used. If not, he said he did not have an answer. He reinforced the concept that it was important to show it clearly so that people were not misled. Mr. Phillips suggested the design that allowed a company to change the participation rate at will should be prohibited. Mr. Foley said that some companies feel they need to have the flexibility to change the participation rate given the volatility of the market. Mr. Foley described his tabular detail using numbers from the past 30 years. Ms. Liptak expressed concern about the understandability of the tabular detail and suggested it might create unreasonable expectations because of the high return in the past. She also suggested it drew companies closer to the line where securities registration would be required.

Mr. Foley said that a major solvency concern was poor persistency, and suggested regulators needed to do the very best job they could to create proper expectations. Ms. Liptak cautioned the group that product designs are still being created, and the group needs to be careful not to get too specific so that insurers could design around the requirements.

Mr. Morse suggested that a focus on the product design is not productive because there are so many different designs. He said the investment strategy of the insurer that backs up this product is extremely important. He pointed out a study that said since 1925 the stock market has returned an average of 10%, including dividends. He noted this product does not have dividends so presumably its return would be lower. He said in 13 out of the prior 30 years the individual would have gotten the minimum guaranteed return and asked how to meaningfully disclose that risk. He also pointed out that agents selling equity-indexed products need not be registered, so may not be knowledgeable in equity markets. Ms. Lautzenheiser opined that what is missing is a generic educational piece with a glossary of terms and something that talks generally about the attributes of the product. Ms. Liptak offered to have the technical resource advisers with whom she works develop such a glossary. Mr. Morse commented that the discussion on equity-indexed products had been a good discussion and made clear that the regulators and technical resource advisers did not have answers yet for many questions.

Having no further business the Life Disclosure Working Group adjourned at 2:40 p.m.

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ATTACHMENT FOUR

Replacement Issues Working Group
Chicago, Ill.
June 10, 1997

The Replacement Issues Working Group of the Life Insurance (A) Committee met in the Continental A Room of the Chicago Hilton & Towers in Chicago, Ill., at 11 a.m. on June 10, 1997. Paul DeAngelo (N.J.) chaired the meeting. The following working group members or their representatives were present: Richard Rogers (Ill.); Rosanne Mead (Iowa); Lester Dunlap (La.); Cindy Martin (Mass.); Cindy Amann (Mo.); Bill Carmello representing Rick Morse (N.Y.); Joel Ario (Ore.); Ted Becker (Texas); and Tom Van Cooper (Vt.).

1. Adopt Minutes of May 7, 1997, Conference Call

Rosanne Mead (Iowa) moved and Lester Dunlap (La.) seconded a motion to adopt the minutes of the May 7, 1997, conference call (Attachment Four-C). The motion passed.

2. Discuss Draft of Replacements of Life Insurance Model Regulation

Paul DeAngelo (N.J.) said he had prepared an initial draft of a new model to replace the existing NAIC Model on Replacements of Life Insurance and Annuities Policies (Attachment Four-A). He emphasized that this is a draft for discussion purposes and it is not anything endorsed by the working group or any of its membership. He pointed out that it was not even necessarily all something that he could endorse but rather an inclusion of all of the various suggestions made. He opined that the working group needed to be somewhat creative in crafting solutions to the problems that had been identified.

Mr. DeAngelo briefly summarized what he considered to be the highlights of the draft. He said the new draft broke out financed sales to address the use of any policy values to finance a new policy of life insurance or an annuity. He said that to the average lay person the concept of replacement does not necessarily include paying a premium on a new policy from an existing policy's value. He also said it is important to get information on replacements and financed sales to all consumers. The main problem with such sales is that they are not reported. Most of the protections in the existing model are for those transactions identified as replacements. He suggested that notice should be given to all applicants instead of just replacements but the information should be simplified and clarified.

Mr. DeAngelo drew the attention of the working group to Sections 2E and F that define "financed sale" and "financing." These are broken out from the definition of replacement in the prior model. Mr. Dunlap asked what the significance was of the 13-month period and Mr. DeAngelo responded that for those who are paying through an annual payment, sometimes the financing aspect does not occur until the second payment is due. Mr. DeAngelo said Subsection J, the definition of illustration, is from the Life Insurance Illustrations Model Regulation.

Mr. DeAngelo pointed out that in Section 3 the exemption for group annuities had been retained from the prior NAIC model but that the draft was intended to apply to individual annuities and contained a limited exemption for variable contracts was included.

Section 4 contains requirements for statements from the applicant and the producer as to whether the sale is being financed or involves replacement and suggested that this statement be separate from the application. He pointed out that in Subsection B the requirement is that the agent read the notice to the applicant. Subsection C requires a list of all policies, including identification of whether these will be replaced or serve as a source of financing for the new policy.

Turning to Section 5, Mr. DeAngelo noted that Subsections A and B are basically taken from the Pennsylvania law. Subsection D requires the company to maintain a record of complaints against its agents. Subsection F requires that if an agent follows all of the replacement rules, he or she is not penalized and is paid a full commission. He opined that this largely removes the disincentive to report a sale as a replacement. Joel Ario (Ore.) asked if the term "normal commission" was clear. Mr. DeAngelo responded that at one point the language in his draft had said "full commission" and he needed industry input on the clearest way to get across this concept. Subsection O requires a separate policy notice that explains the effect of using policy values because many consumers do not understand the effect of this act.

Section 6D contains a 60-day free look and Mr. DeAngelo said that he had already received a comment that for registered products this was a problem. He noted that Subsection F also includes a 60-day freeze on commissions. Subsection G requires an offer of a full refund of premiums if the product was not handled as a replacement when it should have been. This is because the consumer did not get the appropriate disclosures.

Mr. DeAngelo said some of the new material in Sections 7 and 8 comes from the pending revised New York Regulation 60.

Mr. DeAngelo asked members of the working group for comments on the draft. Tom Van Cooper (Vt.) commented that burden should be on the insurer to supervise its agents. He wondered if the draft should say more about the agent's obligation to determine the suitability of the replacement. He suggested adding language to specifically place the burden on the insurer to make sure suitability was considered. Mr. DeAngelo responded that this might create a disincentive for notifying the insurer that it was a replacement. Cindy Martin (Mass.) said the draft contained a lot of disincentives for agents and thought it was appropriate for the working group to look at adding a suitability requirement. Mr. DeAngelo asked what she considered to be disincentives in the draft. Ms. Martin responded that the notices and signature requirements were disincentives but Mr.

DeAngelo reminded her that this was required on all sales in an effort to reduce the disincentives. Mr. Van Cooper suggested the working group first focus on the best environment for review for suitability, and then worry about a chilling effect. He noted that in Vermont the regulators often found that consumers did not understand the suitability of a replacement and sometimes even the agent did not understand what was a suitable replacement. Mr. DeAngelo asked that Mr. Van Cooper draft some suggested language for the working group to consider at an interim meeting.

Roger Strauss (Iowa) asked about the effect of the 60-day free look when the other policy had been canceled. He asked if it was fair to expect the prior policy to be reinstated. Mr. DeAngelo responded that in the case of an internal replacement this was not a problem but agreed that it would pose a burden if a different company was involved. He suggested that this burden would be particularly difficult if the policyholder died during the 60-day free look period. He did point out that every company will be on either side of the transaction at some point or another, so perhaps the risk evens out.

Ms. Martin asked for the reason that Mr. DeAngelo did not have the comparison form in this new regulation. Mr. DeAngelo responded that the current NAIC model does not have a replacement form, which had been deleted in the mid-1980s, but noted that some states, including New Jersey, still have the comparison form. He opined that the comparison form does not really help consumers because it is too confusing. He pointed out that now with a new illustration regulation, a consumer will get a basic illustration for his new policy and can get an in-force illustration for the policy being considered for replacement and compare those two forms. Linda Lanam (Life of Virginia) reminded Mr. DeAngelo that the in-force illustration is only required for policies issued after the effective date of the state illustrations law. Some companies do not have the capacity to provide in-force illustrations for policies already in effect. Mr. DeAngelo indicated that this kind of technical input is needed.

Ms. Martin said it is important to give consumers an understanding of the reduction in the policy value if it is used for funding. She said one of her observations was that many policyholders do not understand that the policy value could become depleted. Mr. DeAngelo said he had drafted a notice (Attachment Four-B) that includes the sentence, "A financed sale will deplete the value of your existing policy." He reviewed briefly the notice and suggested that it might include also a list of existing contracts and an indication of whether each would be replaced or used for financing.

Ted Becker (Texas) described a situation where a relative of his had purchased a universal life policy with an enormous policy charge during the first five years. At the end of five years, the agent suggested that he replace it with a new policy that also contained a five-year expense charge. He asked if a form such as that in Attachment Four-B would help this kind of abuse. Mr. DeAngelo asked that Mr. Becker review the form and provide input on that question. He noted that this issue is similar to the suicide and incontestability clauses or surrender charges in an annuity contract. Scott Cipinko (National Alliance of Life Companies—NALC) said this was quite long and that it might be a problem to read that to the applicant. He also suggested that half of Mr. Becker's problem will be resolved when the illustration regulation is in place in Texas.

Arnold Dicke (USLife) said that some policies do dividend additions automatically on an existing policy, and he suggested that the regulators probably did not want to include that as a replacement. He suggested narrowing the definition of financing to eliminate that situation. Mr. Dicke also noted that the 60-day free look period would have reserve implications so there would be complex questions to answer in regard to the Standard Valuation Law and the Standard Nonforfeiture Law. Mr. DeAngelo thanked Mr. Dicke for his input and said these were issues on which the working group would need assistance.

Mr. Dicke said that Section 5F might be clearer if it were stated as a negative. He also wondered whether companies would be comfortable with standards telling them when they had to pay a full commission. Mr. DeAngelo responded that the agent should not be guessing but should have some clear guidance as to when a company would consider financing or replacement to be appropriate or not inappropriate.

Bill Carmello (N.Y.) asked about the term "investment annuity" in Section 2H. He asked what that was and Mr. DeAngelo responded that he was unclear, but that language had been copied from the existing model.

Mr. DeAngelo asked that written comments on the draft of the model regulation be submitted by Aug. 1 to Carolyn Johnson (NAIC/SSO) for distribution to the working group. That will allow the working group to consider an interim meeting or conference call before the Fall National Meeting.

Richard Rogers (Ill.) moved and Cindy Amann (Mo.) seconded a motion to adjourn and this motion was adopted.

Having no further business, the Replacement Issues Working Group adjourned at noon.

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ATTACHMENT FOUR-A

Life Insurance and Annuities Financed
Sales and Replacement Model Regulation
Draft 5/27/97

Table of Contents

Section 1. Purpose

The purpose of this regulation is:

A. To regulate the activities of insurers, agents and brokers with respect to the replacement of existing life insurance and annuities or the financing of new policies or contracts through the use of policy values from existing life insurance or annuities.

B. To protect the interests of life insurance and annuity purchasers by establishing minimum standards of conduct to be observed in replacement or financed sale transactions. It will:

(1) Assure that purchasers receive information with which a decision can be made in his or her own best interest;

(2) Reduce the opportunity for misrepresentation and incomplete disclosure; and

(3) Establish penalties for failure to comply with requirements of this regulation.

Section 2. Definitions

A. "Conservation" means any attempt by an existing insurer or its agent or broker to dissuade a policyowner from the replacement of existing life insurance or annuity. Conservation does not include routine administrative procedures such as late payment reminders, late payment offers or reinstatement offers.

B. "Direct-response sales" means any sale of life insurance or annuity where the insurer does not utilize an agent in the sale or delivery of the policy.

C. "Existing insurer" means the insurance company whose policy or contract is or will be changed or terminated in such a manner as described within the definition of "replacement" or "financed sale."

D. "Existing life insurance or annuity" means any life insurance policy (policy) or annuity contract (contract) in force, including life insurance under a binding or conditional receipt or a life insurance policy or annuity that is within an unconditional refund period.

E. "Financed sale" means the sale of life insurance or annuity involving the actual or intended financing of premiums due on a new policy or contract.

F. "Financing" means the use of any policy values or portions thereof, including dividend accumulations or dividend additions, to pay all or part of any premium or consideration due on either another policy or contract or the policy or contract from which the policy values are taken, whether in a single disbursement or multiple disbursements over a period of time. Financing shall include the use of policy loans for premium payments. It shall also include activation of the automatic premium loan provision to pay premiums on an existing policy, provided that a new policy or contact is issued within a 13-month period prior to or a 13-month period after the new policy or contact effective date.

G. "Replacing insurer" means the insurance company that issues or proposes to issue a new policy or contract and which replaces or finances an existing life insurance policy or annuity.

H. "Registered contract" means variable annuities, investment annuities, variable life insurance under which the death benefits and/or cash values vary in accordance with unit values of investments held in a separate account(s), or any other contracts issued by life insurance companies which are registered with the federal Securities and Exchange Commission.

I. "Replacement" means any transaction in which a new life insurance policy or a new annuity is to be purchased, and it is known or should be known to the proposing agent or broker, or to the proposing insurer if there is no agent or broker, that by reason of such transaction, an existing life insurance policy or annuity has been or is to be:

(1) Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer or otherwise terminated;

(2) Converted to reduced paid-up insurance, continued as extended term insurance, or otherwise reduced in value by the use of nonforfeiture benefits or other policy values;

(3) Amended so as to effect either a reduction in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid; or

(4) Reissued with any reduction in cash value.

J. "Illustration" means a presentation or depiction that includes non-guaranteed elements of a policy of life insurance over a period of years and that is one of the three (3) types defined below.

(1) "Basic illustration" means a ledger or proposal used in the sale of a life insurance policy that shows both guaranteed and non-guaranteed elements.

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

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

K. "Non-guaranteed elements" means the premiums, benefits, values, credits or charges under a policy of life insurance that are not guaranteed or not determined at issue.

L. "Market value adjusted annuity" means a contract containing a long-term substantial interest rate guarantee which provides for adjustment of the cash value prior to the maturity of the guarantee to reflect the market value of the guarantee. The market value of the guarantee is generally the present value of the guaranteed rate using the current interest rate being credited on similar contract with similar maturities.

Section 3. Exemptions

Unless otherwise specifically included, this regulation shall not apply to transactions involving:

A. Credit life insurance;

B. Group life insurance or group annuities;

C. An application to the existing insurer that issued the existing life insurance when a contractual change or a conversion privilege is being exercised.

D. Proposed life insurance that is to replace life insurance under a binding or conditional receipt issued by the same company; and

E. Registered contracts shall be exempt from the requirements of Section 7B; however, premium or contract contribution amounts and identification of the appropriate prospectus or offering circular shall be required in lieu thereof.

Section 4. Duties of Agents and Brokers

Each agent or broker who initiates an application shall:

A. Submit to the insurer with each application for life insurance or annuity:

(1) A statement, separate from the application, signed by the applicant(s) as to whether a replacement of an existing life insurance policy or annuity is involved in the transaction;

(2) A statement, separate from the application, signed by the applicant(s) as to whether financing of premiums due on the new policy or contract, or existing policies or contracts, will occur as a result of the transaction;

(3) A statement, separate from the application, signed by the agent or broker as to whether a replacement of an existing life insurance policy or annuity is involved in the transaction;

(4) A statement, separate from the application, signed by the agent or broker as to whether financing is involved in the transaction.

B. Present and read to the applicant(s), not later than at the time of taking the application, an "Important Notice Regarding Financed Sales and Replacements" in the form as described in Exhibit A or other substantially similar form approved by the Commissioner. The Notice shall be signed by both the applicant and the agent or broker attesting that the Notice has been read aloud by the agent or broker and left with the applicant.

C. Obtain with or as part of an application a list of all existing life insurance policies or annuities, properly identified by name of insurer, the insured, contract number and whether each policy or contract will be replaced or serve as a source of financing. If a contract number has not been issued by the existing insurer, alternative identification, including but not limited to an application or receipt number, shall be listed.

D. Leave with the applicant(s) the original or a copy of written or printed communications used for presentation during a sale or conversion.

E. Submit to the insurer to which an application for life insurance or annuity is presented a copy of each document required by this Subsection, as well as any written or printed materials used in the presentation, including any basic or supplemental illustrations or the required statement where no illustrations are used.

Section 5. Duties of All Insurers that Use Agents or Brokers

Each insurer shall:

A. Establish a system to insure compliance with the requirements of this regulation which will:

(1) Confirm that the requirements of this regulation have been met in every transaction where the applicant or agent has identified the transaction to be a replacement or financed sale; and

(2) Effectively detect transactions which are replacements or financed sales as defined in this regulation but have not been identified as such by the applicant or agent.

B. Compile records of each agent's replacements and financed sales as a percent of the agent's total annual sales, and the number of lapses of life and annuity insurance policies and contracts, by the agent as a percent of the agent's total annual sales.

C. Report annually to the Department by June 30 of each year the percentages of lapses and replacements of its agents as measured under Subsection B above and the number of unidentified replacements or financed sales detected by the company's monitoring system as required in A2 above and any disciplinary action taken against agents or brokers.

D. Maintain records on a calendar year basis of all complaints received against agents or brokers indicating by agent and broker the total number of complaints, the substance of each complaint and the disposition of the complaints. Complaint records shall be retained for five years and made available to the Department upon request.

E. Provide to each agent or broker a written statement of the Company's position with respect to the acceptability of replacements and financed sales providing guidance to its agents or brokers as to the propriety of such transactions expressed either in terms of identifying those situations or circumstances where a replacement or financed sale is acceptable or as a percentage of total sales.

F. Pay the normal commission to an agent or broker in connection with a replacement or financed sale if the transaction is consistent with the insurer's written statement issued pursuant to E above or if the insurer's compliance officer has reviewed the transaction and agreed that the replacement is acceptable. An agent shall have the opportunity to request review by the compliance officer of a replacement or financed sale that is not consistent with the company's written replacement position statement. The compliance officer shall maintain a written record of the reasons for the determination made on each review of a replacement or financed sale transaction until three years after the termination of the policy or contract.

G. Inform its agents of the requirements of this regulation and incorporate the requirements of this regulation into all agent and broker training manuals.

H. Require with or as a part of each application for life insurance or an annuity:

(1) A complete list of all the applicant's existing life insurance policies or annuity contracts, properly identified by name of insurer, the insured, contract number and an indication whether each policy or contract will be replaced or serve as a source of financing. If a contract number has not been issued by the existing insurer, alternative identification, including but not limited to an application or receipt number, shall be listed.

(2) A completed "IMPORTANT Notice Regarding Financed Sales and Replacements."

I. Retain completed and signed copies of the "IMPORTANT Notice Regarding Financed Sales and Replacements" in its home office for at least three years after the termination or expiration of the policy.

J. Require with each application a separate statement signed by the agent or broker as to whether, to the best of his or her knowledge, financing or replacement of a life insurance policy or annuity contract is involved in the transaction.

K. Obtain and retain copies of any proposal including the sales material for the proposed policy or contract, proof of the receipt by the applicant of the "IMPORTANT Notice Regarding Financed Sales and Replacements," the basic illustration and any supplemental illustrations used in the sale and the agent's and applicant's signed statements with respect to financing and replacement in its home office for at least three years after the termination or expiration of the proposed policy or contract. The insurer shall maintain a replacement and financed sales register, cross indexed by replacing agent and existing (or replacing) insurer.

L. Examine any proposal used, including the sales material and illustrations, and ascertain that they meet the requirements of this regulation and are complete and accurate for the proposed policy or contract.

M. Reject any application that does not meet the requirements of this regulation and so notify the applicant of such rejection and the reason therefore.

N. Require, prior to the use of or withdrawal of any policy values including dividend accumulations and dividend additions, a separate written request for each such use or withdrawal, signed by the policyowner or if a withdrawal is permitted to be authorized through a verbal request, a verification that the source of such request is the policy or contract owner.

O. Upon receipt of a request to borrow, surrender or withdraw any policy values, send to the applicant a notice, separate from the check if one is issued, advising the policyowner or contract owner of the effect such release of policy values will have on the non-guaranteed elements, face amount or surrender value of the policy or contract from which the policy values are released.

Section 6. Duties of Replacing Insurers that Use Agents or Brokers

Where a financing or replacement is involved in the transaction, the replacing insurer shall:

A. Verify that the required forms are received and are in compliance with this regulation.

B. Within five business days of receipt of an application indicating replacement or financing, or when the replacement is identified, notify any other existing insurer of the proposed replacement and furnish a copy of the sales material, including illustrations, for the proposed policy or contract.

C. Retain copies of the notification regarding replacement indexed by agent in its home office for at least five years.

D. Provide to the policy or contract owner notice of the right to return the policy or contract within 60 days of the delivery of the contract and receive an unconditional full refund of all premiums or considerations paid on it, including any policy fees or charges or, in the case of a variable or market value adjustment policy or contract, a payment of the cash surrender value determined without regard to any deductions from premiums or surrender charges.

E. Allow credit for the period of time that has elapsed under the existing policy's or contract's incontestability and suicide period up to the face amount of the existing policy or contract;

F. Withhold the payment of commissions until the end of the 60 day period after the date of delivery of the policy or contract.

G. Where it is determined by the replacing insurer that the requirements of this regulation have not been met, provide to the policy or contract owner an in-force illustration, the "IMPORTANT Notice Regarding Financed Sales and Replacements" and an offer of a full refund of premiums without term charges plus interest.

Section 7. Duties of the Existing Insurer

Where a financing or replacement is involved in the transaction, the existing insurer shall:

A. Upon notice that its existing policy or contract may be a source of financing or replaced, retain copies of such notification, indexed by replacing insurer, notifying it of such replacement for at least five years or until the conclusion of the next regular examination conducted by the Insurance Department of its state of domicile, whichever is later;

B. Within 10 days of receipt of a notice that an existing policy or contract is a source of financing or replacement, send an in-force illustration to the policy or contract owner.

C. Within 60 days of the date of delivery of the proposed policy or contract, reinstate and/or restore, without underwriting or imposition of a new contestable or suicide period, such policy or contract upon receipt of:

(1) Written proof that the replacement policy or contract has been cancelled; and

(2) Any funds previously released under such existing policy or contract by the replaced company. Any premium or consideration due on the original policy or contract shall be calculated from the paid-to date. The existing company shall reinstate or restore the original policy or contract to its former status to the extent possible and in accordance with its published reinstatement rules to the extent such rules are not inconsistent with this regulation.

Section 8. Duties of Insurers with Respect to Direct Response Sales

A. In the solicitation of a direct response sale, the insurer shall:

(1) Request from the applicant with or as part of the application:

(a) A list of all existing life insurance policies or annuity contacts and their the policy numbers; and

(b) A statement as to whether any existing policy will be a source of financing or replaced.

(2) Forward with the policy the "IMPORTANT Notice Regarding Financed Sales and Replacements."

B. If in the solicitation of a direct response sale or as indicated on the statement received from the applicant, a replacement is involved, the replacing insurer shall:

(1) Notify the insurer of the existing policy which is to be a source of financing or replaced.

(2) Provide the applicant(s) with notice of the right to return the policy or contract within 60 days of the delivery of the policy or contract and receive an unconditional refund of all premiums or considerations paid on it, including any policy fees or charges or, in the case of a variable or market value adjustment policy or contract, a payment of the cash surrender value determined without regard to any deductions from premiums or surrender charges.

C. Retain completed and signed copies of the "IMPORTANT Notice Regarding Financed Sales and Replacements" in its home office for at least three years after the termination or expiration of the policy. The insurer shall maintain a replacement and financed sales register, cross indexed by replacing agent and existing (or replacing) insurer.

Section 9. Violations and Penalties

A. Any failure to comply with the letter and spirit of this regulation shall be considered a violation of (cite "twisting" Fair Trade Statute). Such failure shall include but not be limited to:

(1) Any deceptive or misleading information set forth in sales material;

(2) Failing to ask the applicant(s) in completing the application the pertinent questions regarding the possibility of financing or replacement:

(3) The incorrect recording of an answer;

(4) Advising an applicant to respond negatively to any question regarding replacement in order to prevent notice to the existing insurer; or

(5) Advising a policyowner to write directly to the company in such a way as to attempt to obscure the identity of the replacing agent or company.

B. Policyowners and contract owners have the right to replace existing life insurance policies or annuity contracts after indicating in or as a part of applications for new coverage that such is not their intention; however, patterns of such action by policyowners or contract owners of the same agent shall be deemed prima facie evidence of the agent's knowledge that replacement was intended in connection with such transactions, and such patterns of action shall be deemed prima facie evidence of the agent's intent to violate this regulation.

C. Violations of this regulation shall subject the violators to penalties including the revocation or suspension of an agent's, broker's or company's license, monetary fines and/or the forfeiture of any commissions or compensation paid to an agent or broker as a result of the transaction in connection with the violations occurred. In addition, the insurer may be required to make restitution, restore policy values and pay interest (at a rate of 10 percent simple per annum) on the amount refunded in cash.

Section 10. Severability

If any section or portion of a section of this regulation, or the applicability thereof to any person or circumstances, is held invalid by a court, the remainder of this regulation, or the applicability of its provisions to other persons, shall not be affected thereby.

Section 11. Effective Date

This regulation shall be effective [insert date].

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ATTACHMENT FOUR-B

IMPORTANT Notice Regarding Financed Sales and Replacements

A financed sale occurs when a new policy is purchased and in connection with the sale funds from an existing policy and used to pay the premiums due to either the new policy or the existing policy.

A financed sale will deplete the value in your existing policy or contract and may reduce the amount paid upon the death of the insured. You may have been advised that you will only be required to pay a limited number of premiums on the new policy from personal funds, after which policy values will pay all premiums due. If dividends will be used, you should be aware that dividends are not guaranteed and may be insufficient to pay all premiums due. If loans are taken to pay premiums, the amount to be paid upon the death of the insured will be reduced by the amount of the loans plus interest.

Do you intend to use any funds from your existing policy(s) or contract(s) to pay the premiums due on the new policy or contract or the existing policy or contract?

YES ________ NO ________ N/A ________

Do you intend to pay all premiums due on the new policy or contract and the existing policy or contract from funds other than those in your insurance policy or annuity contract?

YES ________ NO ________ N/A ________

A policy <u>replacement</u> occurs when a new policy is purchased and in connection with the sale, an existing policy is surrendered, is reduced in value or you discontinue making premium payments on it.

A replacement is generally not in your best interest. There may be surrender cost deducted from your policy or contract. You may be able to make changes to your existing policy or just purchase an additional policy to meet your insurance needs. You should consider contacting your existing agent or company to find out your options.

Do you intend to continue your existing policy(s) or contract(s) (if any) and continue to pay the premiums due on the policy?

YES ________ NO ________ N/A ________

If this transaction is a financed sale or replacement, you may consider within 60 days of delivery of the new policy without penalty.

I certify that the agent has read this Notice to me aloud.

____

Policyowner's Signature

I certify that I have read this Notice aloud to the applicant and that the responses given herein are accurate.

____

Agent's Signature

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ATTACHMENT FOUR-C

Replacement Issues Working Group
Conference Call
May 7, 1997

The Replacement Issues Working Group met by conference call at 2 p.m. on May 7, 1997. The meeting was called to order by Paul DeAngelo (N.J.), Chair. The following working group members or their representatives participated: Richard Rogers (Ill.); Rosanne Mead (Iowa); Lester Dunlap (La.); Cindy Amann (Mo.); Rick Morse (N.Y.); Russ Line represented Kip May (Ohio); Joel Ario (Ore.); Ted Becker (Texas); and Tom Van Cooper (Vt.).

Paul DeAngelo (N.J.) noted that three working group members had agreed to review the materials forwarded by the American Council of Life Insurance (ACLI) to address the issues in the survey being discussed by the working group. The three members who agreed to review the materials are Lester Dunlap (La.), Rosanne Mead (Iowa) and Cindy Amann (Mo.). Mr. Dunlap reported that the three had met by conference call on May 2 to discuss the information they had reviewed. He said that the ACLI had provided a tremendous amount of information but, in the opinion of all three, the information did not provide the specifics that the survey was intended to solicit. Some information from the ACLI was outdated and the responses were overly generalized. Mr. Dunlap said that the three members of the review team had also agreed to identify particular parts of the survey they thought would be helpful in drafting a replacement regulation. He pointed out the information on state variations in agent termination laws and the meaning of "termination for cause." From the standpoint of review, he said this is an issue of importance that could cut down on the problems of getting rid of bad actors. However, Mr. Dunlap questioned whether this went beyond the charge to the working group.

Ms. Amann said that she had identified a number of areas that deserved further review by the working group. She agreed the issue highlighted by Mr. Dunlap was important, and also suggested the working group look at the universal definition of replacement, the development of suitability and compliance programs, commissions, agents training and ethics, and uniformity of laws regarding the review of sales materials and illustrations. Ms. Mead looked for trends that she suggested the working group might want to address in its regulation. She noted the materials from the ACLI illustrated the difficulties companies had with retention of agents. She pointed out a 1990 report that showed only 25% of the agents are still active after four years and a 1995 agent retention study that showed only 17% of the agents still active after four years. She also expressed concern about a study showing that 80% of the companies do not contact orphan policyholders.

Mr. DeAngelo pointed out that some of the data showed as high as 40% of sales were replacements. He asked the working group whether it desired to proceed with drafting now without doing a survey. Joel Ario (Ore.) suggested that the working group go forward with drafting and, as the process proceeds, the working group may identify specific proposals that are more controversial. The working group can ask for information narrowly drawn to answer those questions. He said this would result in a more focused survey. Mr. Ario moved that the working group go forward with drafting model language and suspend a survey, but consider it further as the need might arise. Ms. Amann seconded the motion and it was adopted.

Ron Panneton (National Association of Life Underwriters) said he sent comments to the working group, which will be available to the members shortly. He suggested that the working group go forward with drafting and once the suggestions are down on paper, any that do not have support can be deleted, and those with value can be expanded. Mr. DeAngelo agreed to prepare an initial draft, and said he hoped to have it ready for working group review two weeks prior to the Summer National Meeting in Chicago. He said discussion of this draft would be the main topic of business at the working group's meeting in Chicago.

Mr. DeAngelo said that the working group might want to change the title of the regulation to reflect a broader focus if the draft follows an approach similar to that in New York where the draft regulation considers any use of a policy value to fund a new policy a replacement. He suggested a title such as "Premium Funding and Replacement" or "Policy Financing and Replacement." Rick Morse (N.Y.) said that once the working group comes to consensus on exactly what replacement is, the title will be easy. Mr. DeAngelo noted that the Life Disclosure Working Group identified some areas in the replacement regulation that needed review, and suggested the working group consider the effect on replacements, in-force illustrations, and orphan policies. He said this project provided an opportunity to dovetail its work with the work of the Life Disclosure Working Group.

Marybeth Stevens (ACLI) asked if the interested parties would see the draft before the Summer National Meeting. Mr. DeAngelo responded that there would not be time, but that the working group would solicit comments after the Summer National Meeting.

Having no further business, the Replacement Issues Working Group adjourned at 3 p.m.

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ATTACHMENT FIVE

Synthetic GIC Working Group
Chicago, Illinois
June 8, 1997

The Synthetic GIC Working Group of the Life Insurance (A) Committee met in the Joliet Room of the Chicago Hilton & Towers in Chicago, Ill., at 12:30 p.m. on June 8, 1997. Larry Gorski (Ill.) chaired the meeting. The following working group members or their representatives were present: Sheldon Summers representing Woody Girion (Calif.); Jack Gies (Conn.); Larry Hinton representing Reginald Berry (D.C.); Lynda Klebold (N.J.); and Martin Carus and Bill Carmello representing Rick Morse (N.Y.).

Brian Haendiges (Ætna), who coordinated the technical resource advisors, highlighted the features of the proposed revision of the Synthetic Guaranteed Investment Contracts Model Regulation that had been prepared by the advisors (Attachment Five-A). Mr. Haendiges said the group clarified the scope of the regulation by deciding not to cover certain types of contracts such as payout annuities, since such products do not yet exist. He said an important feature was a file and use provision in Section 5 that allowed companies to use policy forms quickly to react to the changing market. He said the file and use provision was written very conservatively so that companies would not use it lightly. He also directed the attention of the working group to a section on reserves (Section 10). Jack Gies (Conn.) moved and Larry Hinton (D.C.) seconded a motion to receive the report of the technical resource advisors. The motion carried.

Mr. Gorski said it was his intention to go through Sections 1 through 5 during the meeting and entertain a motion to send the reserving section to the Life and Health Actuarial (Technical) Task Force for comment, and to have a conference call in late July or early August to finish going through the draft. Mr. Gorski asked if there were any comments on Section 2 and Lynda Klebold (N.J.) asked the purpose of the addition of the phrase "in whole or in part." Mr. Haendiges said that there were occasions when a portion of a contract would be supported by a synthetic GIC and half by a separate account investment. He did not want that type of arrangement to be excluded from the model act.

Mr. Gorski questioned the phrase in Section 3 that began "functions as an accumulation fund." He said he did not think this was an appropriate description of a synthetic GIC because it really functions as a guarantor of the accumulation fund. Mr. Haendiges agreed it would be appropriate to make a change in that phrase.

Mr. Gorski next asked the group to review Section 4D, the definition of the crediting rate formula. He suggested it would be appropriate to delete the word "fixed" because some contracts, over time, may credit a floating rate. Mr. Haendiges said the advisors did not want to describe a variable return based on an index and said some products have a fixed rate but it is not declared in advance. Mr. Gorski responded that products may be developed that construct a rate of return based on something other than a fixed rate, such as the performance of the contract being wrapped. Bill Carmello (N.Y.) said the industry proposal limits the scope so that the working group can finish this project and then can go back and add as necessary. Bob Brown (CIGNA) added that a fixed rate of return might be changed every three months; it is not necessarily fixed for the whole contract. Mr. Gies said that was a helpful comment because he is concerned that the term "fixed rate of return" was not defined. Mr. Haendiges asked if it would be helpful to add a definition of that term. Martin Carus (N.Y.) asked if the draft needs to include the word "fixed." He suggested that if the only place it is used is in Section 5H(7), the definition might not be necessary.

Mr. Gorski next turned to Subsection I, a definition of hedging instrument. He asked why there was not a definition of qualified broker or dealer or qualified bank. Mr. Haendiges said this was dealt with in the reserve section. Blaine Shepherd (Minn.) questioned the inclusion of the term "synthetic investment" in the definition of hedging instrument. He suggested that the second half of the definition actually stepped away from a hedging transaction. Mr. Gorski suggested that the synthetic investment was acting as a hedge for the entire portfolio. Mr. Carmello said this type of product fits better in a separate account with a market value adjustment. Mr. Carus asked how the criteria listed in Section 9 would become part of the investment guidelines. Mr. Haendiges responded that this was included in Subsections H(6), (7) (10).

In Subsection J, Mr. Gorski said an important element of the investment guidelines is a discussion of market fluctuation limits.

Ms. Klebold moved to Subsection K, the definition of "investment manager." She said the revised definition included no constraint on an investment manager, whereas the prior draft had contained quite a few criteria for an investment manager. Mr. Haendiges responded that the technical resource advisors did not think it was appropriate to regulate who could be an investment advisor. Ms. Klebold asked who or what authorized the investment manager. Mr. Haendiges responded that it could be an in-house counsel or other person authorized by the company. Mr. Gorski asked if the drafters were increasing the risk faced by the insurance company by eliminating the qualifications. He suggested it put an increased burden on the plan to be sure that it authorized appropriately. Ms. Klebold asked if it was the drafters' intent that the regulators should rely entirely on the plan. Mr. Haendiges responded that this was investment management, not insurance. Mr. Carmello asked if the investment manager was authorized by the insurer. He suggested that saying authorized without a notation of who authorized did not make sense. Mr. Haendiges suggested that it would be helpful to say proof should be provided to the insurer that this individual is an authorized investment manager. Mr. Gorski suggested that it would be better language to say that the person had fiduciary responsibility to manage the assets.

Ms. Klebold pointed out that in Subsection M, the definition of permitted custodial institution, the reference to custodial relationship had been removed. Mr. Haendiges said the technical resource advisors drafted the language so that insurance departments were not trying to regulate anything other than insurance. Mr. Gies asked how an insurer would deal with the risks that the investment manager was not an appropriate manager. He asked if the insurer would not write the coverage, or would charge a higher premium. Mr. Haendiges responded that there are a variety of laws about custodians and the advisors tried to make this law general enough not to regulate the custodians within this synthetic GIC law. Mr. Gies asked how an insurer would protect itself and Mr. Haendiges responded that the company would do due diligence to make sure the custodian was authorized. Mr. Carus suggested that it would be helpful to ask legal counsel what the responsibility of a custodian was; whether he was a fiduciary or a bailee or an agent. Mr. Gorski asked staff to research this and be ready to report at an interim conference call of the working group.

Mr. Gorski asked Mr. Haendiges to review the reasons for the inclusion of the provisions of Section 5. He said the file and use approach included would allow the companies to remain more competitive. He said it was intended to be used conservatively because it included a provision for the regulator to ask for changes anytime during the 60 days after filing. Ms. Klebold suggested this would not match the general filing statutes in many states so they would be reluctant to pass this model. She said she could not adopt these regulations in New Jersey because the New Jersey law had different requirements. Mr. Carus suggested the model could be written to follow its provisions or the applicable state law. Mr. Gorski questioned the provision of Subsection D(2) that allowed the commissioner to disapprove a filing for a contract issued in another state. He asked why the regulation adopted in one state would deal with contracts in another state. Mr. Carus responded that New York regulates contracts issued in another state because it is concerned about how the contracts a company is issuing will affect New York policyholders. Mr. Haendiges pointed out that the filing requirement for the domestic state included filing the plan of operation, whereas only the contract needed to be filed in the nondomiciliary state. Mr. Gorski questioned the provision that required only the filing of the plan of operation in the domestic state with a bracketed option to file the contract. He said filing the plan of operation without the contract would not be meaningful and suggested removing those brackets.

Mr. Carus said that Section 5A referred only to the size of the company and he thought it was more important to have a qualitative than a quantitative requirement. He suggested this was not the right approach and felt there needed to be a relationship to risk-based capital.

Mr. Haendiges went on to say that the contract and plan of operation would be deemed approved if the company did not hear back in 60 days. He said the company would only use this approach if it was certain that the contract would be approved because otherwise it would have to go back and change existing contracts. Mr. Gorski said there would be some risks to the insurer that, if it changed the contract, the company would lose money, so he concluded that the risk is much smaller than it appears at first blush because the regulator would be reluctant to require a change in the contract.

Mr. Carmello moved and Mr. Gies seconded a motion to refer the section on reserves to the Life and Health Actuarial (Technical) Task Force, and the motion passed. Mr. Gorski said a conference call will be held to continue the discussion, and expressed hope that the technical resource advisors would be able to suggest responses to the working group's concerns.

Having no further business, the Synthetic GIC Working Group adjourned at 2 p.m.

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ATTACHMENT FIVE-A

Synthetic Guaranteed Investment Contracts Model Regulation
Draft suggested by technical resource advisors

Table of Contents

Section 1. Authority

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

Section 2. Purpose

The purpose of this regulation is to prescribe:

(a~~1~~) the terms and conditions under which life insurance companies may issue group annuity contracts and other agreements that in whole or in part establish the insurer's ~~insurance company's~~ obligation by reference to a segregated portfolio of assets which is neither owned by nor in the possession of the insurer ~~insurance company~~;

(b~~2~~) the essential operational features of the segregated portfolio of assets; and

(c~~3~~) the reserve requirements for such group annuity contracts and agreements.

Section 3. Scope and Application

This regulation applies to that portion of a group annuity contract~~s~~ or ~~and~~ other agreement~~s~~ described in Section 4(c) that functions as an accumulation fund having benefit guarantees relating to a principal amount and levels of interest at a rate or rates specified in advance. It applies to all such contracts issued after [insert prospective effective date for applicable state].~~:~~

~~(1) are used to fund defined contribution plans;~~

~~(2) are benefit responsive; and~~

~~(3) guarantee principal and stated interest rates or rates that are delivered in advance.~~

Section 4. Definitions

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

(a) "Actuarial Opinion and Memorandum" means the opinion and memorandum of a Qualified Actuary required to be submitted to the Commissioner pursuant to Section 10(b) of this Regulation.

(b) "Asset Maintenance Requirement" means the requirement to maintain assets to fund contract benefits in accordance with Section 10 of this Regulation.

(c~~a~~) "Synthetic Guaranteed Investment Contract" or "Contract" means a group annuity contract or other agreement which in whole or in part establishes the insurer's ~~insurance company's~~ obligations by reference to a portfolio of assets which is neither owned by nor in the possession of the insurer ~~insurance company~~.

(d~~b~~) "Contract Value Record" means an accounting record, ~~established~~ provided by the Contract in relation to a ~~the~~ Segregated ~~p~~Portfolio of assets, which is credited with a fixed rate of return over regular periods, and which is used to measure the extent of the insurer's obligation to the contractholder. The fixed rate of return credited to the Contract Value Record is determined by means of a Crediting Rate Formula. ~~may be experience rated relative to the Market Value Record and is used to measure the extent of the insurance company's obligations to the contractholder.~~

(e~~c~~) "Crediting Rate Formula" means a mathematical formula used to calculate the fixed rate of return credited to the Contract Value Record during any Rate Period and based in part upon the differences between the Contract Value Record and the Market Value Record amortized over an appropriate period.~~and on a period of time related to the average duration of the assets held in the Segregated Portfolio.~~

(f) "Duration" means, with respect to the Segregated Portfolio assets or guaranteed contract liabilities, a measure of price sensitivity to changes in interest rates, such as the Macaulay duration or option-adjusted duration.

(g) "Fair Market Value" means a reasonable estimate of the amount that a knowledgeable buyer of an asset would be willing to pay, and a knowledgeable seller of such asset would be willing to accept, for such asset without duress in an arm's length transaction. In the case of a publicly traded security, the Fair Market Value consists of the price at which such security is traded or, if no such price is available, a price that appropriately reflects the latest bid and asked prices for such security. In the case of a debt instrument that is not publicly traded, the Fair Market Value consists of the discounted present value of the asset calculated at a reasonable discount rate. For all other non-publicly traded assets, Fair Market Value will be determined in accordance with valuation practices standardly used within the financial industry.

(h) "Guaranteed Minimum Benefits" means contract benefits on any specified date which may be either (i) a fixed minimum interest rate or principal guarantee related to the Segregated Portfolio; or, (ii) an assurance as to the future investment return or performance of the Segregated Portfolio; or (iii) the Fair Market Value of the Segregated Portfolio (to the extent that the Fair Market Value of such assets determines the contractholder's benefits).

(i) "Hedging Instrument" means (i) any interest rate futures agreement, foreign currency futures agreement, or option to purchase any such agreement, or any security or foreign currency, used in a bona fide hedging transaction; or (ii) any financial agreement or arrangement entered into with a qualified broker or dealer or a qualified bank in connection with investment in one or more securities in order to reduce the risk of changes in market valuation or to create a synthetic investment which when added to the portfolio reduces the risk of changes in market valuation. An instrument shall not be considered to be a hedging instrument if it is purchased in conjunction with another instrument where the effect of the combined transaction is an increase in the portfolio's exposure to market volatility.

(j~~d~~) "Investment Guidelines" means the set of written guidelines, established in advance by the person(s) with investment authority over the Segregated Portfolio, ~~contractholder~~ to be followed by the Investment Manager.~~setting forth the quality and duration corridors within which the Investment Manager may invest and reinvest the assets within the Segregated Portfolio.~~ Such guidelines shall include a description of the Segregated Portfolio's investment objectives, and shall describe the asset class, quality, diversification, and other requirements of the Segregated Portfolio.

(k~~e~~) "Investment Manager" means the person or persons (including the contractholder) authorized ~~the insurance company, if it is registered as an investment adviser under the Investment Advisers Act of 1940, or any third party entity registered as an investment adviser under the Investment Adviser Act of 1940, appointed by the contractholder~~ to manage the assets in the Segregated Portfolio in accordance with the Investment Guidelines.

(l~~f~~) "Market Value Record" means an accounting record provided ~~established~~ by the Contract to reflect the Fair Market Value of ~~in relation to the market value of the portfolio of assets and expressed as the sum of (i) the aggregate of the prices at which the publicly traded assets held in the Segregated Portfolio are traded as of any valuation date, or in the case of any asset for which no such price is available, a price that appropriately reflects its fair market value, plus (ii) any related cash or currency held in~~ the Segregated Portfolio.

(m~~g~~) "Permitted Custodial Institution" means a bank, trust company or other duly licensed ~~fiduciary services~~ provider of custodial services.

(n) "Plan of Operation" means the Plan of Operation filed with the Commissioner of the domiciliary state pursuant to Section 5 of this Regulation.

(o) "Qualified Actuary" means any individual who meets the qualification standards set forth in [insert statutory reference].

(p~~h~~) "Rate Period" means the period of time during which the fixed rate of return credited to the Contract Value Record is applicable between Crediting ~~Experience~~ Rate~~ing~~ Formula adjustments.

(q~~i~~) "Segregated Portfolio" means (i) a portfolio or sub-portfolio of assets to which the ~~c~~Contract pertains that is held in a custody or trust account by the Permitted Custodial Institution and identified on the records of the Permitted Custodial Institution as special custody assets held for the exclusive benefit of the retirement plans or other entities on whose behalf the contractholder holds the Contract; and (ii) any related cash or currency received by the Permitted Custodial Institution for the account of the contractholder and held in a deposit account for the exclusive benefit of the retirement plans or other entities on whose behalf the contractholder holds the Contract.

(r) "Spot Rate" corresponding to a given time of benefit payment means the yield on a zero-coupon non-callable United States Government Obligation maturing at that time, or the zero-coupon yield implied by the price of a representative sampling of coupon-bearing non-callable United States Government Obligations in accordance with a formula set forth in the Plan of Operation filed pursuant to Section 5 of this Regulation; provided that, to the extent that guaranteed contract liabilities are denominated in the currency of a foreign country rated in one of the two highest rating categories by an independent nationally recognized United States rating agency acceptable to the Commissioner and are supported by investments denominated in the currency of such foreign country, the spot rate may be determined by reference to substantially similar obligations of the government of such foreign country.

(s) "Unilateral Contract Termination Event" means any event allowing the insurer to unilaterally and immediately terminate the Contract, without future liability or obligation to the contractholder, as described in Section 9 of this Regulation.

(t) "United States Government Obligation" means a direct obligation issued, assumed, guaranteed, or insured by the United States of America or by any agency or instrumentality thereof.

Section 5 Financial Qualification of Insurer; Synthetic Guaranteed Investment Contract Filing and Approval Requirements ~~Segregated Portfolio Operational Features~~

No Contract may be delivered or issued for delivery in the State of [insert name of adopting state] unless the issuing insurer is licensed as a life insurance company in this State and has (i) satisfied the financial qualification requirements of this Section and (ii) either satisfied the filing and approval requirements of this Section or elected to proceed under the file and use provision set forth in subsection (d). No domestic insurer may deliver or issue for delivery a Contract outside of this State unless such insurer has (i) satisfied the financial requirements of this Section and (ii) satisfied the requirements of subsection (b) or elected to proceed under the file and use provision set forth in subsection (d).

(a) An insurer will be financially qualified under this Section if its most recent statutory financial statements reflect at least one billion dollars ($1,000,000,000) in admitted assets or one hundred million dollars ($100,000,000) in capital and surplus. ~~To become authorized to issue Contracts subject to this regulation, the insurance company shall file for approval with the Commissioner a plan of operation for each Contract, accompanied by the contract or description thereof, and an undertaking to file actuarial opinions and memoranda in conformity with the requirements of this regulation.~~

(b) A domestic insurer will have satisfied the filing and approval requirements of this Section if the insurer has filed a Plan of Operation pertaining to the Contract, [together with a copy of the form of such Contract][1], with the Commissioner and such filing has been affirmatively approved or has not been disapproved within the sixty (60) day period following such filing, in which event such Plan of Operation and such form of Contract shall be deemed approved.

(c) A non-domestic insurer will have satisfied the filing and approval requirements of this Section if:

(1) the insurer shall have filed a form of such Contract with the Commissioner and such form has been affirmatively approved or has not been disapproved within the sixty (60) day period following such filing, in which event such form of Contract shall be deemed approved;

(2) in the event that the insurer's domiciliary insurance department has promulgated rules or regulations governing Synthetic Guaranteed Investment Contracts, the insurer shall have filed with and received all applicable approvals of its domiciliary state insurance department (or be authorized to proceed under an applicable file and use provision) pertaining to such Contract; and

(3) in the event that the insurer's domiciliary state insurance department has not promulgated rules or regulations governing Synthetic Guaranteed Investment Contracts, the insurer shall have filed with the Commissioner on an informational basis a Plan of Operation prepared in conformity with the National Association of Insurance Commissioners' Model Synthetic Guaranteed Investment Contract Regulation.

(d) Notwithstanding the fact that the approvals otherwise required by subsection (b) or subsection (c)(1) have not been received, Contracts may be delivered or issued for delivery in this State (and outside of this State, in the case of domestic insurers) by insurers electing to proceed under the following file and use provisions:

(1) a domestic insurer may proceed if (i) the Contract and Plan of Operation filing required by subsection (b) has been filed with the Commissioner accompanied by the insurer's written certification that such filed items are believed to comply with all applicable requirements of this Regulation, and (ii) the Commissioner has not disapproved such filing or objected to any of the provisions of such filing;

(2) a non-domestic insurer may proceed if (i) the Contract filing required by subsection (c)(1) has been filed with the Commissioner accompanied by the insurer's written certification that such Contract is believed to comply with all applicable requirements of this Regulation, (ii) the Commissioner has not disapproved such filing or objected to any of the provisions of such filing, and (iii) the requirements of subsections (c)(2) or (c)(3) have been met.

(e) A Contract delivered or issued for delivery in this State by an insurer proceeding under the file and use provisions of subsection (d) shall be subject to such changes as the Commissioner may subsequently require as a condition of approval. Prior to the sale of such a Contract, the insurer shall make prominent written disclosure to the contractholder that the Contract is subject to such change.

[1] Drafting Note: Some states may wish to eliminate this requirement.

(f) In the event that the Commissioner disapproves the filing of any insurer that is required under this Section, such insurer shall have the right to a hearing within thirty (30) days of such disapproval.

(g) No Contract subject to this Regulation may be written unless the assets to which it pertains and for which a Contract Value Record is established are maintained in a Segregated Portfolio of a Permitted Custodial Institution.

(h~~b~~) The ~~p~~Plan of ~~o~~Operation shall include but not be limited to:

(1)~~—~~A statement that the Plan of Operation will be administered in accordance with the requirements prescribed by the Commissioner pursuant to Section [insert citation for authority];~~.~~

(2) A description of how the Contract Value Record will be determined, and, where applicable, adjusted by a Crediting ~~experience r~~Rate Formula;

(3) A statement describing ~~of how~~ the methods and procedures used to value statutory ~~the guaranteed contract~~ liabilities for purposes of Section 10~~are to be valued~~;

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

~~(5) A description of how the Contract Value Record will be determined, and, where applicable, adjusted by experience rating;~~

(4~~6~~) A description of how the Fair Market Value will be determined, ~~established and maintained,~~ including a description of the rules for valuing securities and other assets that are not publicly traded;

(5~~7~~) A description of how information concerning the assets in the ~~s~~Segregated ~~p~~Portfolio and related transactions will be reported to and verified by the insurer for purposes of verifying that the Segregated Portfolio is being managed in accordance with the Investment Guidelines. Such reporting shall be prepared no less frequently than quarterly, and shall include a complete statement of Segregated Portfolio holdings and their Fair Market Value;

(6~~8~~) A description of how the investments in the ~~s~~Segregated ~~p~~Portfolio reflect provision for benefits insured ~~wrapped~~ by the contract;

~~(9) A description of any requirements for plans purchasing Synthetic GIC's to establish a buffer fund or an allocation procedure which limits the allocable share of benefit payments made from the segregated portfolio;~~

(7~~10~~) A description of the Crediting ~~Experience~~ Rate~~ing~~ Formula if any and how it will operate to take into account differences between the Market Value and Contract Value ~~r~~Records, including a demonstration of how the interest rate credited to the Contract Value Record will be affected by changes in the investment returns of the Segregated Portfolio and reasonably anticipated deposits to and withdrawals from the Segregated Portfolio by the contractholder. The demonstration shall include at least three hypothetical return scenarios (level, increasing, and decreasing) and for each of these scenarios, at least three withdrawal scenarios (zero, moderate, and high) shall be modeled. The Department may require additional scenarios if deemed necessary to fully understand the risks under the Contract. The demonstration period shall be the greater of five years or the minimum period the insurer must underwrite the risk;

(8~~11~~) A description of all termination events, discontinuation triggers and options, notice requirements, corrective action procedures and all other ~~c~~Contract safeguards. Include also a list of events that give the insurer the right to terminate the ~~c~~Contract immediately~~, distinguishing between events unique to Synthetic GIC's and events that apply generally to group annuity contracts providing guaranteed benefits~~;

(9~~12~~) A description of the procedures to be followed when a Unilateral Contract ~~t~~Termination ~~e~~Event occurs;~~ but the Company fails to terminate the contract. The Commissioner will require reports from insurers that fail to terminate a Synthetic GIC when a termination event occurs, describing the corrective action to be taken. The Commissioner will require in the March 1st annual report, an inventory of all material termination events which occurred during the preceding year but where the company decided not to terminate the contract, plus illustrative examples of such events which were not deemed to be material. The Company should also provide an analysis of each such material event, including any increased risk to the company and whether corrective action was fully taken by the March 1 date of the report. The Commissioner will also require a similar report as of July 1 of each year, such report to be made by September 1 of each year would include one of the following statements:~~

~~(i) a statement that no such events have occurred; or~~

~~(ii) a statement that no such material events have occurred, with an illustrative example of the most significant event; or;~~

~~(iii) an enumeration of all material events together with information as in 16(b) below.~~

(10~~13~~) A description of the allowable investment parameters applicable to any Contract issued subject to the submitted Plan of Operation (such parameters might include but are not limited to the objectives, asset classes, quality, duration, and diversification requirements applied to the assets held within the Segregated Portfolio), and a ~~A~~ description of the procedures which will be followed by the insurer ~~insurance company~~ in evaluating the appropriateness of any specific ~~the~~ Investment Guidelines submitted by the contractholder.~~, including a description of the manner by which the insurance company shall monitor the segregated portfolio and verify that it is being managed in accordance with the investment guidelines;~~ If the insurer chooses to operate the Contract in accordance with Investment Guidelines not meeting the criteria established in Section 5(h)(10), approval of each non-conforming set of Investment Guidelines must be obtained from the insurer's domiciliary insurance department;

(11~~14~~) ~~The name and qualifications of any Investment Manager who will be used in managing the Segregated portfolio, if other than the insurance company, including a~~ A description of the criteria used by the insurer ~~insurance company~~ in approving the Investment Manager, if the Investment Manager is an entity other than the insurer, or its wholly-owned subsidiary;

(12~~15~~) A statement certified by a Qualified Actuary ~~demonstration~~ as to the adequacy of the consideration charged by the insurer ~~insurance company~~ for the risks it has assumed with respect to Synthetic Guaranteed Investment Contracts~~GIC's~~;~~.~~

(13~~16~~) A statement that the Actuarial Opinion and Memorandum required by Section 10~~12~~ ~~due each March 1~~ shall include:~~;~~

(a) if a payment has been made by the insurer under a Contract in the prior calendar year, the amount of aggregate risk charges (net of administrative expenses) for Synthetic Guaranteed Investment Contracts~~GIC's, net of any losses,~~ and the aggregate amount of any losses incurred ~~in the preceding calendar year~~; and

(b) an inventory of all material Unilateral Contract Termination Events that have not been cured within the time period specified and that have occurred during the preceding year but where the Company decided not to terminate the Contract~~a statement that the applicable investment guidelines were adhered to during the preceding calendar year~~.

~~(17) A description of the procedures to be followed in accounting for any risk charges;~~

~~(18) An illustration of how the contract will permit under at least three diverse hypothetical interest rate and withdrawal scenarios;~~

~~(19) Acknowledgment that the "prudent man rule" will be adhered to in all investment procedures;~~

~~(20) Acknowledgment that the insurance company will;~~

~~(a) maintain adequate risk reserves;~~

~~(b) collect adequate consideration for the cost of fixed annuities purchased under contract option by transfer from the segregated fund;~~

~~(c) maintain reserves required by [insert statutory citation] for fixed annuities.~~

~~(21) A statement as to whether the Contract provides that assets in the segregated account shall not be chargeable with liabilities arising from any other source;~~

(14~~22~~) Review of the Plan of Operation by the Commissioner may necessitate requests for information to supplement that furnished in the replies to the above questions. In any event, replies made in compliance with these guidelines should contain sufficient detail that any follow-up correspondence can be held to a minimum.

Section 6. Required Contract Provisions

(a) The Contract shall clearly identify all circumstances under which insurer ~~insurance company~~ payments or advances to the contractholder are to be made.

(b) The types of withdrawals made on a market value basis shall be clearly identified in the form of the Contract.

(c) For contracts that do not have a fixed maturity schedule, ~~Except under the circumstances set forth in Section 10 of this Regulation, at termination~~ the Contract shall provide a settlement option permitting the contractholder to receive the Contract Value Record over time, provided that no Unilateral Contract Termination Event, as set forth in Section 9, has occurred. ~~upon payment to the insurance company of the assets thereunder held in the Segregated Portfolio.~~

(d) The Contract shall state the maximum ~~r~~Rate Period between ~~Experience Rating~~ Crediting Rate Formula Recalculations that will be permitted, if any.

(e) The Contract shall grant the insurer ~~insurance company~~ the right to perform audits and inspections of assets held in the Segregated Portfolio from time to time upon reasonable notice to the Permitted Custodial Institution.

(f) The Contract shall provide the insurer ~~insurance company~~ with prior notice of and the right to approve any change of Investment Managers.

(g) The Contract must include a waiver provision stating, or substantially similar to, the following:

> No waiver of remedies by the insurer which is a party to this agreement, following the breach of any contractual provision hereof or of the investment guidelines applicable hereto, or failure to enforce such provisions or guidelines, which breach or failure (i) constitutes grounds for termination of this agreement for cause by such insurer, and (ii) is not cured within thirty (30) days following such insurer's discovery thereof, shall be effective against any applicable insurance commissioner in any future rehabilitation or insolvency proceedings against such insurer ~~with regulatory jurisdiction over this contract, including the domiciliary insurance commissioner,~~ unless approved in advance in writing by such ~~domiciliary insurance~~ commissioner. ~~and any other insurance commissioner with regulatory jurisdiction over this contract.~~

(h) The contractholder and the insurer shall agree on the permissible levels and timing of any new deposits to the Segregated Portfolio.

~~Section 7. Establishment of Segregated Portfolio~~

~~(a) No Contract subject to this Regulation may be written unless the assets which it supports and for which a Contract Value is established are maintained in a Segregated Portfolio of a Permitted Custodial Institution.~~

~~(b) The Segregated Portfolio shall be regularly accounted for by the insurance company. Accountings shall be prepared no less frequently than monthly, and shall include the following items:~~

~~(1) a complete statement of Segregated Portfolio holdings and values; and~~

~~(2) the cash balance within the Segregated Portfolio.~~

~~(c) The insurance company shall maintain a market Value Record at all times for each Contract subject to this Regulation. No less frequently than monthly, the insurance company shall update the Market Value Record to reflect the market value of the Segregated Portfolio. In performing the market value calculation, the insurance company must select a method of valuation designed to reflect the fair market value of the Segregated Portfolio which method may include the use of a vendor market valuation service.~~

~~(d) At least annually, the contractholder and the insurance company shall agree on the permissible levels and timing of any new deposits to the Segregated Portfolio, expressed as a percentage of the contractholder's positive cash flow or in gross dollar amounts.~~

Section 7~~8~~. Investment Management of the Segregated Portfolio

The Investment Manager must have full responsibility for, and ~~sole~~ control over, the management ~~purchase and sale~~ of all ~~s~~Segregated Portfolio assets within the ~~quality and duration~~ constraints specified in the ~~of i~~Investment ~~g~~Guidelines ~~submitted by the contractholder to the Investment Manager and as accepted by the insurance company from time to time~~.

The Investment Guidelines shall be submitted to the insurer ~~insurance company~~ for underwriting review before the Contract becomes ~~became~~ effective. ~~Any changes made to the Investment Guidelines which are not submitted to and accepted by the insurance company prior to the effective date of the change, shall be a reason for the immediate termination of the Contract by the insurance company. The Investment Guidelines may only provide for investments of the segregated Portfolio in instruments for which market values are readily ascertainable.~~

If the insurer accepts a proposed change to the Investment Guidelines or allows the Contract to operate in accordance with Investment Guidelines not meeting the criteria established in Section 5(h)(10), approval of such non-conforming Investment Guidelines must be obtained from the insurer's domiciliary insurance department.

~~(e) Prior to issuing any contract subject to this Regulation, the insurance company shall file with the Commissioner a copy of the Investment Guidelines for the Contract. The filing shall be accompanied by a statement of an authorized officer of the insurance company which shall include:~~

~~(1) a statement of the identify of the Permitted Custodial Institution;~~

~~(2) a description of the manner by which the insurance company shall monitor the Segregated Portfolio and verify that the Segregated Portfolio is being managed in accordance with the Investment Guidelines; and~~

~~(3) an undertaking to file with the Commissioner any changes to the Investment Guidelines upon acceptance of such changes by the insurance company.~~

Section 8~~9~~. Purchase of Annuities

For ~~c~~Contracts which are group annuity contracts, and which mak~~d~~e available to the contractholder the purchase of immediate or deferred annuities for the benefit of individual members of the group, no annuity may be purchased without the delivery of the contractually agreed upon consideration in cash to the insurer ~~insurance company~~ from the Segregated Portfolio for allocation to the insurer's ~~insurance company's~~ general account or a separate account. The insurer shall collect adequate consideration for the cost of fixed annuities purchased under contract option by transfer from the Segregated Portfolio.

Section 9~~10~~. Unilateral Contract Terminations

Any ~~c~~Contract subject to this regulation shall allow the insurer ~~insurance company~~ to unilaterally and immediately terminate, without future liability of the insurer ~~insurance company~~ or obligation to provide further benefits, upon the occurrence of any one of the following events which is material and which is not cured within thirty (30) days following such insurer's discovery thereof:

(a) The Investment Guidelines are changed without the advance consent of the insurer~~insurance company~~ and the Investment Manager is not controlling, controlled by, or under common control with, such insurer;

(b) The Segregated Portfolio, if managed by an entity which is not controlling, controlled by, or under common control with, the insurer, is invested in a manner that does not comply ~~company~~ with the Investment Guidelines; or

(c) ~~i~~Investment discretion over the Segregated Portfolio is exercised by or granted to anyone other than the Investment Manager.

~~Section 11. Disclosure~~

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

Section 10~~12~~. Reserves

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

(a) This subsection provides for the Asset Maintenance Requirements for Segregated Portfolios governed by this Regulation.

(1) At all times there must be minimum reserves held in the general account or one or more separate accounts, as appropriate, equal to (i) in the case of Segregated Portfolios valued at Fair Market Value; or (ii) in the case of Segregated Portfolios valued at amortized cost in accordance with applicable general account rules.

(i) The excess, if any, of the value of the guaranteed contract liabilities (determined in accordance with subdivisions (6) and (7) of this subsection), over the market value of the assets in the Segregated Portfolio (less the deductions provided for in subdivision (2) of this subsection).

(ii) The excess, if any, of the reserve determined in accordance with minimum reserve requirements for general account guaranteed interest contracts over the amortized cost basis of the assets in the Segregated Portfolio determined in accordance with applicable general account amortized cost rules.

The reserve requirements of this subsection must be applied on a contract-by-contract basis.

(2) In determining compliance with the Asset Maintenance Requirement and the reserve for guaranteed contract liabilities in accordance with subdivision (1) of this subsection, the insurer shall deduct a percentage of the market value of an asset in the case of Segregated Portfolios valued at Fair Market Value.

(i) For debt instruments, the percentage will be the NAIC Asset Valuation Reserve, "maximum reserve factor," provided, however, that such factor shall be reduced by 50 percent for the purpose of this calculation if the difference in durations of the assets and liabilities is one year or less.

(ii) For assets which are not debt instruments, 20 percent.

(3) To the extent that guaranteed contract liabilities are denominated in the currency of a foreign country and are supported by Segregated Portfolio assets denominated in the currency of such foreign country, the percentage deduction for such assets under subdivision (2) of this subsection will be that for a substantially similar investment denominated in the currency of the United States.

(4) To the extent that guaranteed contract liabilities are denominated in the currency of the United States and are supported by Segregated Portfolio assets denominated in the currency of a foreign country, and to the extent that

guaranteed contract liabilities are denominated in the currency of a foreign country and are supported by Segregated Portfolio assets denominated in the currency of the United States, the percentage deduction for debt instruments under subdivision (2) of this subsection will be increased by 15% of the market value thereof unless the currency exchange risk thereon has been adequately hedged, in which case the percentage deduction under subdivision (2) of this subsection will be increased by .5%. (No guaranteed contract liabilities denominated in the currency of a foreign country shall be supported by Segregated Portfolio assets denominated in the currency of another foreign country without the approval of the Commissioner.) For purposes of this subdivision, the currency exchange risk on an asset is deemed to be adequately hedged if:

(i) it is an obligation of (1) a jurisdiction, which is rated in one of the two highest rating categories by an independent nationally recognized United States rating agency acceptable to the Commissioner; (2) any political subdivision or other governmental unit of any such jurisdiction, or any agency or instrumentality of any such jurisdiction, political subdivision or other governmental unit; or (3) an institution which is organized under the laws of any such jurisdiction; and

(ii) at all times the principal amount thereof and scheduled interest payments thereon are hedged against the United States dollar pursuant to contracts or agreements which are (1) issued by or traded on a securities exchange or board of trade regulated under the laws of the United States or Canada or a province thereof; (2) entered into with a United States banking institution which has assets in excess of five billion dollars and which has obligations outstanding, or has a parent corporation which has obligations outstanding, which are rated in one of the two highest rating categories by an independent, nationally recognized, United States rating agency, or with a broker-dealer registered with the Securities and Exchange Commission which has net capital in excess of two hundred fifty million dollars; or (3) entered into with any other banking institution which has assets in excess of five billion dollars and which has obligations outstanding, or has a parent corporation which has obligations outstanding, which are rated in one of the two highest rating categories by an independent, nationally recognized, United States rating agency and which is organized under the laws of a jurisdiction which is rated in one of the two highest rating categories by an independent, nationally recognized United States rating agency.

(5) These contracts may provide for the allocation to one or more separate accounts of all or any portion of the amount needed to meet the Asset Maintenance Requirement. If the Contract provides that the assets in the separate account shall not be chargeable with liabilities arising out of any other business of the insurer, the insurer shall maintain in a distinct separate account that is so chargeable, (i) that portion of the amount needed to meet the Asset Maintenance Requirement that has been allocated to separate accounts, less (ii) the amounts contributed to separate accounts by the contractholder in accordance with the Contract and the earnings thereon.

(6) For purposes of this section, the minimum value of guaranteed contract liabilities in the case of Segregated Portfolios valued at Fair Market Value is defined to be the sum of the expected guaranteed contract benefits, each discounted at a rate corresponding to the expected time of payment of the contract benefit that is not greater than the maximum multiple of the Spot Rate supportable by the expected return from the Segregated Portfolio assets (and in no event greater than 105% of the Spot Rate) as described in the Plan of Operation or the actuary's Opinion and Memorandum (pursuant to Section 5(h)), except that if the expected time of payment of a contract benefit is more than thirty years, it shall be discounted from the expected date of payment to year thirty at a rate of no more than 80 percent of the thirty year Spot Rate and for thirty additional years at a rate not greater than 105% of the thirty year Spot Rate.

(7) In calculating the minimum value of guaranteed contract benefits:

(i) all guaranteed benefits potentially available to the contractholder on an ongoing basis must be considered in the valuation process and analysis, and the ultimate reserve held must be sufficient to fund the greatest present value of each independent guaranteed contract benefit. For purposes of this subparagraph, the right granted to the contractholder to exit the Contract by discharging the insurer of its guarantee obligation under the Contract and taking control of the assets in the Segregated Portfolio shall not be considered a guaranteed benefit.

(ii) To the extent that future guaranteed cash flows are dependent upon the benefit responsiveness of an employer sponsored plan, a best estimate based on company experience, or other reasonable criteria if company experience is not available, must be used in the projections of future cash flows.

In projecting cash flows for annuity and life insurance benefits, the mortality tables for such benefits prescribed or authorized by Section [insert statutory reference] of the Insurance Law shall be used.

(b) This subsection provides for the Actuarial Opinion and Memorandum which must be submitted for Segregated Portfolios governed by this Regulation.

(1) An insurer that issues a Synthetic Guaranteed Investment Contract subject to this Regulation shall submit an Actuarial Opinion and Memorandum to the Commissioner annually by March 1 following the December 31 valuation

date showing the status of such accounts as of December 31. The Actuarial Opinion and Memorandum must be in form and substance satisfactory to the Commissioner.[2]

(2) The Actuarial Opinion shall state that, after taking into account any risk charge payable, the Segregated Portfolio assets, and the amount of any reserve liability with respect to the Asset Maintenance Requirement, the account assets make good and sufficient provision for contract liabilities. The opinion shall be accompanied by a certificate of an officer of the company responsible for the monitoring of compliance with the asset maintenance and reserve requirements for such Segregated Portfolios, describing the extent to and manner in which during the preceding year:

(i) actual benefit payments conformed to the benefit payment estimated to be made as described in the Plan of Operation;

(ii) the level of reserves, if any, was appropriate in view of such factors as the nature of the guaranteed contract liabilities and losses experienced in connection with account contracts;

(iii) after taking into account any reserve liability with respect to the Asset Maintenance Requirement, the amount of the account assets satisfied the Asset Maintenance Requirement;

(iv) the determination of the Fair Market Value of the Segregated Portfolio, if applicable, conformed to the valuation procedures described in the Plan of Operation, including (but not limited to) a statement of the procedures and sources of information used during such year;

(v) the fixed-income Segregated Portfolio conformed to, and justified, the rates used to discount contract liabilities for valuation pursuant to Section 10(a)(6) if applicable;

(vi) any rate or rates used pursuant to Section 10(a)(6) to discount guaranteed contract liabilities and other items applicable to the Segregated Portfolio were modified from the rate or rates described in the Plan of Operation filed pursuant to Section 5(h); and

(vii) any assets were transferred to or from the insurer's general account, or any amounts were paid to the insurer by any contractholder to support the insurer's guarantee.

(3) The Actuarial Opinion shall cover the applicable points set forth in Section [insert regulatory reference] of these regulations.

(4) The Actuarial Memorandum shall:

(i) either (1) substantially conform with those portions of Section [insert regulatory reference] of these regulations that are applicable to testing and demonstrating the sufficiency of assets based upon cash flow analysis; or (2) demonstrate why cash flow analysis is not appropriate and set forth the procedures used to determine the sufficiency of account assets;

(ii) clearly describe the assumptions the Qualified Actuary used in support of the Actuarial Opinion, including any assumptions made in projecting cash flows under each class of assets, and any dynamic portfolio hedging techniques utilized and the tests performed on the utilization of such techniques;

(iii) clearly describe how the Qualified Actuary has reflected the risk of default on obligations and mortgage loans, including obligations and mortgage loans that are not investment grade;

(iv) if the Plan of Operation provides for investments in Segregated Portfolio assets other than United States Government Obligations, demonstrate that the rates used to discount contract liabilities pursuant to Section 10(a)(6) if applicable conservatively reflect expected investment returns (taking into account any foreign exchange risks);

(v) if the contracts provide that in certain circumstances they would cease to be funded by a Segregated Portfolio and, instead, would become contracts funded by the general account, clearly describe how any increased reserves would be provided for if and to the extent such circumstances occurred;

(vi) state the amount of reserves and supporting assets as of December 31 and where such reserves are shown in the annual statement; and

(vii) state the amount of any contingency reserve carried as part of surplus.

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[2] Drafting Note: The applicable state may wish to include the information contained in the Actuarial Opinion and Memorandum as part of its overall filing requirements, rather than mandating a separate filing for Synthetic Guaranteed Investment Contracts.

(c) When the insurer issues a Synthetic Guaranteed Investment Contract and complies with the Asset Maintenance Requirements of Section 10(a), it need not maintain an asset valuation reserve with respect to such assets in the case of a Segregated Portfolio valued at Fair Market Value.

(d) This section provides for reserve valuation for Segregated Portfolios governed by this Regulation.

(1) Reserves for Synthetic Guaranteed Investment Contracts subject to this Regulation shall be an amount equal to the sum of the following:

(i) the amounts determined as the minimum reserves as required under Section 10 (a)(1);

(ii) any additional amount determined by the insurer's Qualified Actuary as necessary to make good and sufficient provision for all of the contract liabilities; and

(iii) any additional amount determined as necessary by the Commissioner due to the nature of the benefits.

(2) The amount of any reserves required by subdivision (2) of this subsection may be established by either:

(i) allocating sufficient assets to one or more separate accounts; or

(ii) setting up the additional reserves in the general account.

Section 11~~13~~. Severability

If any provision of this Part or ~~of~~ the application thereof to any person or circumstances is adjudged invalid by a court of competent jurisdiction, such judgment shall not affect or impair the validity of the other provisions of this Part.

Comments on Synthetic Guaranteed Investment Contracts Model Regulation

Section 3: Clarified scope applies regardless of the market in which the contract is sold, and focuses on group annuity contracts or other accumulation fund arrangements where principal is guaranteed and interest rates credited under the contract are declared in advance. Specifically excluded (i) payout annuities under a synthetic structure and (ii) accumulation products that guarantee a return based on a stated index.

New 4(a): Added definition of actuarial opinion and memorandum.

New 4(b): Added definition of asset maintenance requirement.

Prior 4(b); New 4(d): Revised the definition of contract value record to reflect the use of a crediting rate formula, since "experience rated" is not a defined term and may not apply to certain contracts.

Prior 4(c); New 4(e): Revised the definition of crediting rate formula to allow the difference between the contract value record and the market value record to be amortized over an appropriate period, rather than requiring that the period be related to the average duration of the assets.

New 4(f): Added definition of duration.

New 4(g): Added definition of fair market value.

New 4(h): Added definition of guaranteed minimum benefits.

New 4(i): Added definition of hedging instrument.

Prior 4(d); New 4(j): Revised the definition of investment guidelines to broaden the list of portfolio characteristics the guidelines may address.

Prior 4(e); New 4(k): Revised definition of investment manager to clarify the fact that the investment manager may be anyone authorized to act as such by the contractholder, and needn't necessarily be registered as an investment adviser under the Investment Advisers Act of 1940. E.g., the investment manager may be a designated employee of the contractholder.

Prior 4(f); New 4(l): Revised definition of market value record; the added definition of fair market value captures the concepts addressed by the deleted material.

Prior 4(g); New 4(m): Revised definition of permitted custodial institution to clarify that the institution is providing *custodial* services, and is not necessarily functioning as a named fiduciary under ERISA.

New 4(n): Added definition of plan of operation.

New 4(o): Added definition of qualified actuary.

Prior 4(h); New 4(p): Revised definition of rate period to reflect the use of a crediting rate formula, since "experience rating" is not a defined term and may not apply to certain contracts.

New 4(r): Added definition of spot rate.

New 4(s): Added definition of unilateral contract termination event.

New 4(t): Added definition of United States government obligation.

New Wording at the Beginning of Section 5: Added the requirement that an insurance company be licensed in a state in order to issue synthetic GIC contracts in that state, and stipulated that certain financial qualification requirements and filing requirements must also be met.

New 5(a): Added minimum asset or capital and surplus requirements in order for an insurance company to be qualified to issue synthetic GIC contracts.

Prior 5(a); New 5(b): Revised the plan of operation filing requirement to apply to the insurance company's domiciliary insurance department, and added a deemer provision to allow the insurer to issue a contract form as if it had been approved, provided the insurance department has not raised objections within a specified timeframe.

New 5(c): Added the requirement that an insurance company not domiciled in a particular state must file a contract form with the insurance department of that state in order te issue a contract of that type, and must also file the plan of operation with its domiciliary insurance department. Added a deemer provision to allow the insurer to issue a contract form as if it had been approved, provided the insurance department has not raised objections within a specified timeframe.

New 5(d): Added file and use provisions allowing an insurer to issue a contract if it has been filed with the insurance department (along with a certification that it is believed to comply with the regulation), and it has not been disapproved.

New 5(e): Added a disclosure requirement for the new file and use provisions, since changes to the contract may be subsequently required as a condition of approval.

New 5(f): Added a provision allowing the insurer to request a hearing in the event the insurer's filing has been disapproved.

New 5(g) Moved the requirement from Prior Section 7(a) that the assets in the segregated portfolio must be held by a permitted custedial institution.

New 5(h)(3): Consolidated prior 5(b)(3) and 5(b)(4) to require a description of the procedures followed for purposes of New Section 10 – Reserves.

Prior 5(b)(5): Deleted. This sentence duplicated Prior 5(b)(2).

Prior 5(b)(7); New 5(h)(5): Clarified language to include "fair market value," a new defined term. Adjusted the minimum reporting frequency te be more practical, but still reflect the necessity for monitoring risk.

Prior 5(b)(9): Deleted. This is a contract provision rather than a plan of operation provision.

Prior 5(b)(10); New 5(h)(7): Substituted Minnesota language to clarify intent of the provision to show effect on contract rates over time under different scenarios.

Prior 5(b)(12): A portion of this section was moved to put all of the actuarial reporting, opinions, and memoranda in one place – New Section 5(h)(13). The Advisory Group believes that an annual report (rather than a semi-annual report) for these types of events is appropriate. We have simplified the language to remove redundancy and eliminate the reporting of non-material events.

Prior 5(b)(14); New 5(h)(11): This language is consistent with New Section 5(h)(10) and 5(h)(11). In addition, the specific name of the investment manager is not relevant to the operating procedures described in the plan of operation. Rather, the criteria used in the selection of the investment manager and the parameters for the investment guidelines are the most significant determinants of risk.

Prior 5(b)(15); New 5(h)(12): We believe a certification is adequate.

Prior 5(b)(16); New 5(h)(13): A unilateral contract termination event occurs if investment guidelines were not adhered to. We aggregated all annual reporting into one section. Clarified definition of risk charge. Clarified reporting applies only if a loss has occurred (payment has been made from the insurer's general account or other source). Clarified that report is in aggregate on a pool of risk, rathor than on a contract by contract basis.

Prior 5(b)(17); New 5(h)(13): Risk charges are reported in the actuarial opinion and memorandum every year per New Section 5(h)(13).

Prior 5(b)(18): Interest rate illustrations are covered in New Section 5(h)(7).

Prior 5(b)(19): This standard applies to the investment manager and not the issuer. Since general law requires that investment managers of ERISA assets discharge their duties in accordance with the prudent person standard, we suggest that there is no need for a separate acknowledgement of the prudent person rule in this regulation.

Prior 5(b)(20): The maintenance of required risk reserves is addressed in New Section 10 – Reserves. The requirement of adequate consideration for fixed annuities purchased from the insurer by transfer from the segregated portfolio is addressed in New Section 9 – Purchase of Annuities. Reserve requirements for fixed annuities were deemed to be beyond the scope of the regulation.

Prior 5(b)(21): The assets in the segregated portfolio of a synthetic GIC are not held by the insurance company, and are not chargeable with liabilities arising from other business of the insurer. It is therefore redundant to state in the plan of operation whether they are not so chargeable.

6(a): Some synthetic GICs contain an "advance" feature, under which proceeds are advanced to the contractholder to pay benefit withdrawals at book value. The advance is typically recovered, with interest, at a later date such as the maturity of an underlying asset. This wording is intended to capture advances made under this feature as well as payments.

6(c): Modified to reflect fixed maturity synthetics and to take into account the required contract provision that restricts book value payments upon the occurrence of a unilateral contract termination event.

6(g): Modified to:
(1) clarify remedies waived are those available to the insurer rather than the contractholder;
(2) reflect that substantially similar wording is acceptable;
(3) limit the waiver to waivers with respect to material events;
(4) clarify applicability is for purposes of rehabilitation or insolvency proceedings.

Prior 7(a): Moved to Section 5(g) for added clarity.

Prior 7(b): This section was moved to new Section (5)(h)(5) for added clarity and to avoid duplication in the regulation. Clarified language includes "fair market value," a new defined term. Adjusted the minimum reporting frequency to be more practical, but still reflect the necessity for monitoring risk.

Prior 7(c): Maintenance of records is a requirement of new Section 5(h)(5); this section was therefore deleted to reduce redundancy.

Prior 7(d): Moved to Section 6(h) – Required Contract Provisions for added clarity.

Prior 8(a); New 7(a): Modified to reflect the fact that there may be more than one investment manager covered by a single contract.

Prior 8(b); New 7(b): Struck last sentence prohibiting non-market value assets. Covered through the definition of "fair value." Struck immediate termination language as it is already covered in new Section 9(a).

Prior 8(c); New 7(c): Covered submission of investment guidelines in New Sections 5(h)(10) and 5(h)(11). In general, the Advisory Group has modified the approach to the submission of investment guidelines as follows:

5(h)(10) establishes allowable parameters that any particular set of investment guidelines must meet, along with the criteria the insurer will use in evaluating specific guidelines that fall within these parameters. It also requires the insurer to file with the insurance department any investment guidelines that fall outside of these parameters.

5(h)(11) establishes how the issuer will approve the investment manager that will manage the portfolio within the guidelines established in 5(h)(10).

The concept is that, provided the investment guidelines meet the overall policy for investment guidelines established in (5)(h)(10), the guidelines need not be submitted in advance for approval.

Prior 8(c)(1): Deleted. The identify of the permitted custodial institution is not relevant to risk control or monitoring. Rather, these objectives are covered by the monitoring and auditing requirements discussed in New Sections 5(h)(5) and 6(h).

Prior 8(c)(2): Deleted. Covered in New Section 5(h)(5).

Prior 8(c)(3): Deleted. Not necessary to file changes provided the investment guidelines still meet the parameters of New Sections 5(h)(10) and 5(h)(11).

Prior Section 9; New Section 8: Included language from Prior Section 5(b)(20)(b) requiring the insurance company to collect adequate consideration for fixed annuities purchased by a transfer of funds from the segregated portfolio to the general account.

Prior Section 10; New Section 9: Clarify that unilateral contract terminations:
(1) apply only to unusual events; and

(2) do not apply when the insurer or its affiliate is the investment manager, in which case the insurer might otherwise be prone to conflict of interest.

Prior Section 11: Disclosure of unilateral contract termination events and options permitting the contractholder to receive the contract value record over time is required under Section 6 – Required Contract Provisions. This section was therefore deleted to reduce redundancy.

Prior Section 12; New Section 10: Included language consistent with the general approach of California, New York, and proposed Connecticut reserving and actuarial reporting standards for market value separate accounts.

ILLUSTRATIVE AUTHORIZING LEGISLATION FOR SYNTHETIC GICs

Section 1.

(a) Any domestic life insurance company may provide accumulation fund arrangements in connection with the making of any life insurance contract or annuity contract, including any contract that makes life insurance or annuities available on an optional basis, and such company may insure the balance accumulated under such accumulation fund arrangements by promising a rate of return on such arrangements in fixed or variable amounts or in any combination of fixed and variable amounts.

(b) Under such accumulation fund arrangements, the company's obligations may be established by reference to (1) amounts deposited with the company and allocated to its general account or one or more of its separate accounts pursuance to section [cite section of insurance laws authorizing establishment of separate accounts], or (2) an asset portfolio that is not owned or possessed by the insurance company.

NAIC Technical Advisory Group on Synthetic GIC Regulation – Ancillary Issues

There are several ancillary issues which the technical advisory group discussed during its work on the draft language for the model regulation. Although these issues were not addressed in the model regulation per se, the group thought that some of the discussion and comments on these issues might be helpful to the regulatory community in assessing the need for additional regulatory work or the fit with other existing regulations.

1. Risk-Based Capital (RBC) Treatment
The spirit of the draft model regulation fits well with the recently approved new model regulation provisions for synthetics on risk-based capital requirements. That requirement essentially treats synthetics the same as if the assets were held in a guaranteed separate account rather than outside the ownership of the insurer, and applies the RBC approach used for separate accounts. This consistency should help ease regulatory issues that might otherwise arise across different types of regulation.

2. Priority of Synthetic GICs in the Event of Insurer Insolvency
The group believes that the appropriate treatment of any claim on the general account for a synthetic in the event of an insolvency parallels that for a separate account, and although the group has not reviewed the underlying statutes for each state, that this is generally supported by state law. The group agreed that, in the event of an insurer insolvency, a synthetic GIC contractholder should have the same priority as other policyholders with respect to any claim on the assets of the insurer. The extent of the claim would be the excess (if any) of the benefits guaranteed under the contract over the market value of the assets underlying the contract.

3. Guaranty Fund Coverage and Assessments
Guaranty fund coverage would not apply to synthetic GICs, and synthetic GICs would not be subject to guaranty fund assessments; this approach is consistent with the proposed guaranty fund model regulation. To the extent that payout annuities are *actually* purchased from the insurer using assets from the contract, such annuities *would* be subject to guaranty fund coverage and assessments in the same manner as other annuities.

4. Premium Taxes
The group agreed that issues regarding the applicability of state premium taxes to synthetic GIC contracts were beyond the scope of the model regulation.

5. Disclosures to the Contractholder
There are certain disclosure requirements that should apply to synthetic GIC products and that are unique to those products. The insurer should disclose to the contractholder any rights to unilateral contact termination that exist, any fees that could apply at the termination of the contract, any deemers that apply to the contract at the time of issue, and any market value withdrawal conditions that apply to the contract. These disclosures have been addressed in the revised draft model regulation. Other contractholder disclosure issues were beyond the scope of the group.

6. Advances and Loans to the Contractholder
The group wanted to provide some guidance on the accounting and reporting treatment of advances or loans to the contractholder. Such advances or loans might occur under some synthetic GIC structures when the contractholder must make benefit payments to plan participants, but does not have adequate cash on hand to fund such benefits. Since these advances would become obligations to the insurer by the contractholder, they should be treated as policy loans on the insurer's balance sheet. The insurer's cash position would be reduced, and a policy loan asset would be established. Liabilities and net equity

would be unaffected. The group realizes that this treatment may create other issues relative to ERISA treatment of the advance transaction, but that the question of ERISA treatment is beyond the scope of the group.

7. Types of Contracts
The group agreed that this model regulation is intended to apply only to group contracts and not to traditional individual annuities.

8. Symmetry Between Synthetic GICs and Separate Accounts GICs
The group agreed that synthetic and separate account GIC products should be treated in a consistent manner. For example, a model regulation developed to cover separate account GICs should be similar to and consistent in approach with the model regulation on synthetic GICs. At this time, our understanding is that the NAIC is looking as a potential model regulation for separate accounts. We believe they should make consistency with synthetics a priority in that process.

9. Development of a Regulation for Synthetic Products for Annuities in the Course of Payment
Finally, although the group's recommended regulation is not intended to apply directly to so-called "payout" annuities under a synthetic structure; i.e. under a structure in which the assets backing the insurer's obligations are not held in the name of the insurer, we believe that with some modest amount of additional work the proposed regulation could be adapted, or a new parallel regulation developed, to apply to such products. For purposes of speed, and because there is little, if any, knowledge about such products, the group felt it best to wait to develop a regulation. However, should the need for one develop, it should tie closely to this regulation.

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ATTACHMENT SIX

Proposed revisions from Sheldon Summers to the "Effective Date" section of Actuarial Guideline XXXIII. 6/11/97

<u>Effective Date</u>

This guideline shall be effective on Dec. 31, 1998, affecting all contracts issued on or after Jan. 1, 1981. A company may request a grade-in period for contracts issued prior to Dec. 31, 1998, from the domiciliary commissioner upon satisfactory demonstration that the method and level of current reserves held for such contracts are adequate in the aggregate. This phase-in will require establishment of no less than 33 1/3 % of the additional reserves resulting from the application of this guideline on Dec. 31, 1998, ~~50% of the remaining additional reserves~~ <u>no less than 66 2/3 %</u> on Dec. 31, 1999, and 100 % by Dec. 31, 2000.