

LIFE INSURANCE (A) COMMITTEE

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

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MINUTES

The Life Insurance (A) Committee met in Room 6C of the Washington State Convention and Trade Center in Seattle, Wash., at 3 p.m. on Dec. 8, 1997. A quorum was present and Terri Vaughan (Iowa) chaired the meeting. The following committee members or their representatives were present: James H. Brown represented by Lester Dunlap (La.); Steven B. Larsen represented by Donna Imhoff (Md.); Linda Ruthardt represented by Cindy Martin (Mass.); Chris P. Krahling represented by Jerry Fickes (N.M.); Glenn Pomeroy represented by Tom Foley (N. D.); and John Crawford represented by Dan Keating (Okla.).

1. Report of Viatical Settlements Working Group

Lester Dunlap (La.) reported that the Viatical Settlements Working Group adopted a final draft of the Viatical Settlements Model Act for consideration by the Life Insurance (A) Committee. He said the working group looked at the existing Viatical Settlements Model Act and prepared needed amendments. Because there has been a significant growth in the viatical settlement industry over the past few years and more than 20 states have adopted laws on viatical settlements, there is more experience to draw upon than when the model was first prepared. Mr. Dunlap said that during 1997 the working group met at all four national meetings, held two interim meetings and three conference calls leading up to the final draft that the working group adopted at the Winter National Meeting. He highlighted changes from the existing Viatical Settlements Model Act. There are a number of significant new definitions to cover financing entities and this will provide a basis for further discussions in 1998 in the model regulation. Some of the amendments to the model act respond to the

Health Insurance Portability and Accountability Model Act passed by Congress in 1996 and some of the amendments strengthen the approval process and the disclosures. He noted one change that was not made to the model act: the authority to create regulations on minimum payouts is still a part of the model act. Mr. Dunlap said there was significant input from the viatical settlement industry, which was very helpful to the working group. He said technical resource advisors are preparing recommendations for the working group's consideration on the relationship between viatical settlement providers and insurance companies.

Mr. Dunlap moved that the report be adopted and that motion was seconded by Donna Imhoff (Md.). Tom Foley (N.D.) pointed out that the model was not adopted by consensus; the vote was 8 to 5. His concern is that an investor would be able to find out whose policy he is buying. It had been a tradition in the life insurance industry that people should not be in a position where they could gain monetarily by the death of another individual, but the act as drafted now invites this. Mr. Dunlap said that during the development of the model act a number of states shared that concern with Mr. Foley, but the concerns were alleviated by two states that reported that they had not seen any problems. He said the model incorporates references to financing entities so that the working group can go forward and deal more extensively with the issue in development of the Viatical Settlements Model Regulation in 1998. Commissioner Vaughan asked if any states had reported problems with the financing entities and Mr. Dunlap responded in the negative. Mr. Foley pointed out that insurance regulators would not even know; if a viator died mysteriously, it would not be reported to the insurance department. Mr. Fickes said the same issue had been debated in New Mexico and was never resolved. He pointed out that he would recuse himself from voting on this model because his son is a major shareholder in a viatical settlement provider. Ms. Martin asked Mr. Dunlap to describe some of the alternative language the working group had considered.

Commissioner Vaughan noted that the meeting time for the A Committee is limited and asked if there is any urgency to consider adoption of the model act now, or whether the A Committee could receive the report and hear further comments at the Spring National Meeting in 1998. Mr. Dunlap agreed that would be appropriate and withdrew his motion. Ms. Imhoff moved and Ms. Martin seconded a motion to receive the Viatical Settlements Working Group report and to solicit comments to the Life Insurance (A) Committee before the Spring National Meeting. The motion to receive the Viatical Settlements Working Group report carried (Attachment One). Commissioner Vaughan asked that comments on this model be forwarded to Carolyn Johnson (NAIC/SSO) for distribution to the members of the Life Insurance (A) Committee.

2. Report of Annuities Working Group

Mr. Fickes said one activity of the Annuities Working Group is development of a Charitable Gift Annuities Model Act. The draft had been essentially completed by the Summer National Meeting but one element that had not been completed is the reserve section. The American Academy of Actuaries (AAA) suggested to the working group that it include provisions following the Standard Valuation Law with one variation. The working group accepted the AAA report, adopted the Charitable Gift Annuities Model Act, and recommended that further exposure of this document take place at the Life Insurance (A) Committee level.

Mr. Fickes said the working group also discussed issues of suitability and recommends that, to avoid duplication, this charge be moved to the Life Disclosure Working Group. He said this completes the charges to the Annuities Working Group and the working group believes that it is no longer needed. The working group also recommends that the name of the Life Insurance (A) Committee be changed to the Life Insurance and Annuities (A) Committee. He said this would assure that there was a place for discussion of annuity issues. Mr. Fickes moved and Mr. Foley seconded a motion to receive the report of the Annuities Working Group and the motion passed (Attachment Two).

Commissioner Vaughan pointed out that a name change for the A Committee would require a change to the NAIC Bylaws.

3. Report of Life Disclosure Working Group

Mr. Foley reported that the Life Disclosure Working Group spent six hours at the Winter National Meeting talking about annuity disclosure issues. The Annuity Disclosure and Sales Illustrations Model Regulation was discussed extensively and some changes were made to the current draft. Mr. Foley said the working group anticipates meeting in February to discuss the remaining significant issues. In addition, the working group believes that there are a number of issues related to the Life Insurance Illustrations Model Regulation that should be discussed in 1998 and suggests a charge to that effect. Mr. Foley said the working group has been drafting buyer's guides with the assistance of technical resource advisors and anticipates further discussion at the interim meeting.

Commissioner Vaughan asked Mr. Foley when he anticipates the working group will complete action on the model. Mr. Foley responded that the development of the model regulation and the buyer's guides should be completed by the 1998 Summer National Meeting. Commissioner Vaughan said that, given the attention to equity-indexed annuities, it is important to move expeditiously on this project. Ms. Martin moved and Dan Keating (Okla.) seconded a motion to receive the Life Disclosure Working Group report. Mr. Foley added that it appears the working group has many ongoing issues and suggested there might be some merit to making the working group a task force to emphasize its long-term nature. Commissioner Vaughan suggested that might also require a bylaws change. The motion to receive the report of the Life Disclosure Working Group passed (Attachment Three).

4. Report of Replacement Issues Working Group

The working group met by conference call Oct. 21, 1997, and for five and one-half hours at the Winter National Meeting to complete development of the Life Insurance and Annuities Replacements Model Regulation. Paul DeAngelo (N.J.) said that while the group had made considerable progress, there are still several issues to resolve. He said that a conference call will be held Jan. 15, 1998, and then a new draft will be released for comment. He expressed the opinion that the working group would present a final draft to the Life Insurance (A) Committee by the Spring National Meeting. In addition, the Replacement Issues Working Group is charged to comment to the A Committee on a number of other issues related to suitability and agents' compensation. Mr. Foley moved and Mr. Fickes seconded a motion to receive the Replacement Issues Working Group report. Commissioner Vaughan said that she knew Mr. DeAngelo was disappointed that the draft is not completed, but it is appropriate to take the time needed to prepare the document. The motion to receive the Replacement Issues Working Group report passed (Attachment Four).

5. Report of Synthetic GIC Working Group

Larry Gorski (Ill.) reported that the Synthetic GIC Working Group had a draft regulation ready for formal exposure and comment. At the Winter National Meeting the Life and Health Actuarial Task Force recommended support for the reserves section so the regulation was ready for final comments before adoption. Mr. Gorski said he had heard concerns from Doug Barnert (Barnert Associates, Inc.), representing the National Alliance of Life Companies (NALC). He said Mr. Barnert expressed concern about two issues: the financial requirements for insurers writing synthetic guaranteed investment contracts (GICs) and the requirement for an asset adequacy analysis. Mr. Gorski said the model contains commissioner discretion for the amount of capital so he did not see that as a problem. He noted that the asset adequacy issue is more appropriately dealt with in the Synthetic GIC Model Regulation than in the Actuarial Opinion and Memorandum Regulation. This way, only the synthetic GIC business would be subjected to the analysis instead of the company's entire business. He suggested that the NALC members are not likely to get into this business at any rate since it is a highly sophisticated product. He reported that the working group expects to recommend the model for final adoption at the Spring National Meeting. Mr. Foley moved and Mr. Keating seconded a motion to receive the Synthetic GIC Working Group report. Mr. Barnert said that he wants to make sure the Life Insurance (A) Committee understands that the comments Mr. Gorski reported are not part of the Synthetic GIC Working Group meeting, although they are obviously a part of these minutes. He said he will present written comments to the working group to describe his concerns. The motion to receive the Synthetic GIC Working Group report was adopted (Attachment Five).

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

Mr. Foley reported that the Life and Health Actuarial Task Force met Dec. 4 and 5, 1997, and discussed equity-indexed annuities. Actuarial Guideline ZZZ, setting out reserves for equity-indexed annuities, will be exposed for comment. Mr. Foley said the nonforfeiture project upon which the task force has worked for the last three years is bogging down and the task force is not reaching consensus. He expressed hope that, after disclosure has been explored to a greater extent, the nonforfeiture project will be able to get moving again. The task force received a significant report from the AAA on the Standard Valuation Law and anticipates a draft of a model act in the summer of 1998. He suggested that once the task force gets a better handle on valuation issues, it may be able to make progress on nonforfeiture. Commissioner Vaughan expressed concern that the task force is so discouraged about the nonforfeiture project. Mr. Foley responded that there is not consensus among the industry or among the regulators. Mr. Foley moved and Mr. Fickes seconded a motion to receive the report of the Life and Health Actuarial (Technical) Task Force, including exposure of Actuarial Guidelines ZZZ. The motion carried.

7. Review 1998 Charges and Discuss Charges for 1999

Commissioner Vaughan noted that the 1998 charges had been adopted by the A Committee in 1996 and are now being considered for amendment. The committee members reviewed the suggestions for charges. Commissioner Vaughan noted that one of the suggestions for a charge is a recommendation from the Financial Condition (EX4) Subcommittee on the Questions & Answers document for the Life Reinsurance Agreements Model Regulation that has become a part of the codification project. She noted that the charge may not be needed after the Executive Committee meeting to be held later at the Winter National Meeting. She noted that one charge was forwarded from the Statistical (Technical) Task Force, which had been responsible for the life insurance market shares report. Because its expertise is primarily in property/casualty issues, the task force suggested that the Life Insurance (A) Committee review the life reports. Another proposal from the Farmers Insurance Group of Companies is to consider a charge related to a standard paramedical examination report. Commissioner Vaughan asked if anyone in the audience wished to speak to this charge or had a reason why the NAIC should take up this issue. There was no response and the committee decided not to pursue a charge at this time.

Commissioner Vaughan noted that during the conference calls on the Securities and Exchange Commission (SEC) letter, the committee recognized the need to look at some other issues related to equity-indexed products, such as marketing and licensing. She also noted that there were several suitability issues in other charges and suggested taking the suitability and marketing issues and putting them in one charge for the Life Insurance (A) Committee to handle. With the amendments discussed, the committee decided to recommend the charges included as Attachment Six. The committee also reviewed the charges of the Life and Health Actuarial Task Force related to life insurance issues and approved those. The charges for 1999 were reviewed for both the Life Insurance (A) Committee and the Life and Health Actuarial (Technical) Task Force and agreement was given to request these charges from the Executive Committee.

8. Adopt Minutes of Nov. 6 and Nov. 17, 1997, Conference Calls

Commissioner Terri Vaughan (Iowa) reported that the letter to the Securities and Exchange Commission prepared as a result of the conference calls of the Life Insurance (A) Committee was amended and adopted by the Plenary at its Dec. 8, 1997, meeting. She said that with a modest wording change to one of the paragraphs, the Plenary agreed that it would be appropriate to send the letter to the SEC over the signature of the president of the NAIC. Jerry Fickes (N.M.) moved and Cindy Martin (Mass.) seconded a motion to adopt the minutes of the conference calls of Nov. 6, 1997, and Nov. 17, 1997 (Attachment Seven). The motion passed.

9. Any Other Matters Brought Before the Committee

Dwight Bartlett (Bartlett Consulting) reported that he recently became aware of an activity that should be of concern to the Life Insurance (A) Committee. He said he had recently heard numerous advertisements offering to purchase individuals' annuities for cash. The phone number that was provided is the same as the telephone number for the Viatical Association of America. He found that the organization typically purchases structured settlements, generally at a discount of 18-20%. Mr. Bartlett said he found this to be a very disturbing development and recommended that the A Committee watch this issue.

Having no further business, the Life Insurance (A) Committee adjourned at 4:10 p.m.

ATTACHMENT ONE

Viatical Settlements Working Group Seattle, Washington December 6, 1997

The Viatical Settlements Working Group of the Life Insurance (A) Committee met in Room 602/603 of the Washington State Convention and Trade Center in Seattle, Wash., at 2 p.m. on Dec. 6, 1997. Lester Dunlap (La.) chaired the meeting. The following working group members were present: Linda Brunette (Alaska); Gregory Harris (Ariz.); Kevin McCarty (Fla.); Ron Kotowski (Ill.); Marlyn Burch (Kan.); Rick Diamond (Maine); Tom Jacks (N.C.); Tom Foley (N.D.); Dan Keating (Okla.); Richard McKintock (Ore.); Ted Becker (Texas); and Troy Pritchett (Utah).

1. Consider Secondary Market Issues in Regard to Adoption of Viatical Settlements Model Act

Lester Dunlap (La.) said the major issue remaining before adoption of the Viatical Settlements Model Act is to consider the impact of the secondary market. He invited representatives from the viatical settlement industry to address the issue. Doug Head (Medical Escrow Society) said there is a great deal of concern within the viatical settlement industry about the proposal before the working group to limit the secondary market to only licensed viatical settlement providers. He said his job as a viatical settlement broker is to bring the maximum return to a viator and this is only possible by providing collateral to those who are considering investing in a viatical settlement. Mr. Head supports the proposal from Texas that was presented to the working group in a letter from Rhonda Myron and Beth Hill (Texas). The letter said that the Texas law does not prohibit a resale of a viatical settlement, and Texas has discovered no problems with that policy. Holly Roth (Viaticus) emphasized that, if there is a securitization, the contact with the viator should continue to be made by the viatical settlement provider. Mr. Dunlap asked for reactions by members of the working group to this proposal.

Tom Foley (N.D.) asked who would be aware of the identity of the person viaticating the policy. Ms. Roth responded that the viatical settlement broker would, of course, be aware of the individual's identity and so would the viatical settlement provider. She said for Viaticus, that was the extent of the knowledge because Viaticus does not solicit outside funding. She asked other representatives from the viatical settlement industry to respond for their situations. Mike McNerney (Mutual Benefits Company) said that different entities have different ways of structuring financing. He said in some cases a third party holds all the policies and, in that case, that entity would know the identity of the policyholders. He said in some cases, individuals purchase the policies and would be aware of that information. He said his company was extremely protective of the names of policyowners that it purchased, but in some cases they solicit bids from six or seven individuals who would know the identity of the person viaticating the policy. He said it was difficult to balance the need for privacy with the need for funding. Mr. Foley responded that the fact that other individuals could learn the name of the individual viaticating a policy concerned him greatly. Mr. McNerney said he thought the Texas proposal met the commercial need of the viatical settlement providers, but still provided protection for the viator. Mr. Foley contended that if someone knows the viator's name, he could be encouraged to make sure that individual dies sooner rather than later, to increase the return on the investment. Mr. McNerney responded that there is no evidence that anyone is doing this. Mr. Foley responded that it was no stretch in his imagination that there could be people who would be encouraged by this law to act in that manner.

Rick Diamond (Maine) said that Maine had the same concerns as Mr. Foley expressed and decided in its law to distinguish between institutional investors and other financing entities. The new Maine statute defines an institutional investor and says that the identity of a viator can only be revealed to an institutional investor. Mr. McNerney responded that this creates an imbalance in the industry. He said his company uses private financing so he would be out of business if the model used the Maine format. Kevin McCarty (Fla.) asked if the model could be drafted in such a way that the name would never be disclosed except to the viatical settlement provider and the viatical settlement broker. Mr. McNerney said that whoever would be making premium payments would need to know who the payments were for. Mr. McCarty suggested that any restrictions on the financing of viatical settlement providers would limit the amount of dollars available in the market. Ms. Roth said that an individual would be uncomfortable investing in a viatical settlement without knowing that the individual exists, so he would be uncomfortable without a name. Mr. McNerney said that more than half of the money in the viatical settlement marketplace today is coming from private investors so there would be a significant reduction in available funding. Mr. Diamond clarified that the Maine statute does not limit the financing but limits receipt of confidential information to the institutional investor.

Mr. Head responded that, since the Maine law is brand-new, the industry has had no experience with whether it will reduce the amount of funding available. Troy Pritchett (Utah) said that anyone who wanted to buy a viatical settlement policy could still do so; the individual just had to get a license. He suggested this might not reduce the funds available. Mr. McNerney said there would be fewer bidders in that instance, therefore less funds available.

Mr. McCarty moved to adopt the model with the following changes: Section 4A(8) should read "The viatical settlement provider has assigned, transferred or pledged a viaticated policy to a person other than a viatical settlement provider, licensed in this state or to a financing entity...." In addition, language would be inserted in Section 9F to say that "contacts with the insured for the purpose of determining the health status of the insured by the viatical settlement provider or the viatical settlement broker after the viatical settlement has occurred shall only be made by the viatical settlement provider or broker licensed in this state and shall be limited..." Tom Jacks (N.C.) seconded the motion. Ron Kotowski (Ill.) asked if disclosure language could be addressed in the regulation. Mr. Foley responded that he thought it was important to address the issue in the model act. Mr. Dunlap asked for a vote and the states of Alaska, Florida, Illinois, Kansas, North Carolina, Texas, Arizona and Louisiana voted in favor of the motion. The states of Maine, North Dakota, Oklahoma, Oregon and Utah voted against the motion. The motion to adopt the Viatical Settlements Model Act with the revisions suggested by Mr. McCarty passed (Attachment One-A).

2. Adopt Minutes of Oct. 30, 1997, Conference Call

Mr. Kotowski moved and Dan Keating (Okla.) seconded a motion to adopt the minutes of the Oct. 30, 1997, conference call. The motion passed (Attachment One-B).

3. Review 1998 Charges and Discuss Charges for 1999

Mr. Dunlap said he thought it was realistic to complete the amendments to the Viatical Settlement Regulation during 1998 and suggested requesting that charge from the Life Insurance (A) Committee. The working group agreed to make the recommendation.

Having no further business, the Viatical Settlements Working Group adjourned at 3:10 p.m.

ATTACHMENT ONE-A

Viatical Settlements Model Act Draft: 12/6/97

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Section 1. Short Title

This Act may be cited as the Viatical Settlements Act.

Section 2. Definitions

A. "Financing entity" means an underwriter, placement agent, lender, purchaser of securities, purchaser of a policy or certificate from a viatical settlement provider, credit enhancer, or any person that may be a party to a viatical settlement contract and that has a direct ownership in a policy or certificate that is the subject of a viatical settlement contract but whose sole activity related to the transaction is providing funds to effect the viatical settlement and who has an agreement in writing with a licensed viatical settlement provider to act as a participant in a financing transaction.

B. "Financing transaction" means a transaction in which a licensed viatical settlement provider or a financing entity obtains financing for viatical settlement contracts, viaticated policies or interests therein including, without limitation, any secured or unsecured financing, any securitization transaction or any securities offering either registered or exempt from registration under federal and state securities law, or any direct purchase of interests in a policy or certificate, if the financing transaction complies with federal and state securities law.

AC. "Person" means a ~~natural or artificial legal entity, including but not limited to, an individuals, partnerships, limited liability company, associations, trusts, corporation or other legal entity.~~

D. (1) "Viatical settlement representative" means a person who is an authorized agent of a licensed viatical settlement provider or viatical settlement broker, as applicable, who acts or aids in any manner in the solicitation of a viatical settlement. Viatical settlement representative shall not include:

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

(b) Any person who is retained to represent a viator and whose compensation is paid by or at the direction of the viator regardless of whether the viatical settlement is consummated.

(2) A viatical settlement representative is deemed to represent only the viatical settlement provider or viatical settlement broker.

BE. ~~"Viatical settlement broker" means an individual, partnership, corporation or other entity who or which for another a person 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" The term does not include an attorney, accountant or financial planner retained to represent the viator whose compensation is not paid by the viatical settlement provider paid directly by or at the direction of the viator.~~

GE. ~~"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 all or a portion of the insurance policy or certificate of insurance to the viatical settlement provider. A viatical settlement contract also includes a contract for a loan or other financial transaction secured primarily by an individual or group life insurance policy, other than a loan by a life insurance company pursuant to the terms of the life insurance contract, or a loan secured by the cash value of a policy.~~

BG. ~~"Viatical settlement provider" means an individual, partnership, corporation or other entity a person, other than a viator, 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 a person that obtains financing from a financing entity for the purchase, acquisition, transfer or other assignment of one or more viatical settlement contracts, viaticated policies or interests therein, 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] and pursuant to the contract; 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.~~

EH. ~~"Viator" means the owner of a life insurance policy or a certificate holder under a group 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 enters or seeks to enter into a viatical settlement contract.~~

HL. "Viaticated policy" means a life insurance policy or certificate that has been acquired by a viatical settlement provider pursuant to a viatical settlement contract.

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 representative or viatical settlement broker or enter into or solicit a viatical settlement contract without first having obtained a license from the commissioner.

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 representative 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 fee of \$[insert amount]~~ the fees of [insert amounts] specified in Section [insert appropriate section].

C. Licenses may be renewed from year to year on the anniversary date upon payment of the annual renewal fees ~~specified in Section [insert appropriate section] of \$[insert amount].~~ 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.

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, members 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 legal entity if not satisfied that any officer, employee, stockholder, ~~or partner or member~~ thereof who may materially influence the applicant's conduct meets the standards of this Act.

E. A license issued to a ~~partnership, corporation or other legal entity~~ authorizes all members, officers and designated employees to act as viatical settlement providers, ~~or viatical settlement brokers or viatical settlement representatives, as applicable,~~ 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 legal entity, 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 domicile.

G. The commissioner shall not issue ~~any~~ any license to ~~any~~ any nonresident applicant, 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 and Denial

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

- (1) There was any material misrepresentation in the application for the license;
- (2) ~~The holder of the license~~ The licensee or any officer, partner, member or key management personnel has been ~~convicted guilty of~~ convicted 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;~~
- (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, any felony, or to a misdemeanor involving fraud or moral turpitude, regardless of whether a judgment of conviction has been entered by the court;~~
- (5) The viatical settlement provider has entered into any viatical settlement contract that has not been approved pursuant to this Act;
- (6) The viatical settlement provider has failed to honor contractual obligations set out in a viatical settlement contract;

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

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

(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, viatical settlement broker or viatical settlement representative, 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 person may shall not use any viatical settlement contract or provide to a viator a disclosure statement form in this state unless it has been filed with and approved by the commissioner. Any viatical settlement contract form 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 or disclosure statement 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 policyowner viator.~~

Section 6. Reporting Requirements and Confidentiality

A. 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.

B. Except as otherwise allowed or required by law, a viatical settlement provider, viatical settlement representative, 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 as a viator 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.

Drafting Note: In implementing this section, states should keep in mind privacy considerations of viators. However, the language needs to be broad enough to allow licensed entities to notify commissioners of unlicensed activity and for insurers to make necessary disclosures to reinsurers and in similar situations.

Section 7. 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 viatical settlement provider and shall be available to the commissioner for inspection during reasonable business hours. A viatical settlement provider shall maintain records of each viatical settlement until five (5) years after the death of the insured.

Section 8. Disclosure

A. A viatical settlement provider, viatical settlement representative or viatical settlement broker shall disclose the following information to the viator no later than the date the viatical settlement contract is signed by all parties at than the time of application:

A-(1) 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-(2) 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;

~~C-(3) The fact that Proceeds of the viatical settlement could be subject to the claims of creditors;~~

~~D-(4) The fact that 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-(5) 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) calendar (15) days, whichever is less, after of the receipt of the viatical settlement proceeds by the viator, as provided in Section 9C; and~~

~~F-(6) The date by which the funds will be available to the viator and the source of the funds. Funds will be sent to the viator within two (2) business days after the viatical settlement provider has received the insurer or group administrator's acknowledgment that ownership of the policy or interest in the certificate has been transferred and the beneficiary has been designated pursuant to the viatical settlement contract; and~~

~~(7) Entering into a viatical settlement contract may cause other rights or benefits, including conversion rights and waiver of premium benefits that may exist under the policy or certificate, to be forfeited by the viator and that assistance should be sought from a financial adviser.~~

B. A viatical settlement provider shall disclose the following information to the viator prior to the date the viatical settlement contract is signed by all parties:

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

(2) 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 shall 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

(3) The dollar amount of the current death benefit payable to the viatical settlement provider under the policy or certificate. The viatical settlement provider shall also disclose the availability of any additional guaranteed insurance benefits, the dollar amount of any accidental death and dismemberment benefits under the policy or certificate and the viatical settlement provider's interest in those benefits.

Section 9. General Rules

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

~~(1) If the viator is the insured, Aa written statement from a licensed attending physician that the person-viator is of sound mind and under no constraint or undue influence to enter into a viatical settlement contract;~~

~~(2) A witnessed document in which the person-viator consents to the viatical settlement contract, acknowledges the that the insured has a catastrophic, or life threatening or chronic illness or condition, represents that he or she the viator 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; releases his or her medical records and acknowledges that he or she has entered into the viatical settlement contract freely and voluntarily; and~~

~~(3) A document in which the insured consents to the release of his or her medical records to a viatical settlement provider or viatical settlement broker.~~

~~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 of right to rescind the contract for at least thirty (30) days from the date of the contract or fifteen (15) calendar days from of the receipt of the viatical settlement proceeds whichever is less. If the insured dies during the rescission period, the viatical settlement contract shall be deemed to have been rescinded, subject to repayment to the viatical settlement provider of all viatical settlement proceeds.~~

~~D. Immediately upon the viatical settlement provider's receipt from the viator of documents to effect the transfer of the insurance policy, the viatical settlement provider shall pay the proceeds of the viatical settlement to an escrow or trust account in a bank approved by the commissioner state or federally chartered financial institution whose deposits are insured by the Federal Deposit Insurance Corporation (FDIC). The account shall be managed by a trustee or escrow agent independent of the parties to the contract pending acknowledgment of the transfer by the issuer of the policy. The trustee or escrow agent shall be required to transfer the proceeds due to the viator immediately upon the viatical settlement provider's receipt of acknowledgment of the transfer from the insurer of the insurance policy.~~

E. Failure to tender the viatical settlement by the date disclosed to the viator renders the contract null and void. Failure to tender consideration to the viator for the viatical settlement contract within the time disclosed pursuant to Section 8A(6) renders the viatical settlement contract voidable by the viator for lack of consideration until the time consideration is tendered to and accepted by the viator.

F. Contacts with the insured for the purpose of determining the health status of the insured by the viatical settlement provider, viatical settlement broker or viatical settlement representative after the viatical settlement has occurred shall only be made by the viatical settlement provider or broker licensed in this state and shall be limited to once every three (3) months for insureds with a life expectancy of more than one year, and to no more than one per month for insureds 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.

Section 10. 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 viatical settlement providers, representatives 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 for viatical settlement providers; and~~
- E. Adopt rules governing the relationship and responsibilities of both insurers and viatical settlement providers, brokers and representatives during the viatication of a life insurance policy or certificate.

Section 11. 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 ~~Act~~.

Section 12. Effective Date

This Act shall take effect on [insert date]. ~~A~~No viatical settlement provider, ~~viatical settlement representative or viatical settlement broker~~ transacting business in this state may continue to do so ~~pending approval or disapproval of the provider, representative 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.~~

ATTACHMENT ONE-B

Viatical Settlements Working Group Conference Call October 30, 1997

The Viatical Settlements Working Group of the Life Insurance (A) Committee met by conference call on Oct. 30, 1997. Lester Dunlap (La.) chaired the meeting. The following working group members participated: John Davis (Ala.); Kevin McCarty (Fla.); Ron Kotowski (Ill.); Marilyn Burch (Kan.); Rick Diamond (Maine); Tom Jacks (N.C.); and Beth Hill and Chris Orr (Texas).

Lester Dunlap (La.) said the purpose of the conference call is to review the outstanding issues on the Viatical Settlements Model Act, with a goal to have a draft to submit for adoption by the Life Insurance (A) Committee at the Winter National Meeting.

1. Authority to Promulgate Regulations

Mr. Dunlap said one issue to discuss was a suggestion for rewording Section 10E on the authority to adopt regulations affecting the insurance industry. He said suggestions were received from Holly Roth (Viaticus) and Julie Spiezio (American Council of Life Insurance—ACLI). Mr. Dunlap asked Ms. Spiezio to explain her proposal. Ms. Spiezio said the change in language she was recommending would reflect that the rules being developed are intended to address the relationship between viatical settlement providers and insurers. She noted that one of the insurers' concerns is a lack of limitations on the requests being received by insurers. For example, sometimes the request for information is 10 pages long with questions not necessarily appropriate for insurers to answer. Examples of questions that the insurer could get are, "is the viator employed?" or, "how old is the viator?"

She suggested that requests be limited to the type of information that could only come from an insurer. Mr. Dunlap asked if the intent of the suggested language is to clarify what will be considered when the working group develops regulations. Ms. Spiezio acknowledged that was correct and noted that her suggestion does not delete any words but adds words to the draft. Ron Kotowski (Ill.) said this language struck a good balance and he was in favor of the suggestion. Robert Shear (Accelerated Benefits Capital), representing the Viatical Association of America (VAA), said the language suggested by the ACLI was agreeable to the viatical settlement industry. The working group agreed to replace the language that had been in the earlier draft of Section 10E with the suggestion from Ms. Spiezio.

Mr. Dunlap asked for an update of the activities of the technical resource advisors. Ms. Roth responded that the technical resource advisors attempted to schedule a meeting prior to the Winter National Meeting but are unable to do so. She said the advisors will meet during the national meeting. Ms. Roth agreed to send to NAIC staff a list of the persons who indicated an interest in being technical resource advisors.

2. Suggestion from Representative Geller (Fla.)

Mr. Dunlap said the draft dated Sept. 20, 1997, contains a boxed paragraph that is included in the document adopted by the National Conference of Insurance Legislators (NCOIL). He said that the working group considered this at the Fall National Meeting but did not make a decision. Doug Head (Medical Escrow Society) said this concept does not seem to have much support, even in NCOIL. He said it gets into the regulation of fees and suggested this was not an appropriate place for regulation. Mr. Kotowski said Illinois law does not contain such a requirement for anything that the department regulates and he did not think it was necessary for viatical settlements. Mr. Dunlap agreed with the sentiments of Mr. Head and Mr. Kotowski. He said the amount of the final settlement is the most important aspect. No other members of the working group spoke in support of this proposal so it was decided to delete the boxed paragraph from consideration.

3. Secondary Market

Drew Backstrand (Viaticare Financial Services) said the VAA has a suggestion for revised language for Section 9F that was taken from the Texas law. Its purpose is to deal with a transfer of ownership in a viaticated policy. He said that Section 4A(8) would also need to be changed. He said the purpose of these two suggestions is to provide for liquidity in the market, but at the same time to protect consumers. This allows transfer of a viaticated policy but requires that the viatical settlement provider track the necessary information. Mr. Shear said the language the VAA is suggesting would be added at the end of Section 9F: "At the time a viatical settlement provider sells or otherwise transfers its ownership of or interest in a viaticated policy to a financing entity, the purchaser or transferee must appoint, in writing, either the viatical settlement provider that entered into the initial viatical settlement contract or the viatical settlement broker who received commission from the initial viatical settlement contract to contact the insured for the purpose of determining the insured's health status." The change being recommended to Section 4A(8) is as follows: "The viatical settlement provider has assigned, transferred or pledged a viaticated policy to a person other than to a licensed viatical settlement provider or a financing entity."

Chris Orr (Texas) said this language had worked well in Texas; the department had not received any complaints from viators. Scott Page (Page & Associates), representing the National Viatical Association, asked if the transfer would be to a licensed entity or a financing entity. Mr. Backstrand responded that a financing entity was specifically defined in the model act. Mr. Page asked if the suggested changes from the VAA would include individual investors and suggested this could circumvent the intent of the model. Mr. Dunlap responded that this issue has been discussed extensively by the working group and he said the working group had agreed previously to leave Section 4A(8) as it now stands. Mr. Backstrand responded that this would dry up funding sources and impede the securitization of viatical settlements. Mr. Dunlap responded that Tom Foley (N.D.), who was not present on the conference call, had been very adamant that only transfers to other licensed entities be allowed. He had expressed concerns that once the regulators moved passed licensed providers, abuses were possible. Mr. Shear said he did not think it was anyone's intent to regulate banks setting up trusts to securitize viatical settlements. Mr. Backstrand said the language in the model as it now exists would require a trust such as Mr. Shear's example to get licensed as a viatical settlement provider. The model does not make a distinction between financing entities that are banks and investment companies and financing entities that are individuals. He said he would be amenable to a definition that limits the financing entities to financial institutions. Mr. Shear agreed to rewrite the suggestion from the VAA to distinguish between the two types of financing entities and to bring a proposal to the working group. Mr. Kotowski emphasized that this was an opportunity for the viatical industry and that the working group would make a decision at the Winter National Meeting. Mr. Dunlap asked the viatical industry to provide a suggestion for changed language and the reasons for the change to Carolyn Johnson (NAIC/SSO) by Nov. 17, 1997, for mailing to the members of the working group.

Having no further business, the Viatical Settlements Working Group adjourned at 3 p.m.

ATTACHMENT TWO

Annuities Working Group
Seattle, Washington
December 7, 1997

The Annuities Working Group of the Life Insurance (A) Committee met in Room 605 of the Washington State Convention and Trade Center in Seattle, Wash., at 8 a.m. on Dec. 7, 1997. Jerry Fickes (N.M.) chaired the meeting. The following working group

Life Insurance Committee

members or their representatives were present: John Hartnedy (Ark.); Ron Rosen and Sheldon Summers (Calif.); Roger Strauss (Iowa); Tom Jacks (N.C.); Tom Foley (N.D.); Ted Becker (Texas); and Troy Pritchett (Utah).

1. Consider Reserves Section of Charitable Gift Annuities Model Act

Mike Batte (N.M.) described the work done so far by the Annuities Working Group on a model law for charitable gift annuities. He said the model had been virtually completed at the Summer National Meeting and the section on reserves had been forwarded to the American Academy of Actuaries (AAA) for comment. Mike Pressley (Tillinghast), representing the Charitable Gifts Working Group of the Committee of State Life Insurance issues of the AAA, reported on the deliberation of that working group. (Attachment Two-A). He summarized the report as recommending that the minimum reserves required should be the same as the standards included in the Standard Valuation Law, including the Commissioners' Annuity Reserves Valuation Method (CARVM) with one exception: that the maximum valuation interest rate be 100 basis points below what is required for insurers. He explained that many of the charities soliciting charitable gift annuities are small and thus may not be able to command the best interest rate on their investment. Jerry Fickes (N.M.) asked what effect that would have. Mr. Pressley responded that would give them a 5-10% greater reserve. Mr. Pressley said the AAA was recommending that, if minimum surplus is required under the Act, that surplus be equal to 10% of the reserves required under the Act. He said this requirement is fairly common in the states that have laws on the subject. John Hartnedy (Ark.) asked if this recommendation had been compared to the suggestions from the major charitable gift organizations. Mr. Pressley responded that the organizations' recommendations are even more conservative than the recommendation of the AAA.

Tom Foley (N.D.) asked Mr. Pressley if he was aware of any insolvencies of charitable organizations. Mr. Pressley responded that he was not aware of any insolvency. Mr. Hartnedy said his experience was that charitable organizations did not want to calculate appropriate reserves, so they set aside the entire amount contributed until the death of the individual. Mr. Foley asked what type of investments were chosen by charitable organizations. Mr. Hartnedy responded that they were generally quite conservative. He said he had not reviewed any that even came close to the line he would draw as to an inappropriate investment. Mr. Fickes noted that for very large funds a 10% surplus might be quite onerous. He suggested it might be appropriate to add to that requirement a suggestion that it not exceed the surplus required for insurers. He asked if it was wise to force large charitable organizations to carry so much surplus that they were not competitive with insurance companies in the return they were able to provide. Mr. Hartnedy noted that the entire assets of the charitable organization back the annuities, as provided in another section of the model. He said he readily agrees to certain investments because of this provision. Mr. Hartnedy said that he would like to see the document contain a reduction for large companies. Mr. Pressley said the AAA group had discussed this, but decided to keep the calculation simple. Mr. Fickes suggested that a blank be left for states to insert the number they would use for a risk-based capital requirement. Mr. Pressley said he was not sure how a charitable organization would calculate risk-based capital, since it does not file an annual statement.

Mr. Hartnedy moved to include the recommendations of the AAA as presented by Mr. Pressley in the reserve section of the Charitable Gift Annuities Model Act. Sheldon Summers (Calif.) seconded the motion. The motion was adopted.

Ron Rosen (Calif.) moved to adopt the Charitable Gift Annuities Model Act and recommend to the Life Insurance (A) Committee that comments be provided to the Life Insurance (A) Committee until the Spring National Meeting. Mr. Hartnedy seconded the motion. Merle Peterson (Principal Financial) asked if the certification requirements in the model apply only to the state where the company is located, or wherever it does business. Mr. Fickes responded that the company would need the certificate in any state in which it was soliciting annuities. The motion to adopt the Charitable Gift Annuities Model Act passed (Attachment Two-B).

2. Discuss Suitability Requirements for Sales of Annuities

Mr. Fickes reminded the working group members that a survey that the group sent out early in its existence indicated that states are concerned about issues of suitability and sales to seniors. The Annuities Working Group was charged to make a recommendation to the Life Insurance (A) Committee on this issue. Ted Becker (Texas) moved and Mr. Summers seconded a motion that this be forwarded to the Life Disclosure Working Group to consider as a separate item on its agenda. Mr. Becker indicated it should be a separate agenda item so that it would not be lost in the deliberations of that group. Mr. Rosen said the seniors in California have been victimized by contractors encouraging them to repair roofs and do other unnecessary jobs to get ready for the El Niño storms. He said this is an example that this segment of the public needs special care because of unscrupulous persons seeking to take advantage of them. Mr. Foley said that it was his hope that the Life Disclosure Working Group would be developing what he called "real disclosure," that would be usable by all parties. He said the group had been grappling with what additional disclosure might be necessary for seniors, and he was hard-pressed to see how or why different standards were necessary for seniors. He said that perhaps the questions for the Life Disclosure Working Group were whether there were any requirements for seniors on top of what disclosures were required for the general public. Mr. Fickes spoke in favor of the motion and particularly for the fact that it should be a separate agenda item. Roger Strauss (Iowa) suggested that the Buyer's Guide might contain questions that were specifically geared toward seniors. He said it was not necessary to aim suitability particularly at seniors but that their needs should be considered. Jack Gies (Conn.) suggested the members of the working group review the Insurance Marketplace Standards Association (IMSA) program; it may contain useful information that would affect seniors. Mr. Fickes said the Annuities Working Group heard a presentation on IMSA at the Fall National Meeting, but it appeared there were holes in the program with regard to suitability and especially suitability of sales to seniors.

Paul DeAngelo (N.J.) said he had no objection to moving the charge to the Life Disclosure Working Group, but he thought there would be issues beyond disclosure that might need to be addressed. Mr. Fickes said the working group had suggested earlier that this project go to the Senior Issues (B) Task Force, but that group deals primarily with health issues. He said perhaps the Life Insurance (A) Committee also needs a Senior Issues Task Force. Cindy Martin (Mass.) encouraged the group to consider

broadier issues of suitability beyond the needs of senior citizens. She said she looked forward to working with the Life Insurance (A) Committee on suitability issues.

Linda Lanam (Life of Virginia) said it was difficult for the insurance industry to have special rules for seniors when their marketing was not targeted for a specific age. She suggested looking at the disclosures being developed to see if identifiable elements could be added to address senior issues. She said that when she worked for a state insurance department, one of her tasks was to work with senior citizens, and she noted that many did not want to be treated differently, but wanted their needs to met through the general materials being provided. The working group decided to recommend to the Life Insurance (A) Committee that this charge be moved to the Life Disclosure Working Group.

Mr. Fickes said he thought that annuities were a large enough segment of the market that there should be at least a task force chaired by a commissioner, with responsibility for annuity issues. He said an alternative to that was to change the name of the Life Insurance (A) Committee to be the Life Insurance and Annuities (A) Committee. Mr. Gies asked if the annuities focus would be on personal sales or whether it would include guaranteed investment contracts (GICs), synthetic GICs, etc. Mr. Fickes said he thought it was appropriate to direct all of the issues to that task force.

Mr. Strauss noted that the NAIC is trying to cut down on the number of committees and suggested that, if this group did not have a specific charge, a group on annuities was not needed. David Sky (N.H.) said that it had always been his assumption that the duties of the Life Insurance Committee did include annuities, but he said changing its name would formalize that perception. Tom Jacks (N.C.) moved that the Annuities Working Group recommend to the Life Insurance (A) Committee that it change its name and that it be charged with ongoing responsibility for monitoring issues related to annuities. The motion was seconded by Mr. Rosen and passed by the working group.

3. Any Other Matters Brought Before the Working Group

Mr. Fickes asked if the Charitable Gift Annuities Act, when adopted, would have an effect on guaranty fund coverage. Jack Blaine (National Organization of Life and Health Guaranty Associations—NOLHGA) said he did not know the answer to that question. He opined that, according to most state laws, the definition of member insurer would not include a charitable organization. He reminded the group that there were two aspects to guaranty fund coverage: coverage of the annuities in the case of an insolvency and assessment of the member insurers. He said charitable gift organizations likely would not wish to be assessed to cover insolvencies of insurers. Mr. Fickes said he would like to have the Life Insurance (A) Committee suggest a charge to the Insolvency EX5 Subcommittee to review this issue. Mr. Blaine responded that was a good idea and suggested that the earlier this charge was forwarded to EX5 Subcommittee, the better it would be. Mr. Rosen moved and Mr. Hartnedy seconded a motion to have the Life Insurance (A) Committee suggest to the EX5 Subcommittee to review the implications of the Charitable Gift Annuities Model Act. The motion passed.

Having no further business, the Annuities Working Group adjourned at 9:40 a.m.

ATTACHMENT TWO-A

Charitable Gift Annuities Recommendation December 1997

By the Charitable Gifts Working Group
of the Committee of State Life Insurance Issues
of the American Academy of Actuaries

Background and Scope

The Annuities Working Group of the Life Insurance (A) Committee of the National Association of Insurance Commissioners (NAIC) is developing the Charitable Gift Annuities Model Act (the Act). If enacted, this Act would apply to charitable gift annuities (CGAs) issued after the effective date of the Act by charitable organizations as defined by the Act.

The American Academy of Actuaries (AAA) was asked to provide recommendations concerning the calculation of the reserves and surplus to be required under the Act. The AAA's Committee of State Life Insurance Issues (COSLII) was asked to provide the requested information. COSLII formed the Charitable Gifts Working Group (CGWG) to address the issues and prepare this report. Members of CGWG are Frank P. Dino, ASA, MAAA; Allen B. Keith, FSA, MAAA; Michael Mudry, FSA, MAAA; and W. Michael Pressley, FSA, MAAA.

Given our review of comments submitted to the Annuities Working group by Frank Minton and Clinton Schroeder (Board Members of the American Council on Gift Annuities) on March 16, 1997, it is our understanding that:

1. 13 states (Alabama, Arkansas, California, Florida, Hawaii, Iowa, Maryland, New Jersey, New York, North Dakota, Oregon, Washington, Wisconsin) currently regulate gift annuities and require charities to meet certain requirements in order to issue annuities within their borders;

2. nine states (Colorado, Idaho, Illinois, Minnesota, Missouri, Pennsylvania, South Dakota, Texas, Virginia) provide a "conditional exemption" under which charities satisfying certain qualifications and compliance requirements are specifically exempted from regulation;
3. nine states (Indiana, Kentucky, Louisiana, Massachusetts, Maine, Michigan, Ohio, South Carolina, Utah) unconditionally exempt gift annuities from regulation;
4. laws in 20 states/jurisdictions (Arizona, Connecticut, Delaware, District of Columbia, Georgia, Kansas, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, Oklahoma, Rhode Island, Tennessee, Vermont, West Virginia, Wyoming) do not specifically address gift annuities;
5. state requirements vary with respect to whether reserves are required and, if they are required, how they are calculated; and
6. some states require "surplus" equal to the greater of X% of the reserve or \$Y.

The current version of the Act imposes various obligations and requirements on charitable organizations as defined under the Act, including the following:

1. a charitable organization must obtain a certificate of authority prior to issuing CGAs; the commissioner will issue the certificate of authority if the charitable organization is found to be in sound financial condition and otherwise qualified;
2. a charitable organization must maintain a segregated account for its CGAs; the assets maintained in the segregated account are not subject to any claims other than those incurred pursuant to the issuance of CGAs;
3. the minimum amount of assets required to be maintained in the separate account is equal to the sum of the reserves plus surplus required under the Act;
4. the segregated assets are subject to the same investment laws applicable to domestic life insurers;
5. the charitable organization must file certain prescribed annual reports with the Commissioner;
6. the commissioner may examine the assets, liabilities, and affairs of the charitable organization as they pertain to CGAs as deemed appropriate; and
7. certain disclosures requirements are applicable, including a requirement that a charitable organization inform donors that payments under a CGA are backed solely by the full faith and credit of the organization and not by an insurance company or the state.

Recommendations Concerning Reserves and Surplus

The CGWG of COSLII recommends:

1. if minimum reserves are required under the Act, such minimum reserves should be computed using:
 - (a) the Commissioner's Annuity Reserve Valuation Method (CARVM) as defined in the Standard Valuation Law (SVL);
 - (b) any mortality table that is (under the SVL) permitted to be used in determining the minimum standard for the valuation of individual annuities issued during the same calendar year the CGA is issued; and
 - (c) an interest rate 100 basis points less than the maximum interest rate specified under the SVL for use in determining the minimum standard for the valuation of individual annuities issued during the same calendar year the CGA is issued.
2. in determining such minimum reserves, a deduction should be made for any portion of the annuity risk that is reinsured by an authorized insurer or reinsurer. For this purpose, any annuity contract purchased from an authorized insurer or reinsurer by the charitable organization is considered to be "annuity risk reinsured."
3. if minimum surplus is required under the Act, the amount of such minimum surplus should be equal to 10% of the reserves required under the Act.

Recommended Language

The language below is recommended for the Act.

(Note that the scope of the CGWG's assignment in this matter was limited to the computation of any minimum reserves and surplus required under the Act. Accordingly, the language underlined below is not part of the recommendation but was extracted from the draft of the Act.)

Section 4. Surplus and Reserves

A. A charitable organization authorized by the 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 10% of the reserves.

B. (1) Reserves on the outstanding annuities shall not be less than reserves calculated using:

(a) the Commissioner's Annuity Reserve Valuation Method as defined in [insert citation to the Standard Valuation Law];

(b) any mortality table permitted under [insert citation to the Standard Valuation Law] to be used in determining the minimum standard for the valuation of individual annuities issued during the same calendar year as the CGA; and

(c) an interest rate 100 basis points less than the maximum interest rate permitted under [insert citation to the Standard Valuation Law] to be used in determining the minimum standard for the valuation of individual annuities issued during the same calendar year as the CGA.

(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. For this purpose, any annuity contract purchased from an authorized insurer or reinsurer by the charitable organization is considered to be "annuity risk reinsured".

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

Rationale for Recommendations

- Valuation Method

The payments made by charities to donors under charitable gift annuities are in many respects similar to the payments made by insurance companies to annuitants under annuity contracts. Accordingly, the CARVM method required for computing minimum reserves for annuities issued by insurance companies seems appropriate for computing reserves for CGAs.

- Valuation Mortality

We are not aware of any recent mortality studies directly applicable to CGAs; the feasibility of undertaking such studies is questionable. While we think it reasonable to assume that mortality experience under CGAs might be reasonably consistent with the mortality experience under commercial annuities, the factors discussed below warrant consideration.

1. Because of the presumed higher socioeconomic status of those who make large charitable gifts, the mortality rates experienced under CGAs might be expected to be lower than the mortality rates experienced under commercial annuities.

2. It can be argued that, compared to the selection reflected in standard mortality tables constructed from experience under commercial annuities, the selection experienced under CGAs:

- might be relatively more extensive because the average issue age is generally higher for CGAs than for commercial annuities
- might be relatively less extensive because the decision to purchase a CGA is based in part on charitable intent (the realistic value of a typical CGA is perhaps two-thirds of the consideration).

3. The mortality experience of small CGA programs with little spreading of risk is subject to significant deviation from expected. (This can be considered in establishing standards for reviewing applications for a certificate of authority and in minimum surplus requirements.)

- Valuation Interest

1. For many smaller CGA programs, opportunities for higher yielding investments with adequate diversification and liquidity are limited. Relative to assets supporting commercial annuities, CGA assets can be expected to be invested in higher quality/lower yielding securities; thus, it might be appropriate to set lower maximum valuation interest rates for CGAs than for commercial annuities.

2. Typical CGAs are immediate annuities with no cash refund features. Relative to commercial annuities, typical CGAs are subject to relatively less disintermediation risk and perhaps less need for asset adequacy analysis.

3. Consideration was given to recommending that a valuation interest rate equal to the maximum interest rate permitted under the Standard Valuation Law be permitted, provided that an actuarial opinion based on asset adequacy analysis is also provided. Due in part to the fact that the current version of the Act is silent with respect to actuarial opinions concerning reserves, this option was not included in the recommendation.

- Deduction for "Reinsurance"

1. Some charities purchase commercial annuities to cover a portion of the CGAs they issue. In several states that currently regulate CGAs, charities are not permitted to take reserve credit for such commercial annuities. If the commercial carrier is licensed to write business in the state, there seems to be no logical reason to disallow reserve credit; doing so effectively prevents what might otherwise be considered to be an appropriate risk management activity.

- Required Surplus

1. Some level of surplus is desirable. The recommended level of 10% of reserves is admittedly arbitrary, but is consistent with the current requirements in some states.

ATTACHMENT TWO-B

Charitable Gift Annuities Model Act Draft: 12/7/97

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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 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 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~~ ten percent (10%) of the reserves or ~~insert amount~~; whichever is greater.

B. (1) Reserves on the outstanding annuities shall ~~be calculated either~~ not be less than reserves calculated using:

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

~~(b) Other assumptions prescribed by the commissioner.~~

(a) The Commissioner's Annuity Reserve Valuation Method as defined in [insert citation to the state standard valuation law];

(b) Any mortality table permitted under [insert citation to the state standard valuation law] to be used in determining the minimum standard for the valuation of individual annuities issued during the same calendar year as the charitable gift annuity; and

(c) An interest rate 100 basis points less than the maximum interest rate permitted under [insert citation to the state standard valuation law] to be used in determining the minimum standard for the valuation of individual annuities issued during the same calendar year as the charitable gift annuity.

(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. For this purpose, any annuity contract purchased from an authorized insurer or reinsurer by the charitable organization is considered to be "annuity risk reinsured."

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 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 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 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 10. Other Applicable Code Provisions

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 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.

ATTACHMENT THREE

Life Disclosure Working Group
Seattle, Washington
December 6 and 8, 1997

The Life Disclosure Working Group of the Life Insurance (A) Committee met in the Washington State Convention and Trade Center in Seattle, Wash., on Dec. 6 and 8, 1997. Tom Foley (N.D.) chaired the meeting. The following working group members or their representatives were present: John Hartnedy (Ark.); Sheldon Summers (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Paul DeAngelo (N.J.); Jerry Fickes (N.M.); Tom Jacks (N.C.); Ted Becker (Texas); and Troy Pritchett (Utah).

1. Review Draft of Annuity Disclosure and Sales Illustrations Regulation (Attachment Three-A)

Section 1. Purpose

Tom Foley (N.D.) asked if there were any comments or suggestions for changes to Section 1. Charlotte Liptak (TransAmerica) said the life insurance illustrations regulation contains a concept requiring simple clear language that is understandable "as far as possible." She asked if this language could be added to the annuity regulation also. Paul DeAngelo (N.J.) said he believes that concept is understood in the language included. He said New Jersey regulation reviewers would not approve inclusion of that language because it is vague, and he would prefer not to see it in the model regulation. The working group members decided to leave Section 1 as it current exists.

Section 3. Applicability and Scope

Mr. Foley said Subsections A and D have been set for some time and there has been considerable discussion about Subsections B and C. He noted that Subsection C was restructured by staff to break down the elements of the section. Peg VanDrisse (American Express Financial) said she did not oppose the language as drafted, but thought it needed clarification. She said that Paragraph (2) needs to refer to all of Paragraph (1) rather than just Subparagraph (d). Technical resource advisors suggested a number of clarifications. Bill Fisher (MassMutual) recommended changing the second line to clarify that, while the contributions may be thought of as the employee's, technically the law says the contributions are the employer's. He said that language in the Replacement Issues Working Group draft refers to insurance producers so similar changes are recommended here, and language should be added to clarify the difference between education and solicitation. Mr. Foley asked if there were interested parties with remaining concerns about the exemption section. Mr. Fisher responded that many in the industry would prefer not to include Subsection C(2) at all, which is really an exception to an exemption. He also emphasized that the plan provisions control and it is important not to focus too much on the contract. He also reminded the regulators that if the insurance business is burdened with too many disclosure requirements, it will be placed at a competitive disadvantage to other pension investment opportunities. Mr. Foley asked the members of the working group to particularly review Subsection C(2) before the next meeting to determine if it is necessary to include it.

Tom Strohmer (Aetna) also expressed concerns about Paragraph (2). He explained that the client approves its materials to be distributed and now the insurer must also provide disclosure documents required by this regulation. He noted that the contract is negotiated with the employer and further negotiations cannot take place with the individual. He asked the working group to carefully consider whether this provision is needed. Linda Lanam (Life of Virginia) explained that Paragraph (2) was

added because some plans are individually negotiated with the consumer. It is very difficult to balance the needs of a plan where there is negotiation with the individual employee and the needs of the plan negotiated with a sophisticated employer.

Roger Strauss (Iowa) asked why Paragraph (1)(d) was included. He noted that the other examples in Paragraph (1) are tax qualified or similar plans but Subparagraph (d) does not seem to fit. Mr. Fisher said this exemption is written for "top hat" plans designed to supplement other plans for the highly compensated. He said these generally do not need the protection of the model.

Jerry Fickes (N.M.) suggested adding another exemption to Section 3 to cover charitable gift annuities. The working group agreed to add a new Subsection E for that purpose.

Section 4. Definitions

Mr. Fickes noted an inconsistency because equity-indexed annuities are specifically defined, but interest indexed annuities are not. He suggested simply defining an index rather than trying to define the product. Mr. DeAngelo suggested defining equity-indexed annuities and interest-indexed annuities. Donna Claire (Claire Thinking) suggested that the definition of equity-indexed annuities in the American Academy of Actuaries (AAA) report is superior to that currently included in the draft. Mr. Foley directed that this be added for consideration.

Barbara Lautzenheiser (Lautzenheiser & Associates) said that the AAA will look at disciplined current scale and the self-support and lapse-support tests and make a recommendation to the working group. Mr. Foley said these definitions are included as placeholders to remind the working group to have a full discussion after the AAA makes recommendations to the working group.

Ms. Lanam noted that the draft contains the concept of a contract premium but does not include a definition. She said she did not believe there are annuities that require payment of a contract premium to keep them in force. Linda Klebold (N.J.) said she had received submissions in New Jersey with these provisions. Mr. Foley suggested that a definition of a contract premium should be added to the regulation.

Mr. DeAngelo said the definition of non-guaranteed elements was difficult to follow, particularly when considered in light of equity-indexed annuities. He said he did not believe consumers would understand how the guarantees work or understand that some elements are guaranteed even if the exact amount is not. Mr. Foley suggested that it was important to differentiate this and suggested perhaps a three-part definition is needed: the amounts that are truly guaranteed, the portions where there are no guarantees, and the portions where the result is not guaranteed but the procedure for determining the amount is fixed as far as the insurance company is concerned. He said that is significantly different from a situation where the company can change the participation rate or other elements. He asked the members of the working group to give this concept further consideration. Mr. DeAngelo responded that he was not sure policyholders needed all this information. They need to know that results will vary, but extensive disclosures are not always the answer. He said clear disclosure is important and when all of these variables are explained, the explanation is more complicated. Mr. Strauss agreed that too extensive a disclosure is not useful, because the individual would not understand it.

Section 5. Standards for Disclosure

Mr. Foley suggested revisions in the wording for Subsection B(3)(b), (c) and (d). Mr. DeAngelo said an important concept in Subparagraph (b) was to differentiate what happens after the first year. He said he did not see that in Mr. Foley's suggestion for revised wording. Mr. Foley agreed that it was not included. Mr. DeAngelo said this goes to the issue of "sustainable rate." He said it lets the purchaser know whether he can expect to continue the rate received during the first year. Mr. DeAngelo opined that this was the most important information a purchaser could receive. Mr. Foley cautioned that regulators must be careful not to lock in companies to certain rates because it will likely result in lesser values for the consumer. He suggested the buyer's guide disclosure questions could say something like "ask the company about its initial and renewal rate for the last five years." Mr. DeAngelo responded that telling the purchaser what the renewal rate has recently been tells a purchaser what he needs to know without locking in the company. Mr. Foley suggested adding a new Subsection C that would require disclosure of the renewal rate for the past five years.

Ms. Lautzenheiser noted that Paragraph (3) asks for a *description* of the items in Subparagraphs (a) to (i); if it actually includes a number, that would force a full illustration.

Ms. Klebold described some recent contract filings she received in New Jersey and said that she did not know how this regulation would apply. She suggested that equity-indexed products need their own illustration requirements.

John Hartnedy (Ark.) asked if the disclosure is due at or prior to taking the application. He said his agents had questioned how full disclosure could be given earlier than at the time of delivery. Mr. Foley said he envisioned a preprinted disclosure document that would be available at the beginning of the sales process. He said if an illustration was required, there would be some need to discuss the timing of delivery.

Ms. Lanam said the requirements for appropriate sections of the buyer's guide included in Subsection D contain the potential for this document to be extremely long. Mr. Foley responded that the guide would end up to be a large number of paragraphs, but it is designed to describe a large variety of annuity types, and the company would only pick the paragraphs that describe its products. The questions and the answers would be limited to issues related to that company's product. He said he did not believe the document would be very long.

Ms. Lanam asked if Subsection E really belongs here, because the concept of balancing language is not clear. Mr. DeAngelo agreed, and suggested deleting the term "balancing language." He said it is sufficient just to require a description of the negatives and positives of the product features.

Section 6. Contracts to be Illustrated

Mr. Foley said Subsection A includes a requirement for illustrations where non-guaranteed numbers are included in the disclosure materials, for two-tier annuities, and for equity-indexed annuities. Tony Higgins (Life Insurance Fiasco Evasion, Inc.) asked the working group to consider incorporating in Paragraph (2) the model disclosure requirements for two tier annuities. He said they had been developed a number of years ago by the NAIC and were very good.

Mr. Fickes said he would like to see a requirement for illustrations for seniors. He said this would be beneficial because it would describe what the senior citizen could expect to receive. He said one of the big complaints in the New Mexico Department is that there is not enough information for seniors. The working group decided to defer discussion of this issue to the Annuities Working Group meeting, which is discussing issues related to senior citizens. Ms. Lanam reminded the working group that many companies do not have the ability to illustrate and asked that the requirement to illustrate be as limited as possible. Ms. Lautzenheiser added that the AAA report does not recommend a requirement to produce an illustration. Ms. Liptak said that, after the Fall National Meeting, her understanding had been that a disclosure document and hypotheticals would be required for equity-indexed products. She said preparing a basic illustration seems inconsistent. Ted Becker (Texas) suggested tightening up the language so that a company could not assert that its document was not really an illustration so the company could do whatever it wanted. David Sky (N.H.) said if the company exercised its option not to illustrate, it could not show any non-guaranteed performance beyond year one.

Roger Wiard-Bauer (Life USA) said that last year technical resource advisers offered sample disclosures to the working group, and he would appreciate feedback on the level of disclosure provided in those documents. He provided another copy of the same disclosures to the members of the working group. Cindy Martin (Mass.) suggested flagging Section 6 as language to revisit when the discussion on lapse-support and self-support had taken place.

Section 7. General Rules and Prohibitions

Mr. Foley noted the language in Subsection A about lapse-supported and self-supported illustrations and said this will be discussed more extensively after the report from the AAA has been received.

Section 8. Standards for Basic Illustrations

There were no comments on Subsection A on format, which is similar to that required for the Life Insurance Illustrations Model Regulation. Mr. Foley drew the attention of the audience to the fact that the Life Insurance Illustrations Model Regulation is followed by a narrative summary, which is not included in this document because of the earlier requirement for disclosure. Mr. Foley asked if the numeric summary for contract years 5, 10, 20 and at age 65 was appropriate in this context. Chris Kite (FIPSCO) said it was important to see the difference between illustrating an annuity or a life insurance policy. He opined that it could be misleading to show accumulations past the date the insured plans to annuitize or surrender the contract. Mr. Foley said he would like to have Paragraph (1) say something like "show values at four representative ages for this contract," but feared that allowed too much discretion. The working group decided to replace "at age 65" with "at the annuitization age." Mr. Sky said he saw a problem with that because an individual might suggest different annuitization ages to different companies, thereby making comparing illustrations more difficult.

Ms. Liptak asked the meaning of two terms in Subsection A(3): "payment receipt" and "benefit payout." Mr. Foley asked her to consider if there were more descriptive words to include in that section instead.

Mr. Foley asked if the numeric summary should include a midpoint scale, or whether that was less necessary than in life insurance illustrations. Larry Gorski (Ill.) opined that a midpoint scale illustration is very important. He cautioned that there may be more than one feature driving the non-guaranteed benefits, and said the scale could be much different than the midpoint of the current and the guaranteed number. Mr. Kite suggested that, because annuity illustrations are much shorter, the midpoint illustration is much less important. He said the typical illustration might have 4% guaranteed interest and 6% current interest. There was very little space between for the impact of a midpoint illustration. Ms. VanDrissie agreed with the comment made by Mr. Kite. She said the less numbers that were required, the better. She said her company likes to provide three or four settlement options in the illustration. Showing three bases for options made the illustration more overwhelming.

Discussion next turned to Subsection B on tabular detail. Mr. Foley asked if a new Paragraph (1)(c) is needed to provide an illustration with annuitization. Ms. Lanam requested that, however the tabular detail was structured, the working group be careful not to imply that an individual would get both the surrender value and the annuitization value.

Mr. Foley asked technical research advisors to provide samples to the working group of how a numeric summary and tabular detail would look for various types of annuities.

Section 10. Delivery of Illustration and Record Retention

Mr. Foley noted that most of the language in Section 10 and in Section 11 comes from the Life Insurance Illustrations Model Regulation. Ms. Lanam suggested that for various types of products and marketing methods, interested parties would want to look at how Sections 10 and 11 would impact on their delivery system.

Section 11. Annual Report: Noticed Contract Owners

Troy Pritchett (Utah) asked if the requirement for annual reports would continue when the annuitant was in payment status, or whether this requirement would just apply to the accumulation status. Mr. Foley said revisions may be necessary to make it very clear that the annual report would still be required when the contract is in payment status.

Ms. Lanam suggested that it would be helpful for technical resource advisors to go through each section to see if anything different needs to be done for an immediate annuity. She said the focus so far has been on the accumulation phase.

2. Related Issues

Ms. Lautzenheiser and Steve Preston (Golden American Life) reported on the AAA Committee considering issues related to lapse support and self support. Ms. Lautzenheiser said the AAA Committee was just beginning the evaluation process but would give the working group a progress report at its interim meeting in February.

Jack Gies (Conn.) said he thought there was an issue for persistency bonuses as to whether the funds will be there when the insurer wants to pay. He suggested insurers could put a liability on the balance sheet to ensure that long-deferred persistency bonuses are available if the company decides to pay them. Ms. Martin suggested it makes sense to have a supportability test. Mr. Foley asked if there were any reason for the working group not to pursue the concept of supportability tests. There was no response from the working group members, so Mr. Foley asked Ms. Lautzenheiser and Mr. Preston to proceed with the assumption that the working group would require these tests. Mr. Preston said the AAA would probably recommend some type of combination approach. He said the more disclosures that are provided, the less testing that is needed. He said there was a practical problem with applying asset/liability testing.

Mr. Foley asked the working group to consider how equity-indexed annuities fit into the descriptions and disclosure materials. He said they were significantly different than other types of annuities. Mr. Becker asked if any thought had been given to how an annual report might look for an equity-indexed annuity, particularly for a point-to-point product. Ms. Lautzenheiser responded that the AAA report provided to the Life and Health (Technical) Task Force includes recommendations on that issue.

Mr. Foley described the North Dakota approach for a guarantees-only illustration. Mr. DeAngelo asked whether a document showing only guarantees was an illustration. He agreed that an equity-indexed product should demonstrate in simple terms what is guaranteed. Mr. Foley said the working group needs to give this further consideration to be sure it is justified in requiring an illustration for an equity-indexed product. Mr. Gies suggested that a page that showed only guarantees creates a danger that the guarantees may be far distant from the page with the non-guaranteed demonstration. Mr. Foley noted that North Dakota also required a hypothetical illustration for equity-indexed products because it is a good way to demonstrate how the contract works. He said that the hypothetical illustrations received so far with North Dakota filings had not been adequate. Ms. Liptak said that she believes the guarantees-only page is misleading because it can be taken out of context. She suggested that if regulators want to get across the concept that the contractholder should hold on to his investment, it could be done more easily in narrative fashion.

Mr. Strauss asked about the plans for the buyer's guide. He said technical resource advisors had prepared an equity-indexed products buyer's guide, Lester Dunlap (La.) had prepared a fixed annuities buyer's guide and Mr. Foley described a modular buyer's guide. He asked if the working group would prepare one buyer's guide or three. Mr. Foley responded that the ultimate result will be one buyer's guide with many pieces and suggested further discussion on this issue at an interim meeting.

Mr. Fickes asked when the working group would discuss advertising of annuities. Mr. Foley said his department has the ability to ask for advertising materials, and asked if this needs to be included in the illustrations regulation. Mr. Fickes responded that perhaps there should be a separate advertising model for annuities. Ms. Lanam responded that it is important to review the existing NAIC model on advertising requirements for life insurance and annuities. She expressed the hope that the working group would receive a charge to review that model. She encouraged the working group to review advertising outside of the sales illustration context.

3. Consider Issues Related to the Life Insurance Illustrations Model Regulation

Mark Peavy (NAIC/SSO) reported that the 1998 Generally Recognized Expense Table (GRET) was adopted by the Executive Committee in November and Plenary adopted it on Dec. 8, 1997. To give companies more time to comply with its provisions, the working group decided to have it take effect April 1, 1998. Many actuaries are questioning the impact of that delayed effective date. If a company picked Jan. 1 as its certification date, what would its responsibility be on April 1, 1998? Mr. Peavy suggested there is potential for an uneven playing field if the actuary did not have to do anything. Ms. Claire said the reason the working group adopted an April 1 deadline was to allow companies time to comply. She suggested this will be a problem every year. To force companies to redo their certification on April 1 will be quite an expense for small companies. Mr. Foley responded that the practical reality is that the numbers have been in circulation since mid-1997, so companies have had them available to use. He suggested that the practical answer to this question will vary from state to state. Ms. Claire said this is a major issue for companies because approximately one-third of them use the GRET. She said companies would like to know the official position. Mr. Foley suggested that it would be prudent to use the 1998 GRET for all certifications that use the GRET.

Mr. Foley said he requested that the AAA review development of the Life Insurance Illustrations Model Regulation and see if companies had experienced any problems. Ms. Claire shared with the members of the working group a survey that the AAA intends to send to 2,000 companies for response. Mr. DeAngelo said he thinks it is an excellent idea to get feedback to judge the effectiveness of the working group's effort. He said allowing for comments will produce some particularly useful information.

Mr. Foley asked if the results of this survey will be available to the working group in March, and Ms. Claire agreed to present the results at that time. She said the questionnaire would be sent to the chief actuary of each company.

4. Review 1998 Charges and Discuss Charges for 1999

The working group discussed the draft of charges that was adopted for 1998 and discussed additions and revisions to those charges. Mr. Foley suggested that it might make sense to request that the group be designated a task force to emphasize its long-term nature since the charges will take some time to complete.

George Coleman (Prudential) encouraged the working group particularly to move along with the charge regarding variable life insurance and variable annuities. He said New York is compelled by statute to have its regulations in place by the end of 1998, and he hoped there would be a model by that time for them to consider. Mr. Foley said he would contact the Securities and Exchange Commission (SEC) to see how its regulations regarding variable products were developing. He suggested the working group might need to press forward without seeing what the SEC was considering.

5. Any Other Matters Brought Before the Working Group

Mr. Foley suggested that the working group hold an interim meeting in mid-February to review a revised draft of the model regulation and consider how best to develop the buyer's guides/disclosures. He asked staff to explore the possibility of meeting in Dallas or in New Orleans to reduce weather associated problems.

Having no further business, the Life Disclosure Working Group adjourned.

ATTACHMENT THREE-A

Annuity Disclosure and Sales Illustrations Model Regulation Draft: 12/8/97

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Appendix A.	Buyer's Guide

Section 1. Purpose

The purpose of this regulation is to provide 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 products;
- B. Immediate and deferred annuities that contain no nonguaranteed elements if the contract describing the benefits is provided at time of application or if it is provided at time of delivery and a thirty-day free-look is provided;
- C. (1) Annuities used to fund:
 - (a) An employee pension plan which is covered by the Employee Retirement Income Security Act (ERISA);
 - (b) A plan described by Sections 401(a), 401(k), 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer,
 - (c) A governmental or church plan defined in Section 414 or a deferred compensation plan of a state or local government or tax exempt organization under Section 457 of the Internal Revenue Code; or
 - (d) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor.
- (2) Notwithstanding Paragraph (1)(d), the regulation shall apply to annuities used to fund a plan or arrangement that is funded solely by employee contributions an employee elects to make whether on a pre-tax or after-tax basis, and where the insurance company has been notified that plan participants may choose from among two (2) or more fixed annuity providers and there is a direct solicitation of an individual employee by an insurance agent-a producer for the purchase of an annuity contract. As used in this subsection, direct solicitation shall not include any meeting held by an insurance agent-a producer solely for the purpose of educating or enrolling employees in the plan or arrangement; and

~~D. Structured settlement annuities; and~~

E. Charitable gift 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 premium" means the gross premium that is required to be paid under a fixed premium contract, including the premium for a rider for which benefits are shown in the illustration.
- ~~BC. "Contract owner" means the owner named in the annuity contract or certificate holder in the case of a group annuity contract.~~
- ~~CD. "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.~~
- ~~DE. "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 company fully allocated expenses.
- EF. "Equity-indexed annuity" means an annuity with a minimum guarantee and potential excess interest credited on the basis of the increase in a specified equity index, such as the Standard and Poor's 500, a deferred annuity that ties all or a portion of the benefits payable to the performance of an external index.
- ~~FG. "Generic name" means a short title descriptive of the annuity contract being applied for or illustrated such as "single premium deferred annuity."~~
- ~~GH. "Guaranteed elements" means the benefits, values, credits and charges under an annuity contract that are guaranteed and determined at issue.~~

HJ. "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.

IJ. "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.

JK. "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.

KL. "Interest indexed annuity" means an annuity where the interest credits are linked to an external reference.

KM. "Lapse-supported illustration" means an illustration of a policy form failing the test of self-supporting as defined in this regulation, under a modified persistency rate assumption using persistency rates underlying the disciplined current scale for the first five (5) years and 100% policy persistency thereafter.

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

MQ. "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.

NP. "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 eighth 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. Standards for Disclosure

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 that meets the requirements of Subsection B of this section.

B. At a minimum, the following information shall be ~~contained-described~~ in the disclosure document required to be provided under this regulation:

- (1) The generic name of the contract, the company product name, if different, and form number.
- (2) The insurer's name and address;
- (3) A description of the contract and its benefits, identifying it as an annuity, emphasizing its long-term nature and describing:
 - (a) The guaranteed and non-guaranteed elements of the contract, and their limitations, if any, and an explanation of how they operate;
 - (b) ~~If a first specific rate is mentioned a statement of recent data history is required~~ All the components of the first year crediting rate;
 - (c) ~~The availability of periodic income (annuitization)~~ Income options both on a guaranteed and non-guaranteed basis;
 - (d) ~~The surrender charges if applicable, specifically their duration and how they are applied~~ Any value reductions caused by withdrawals from or surrender of the contract;
 - (e) Any other fees and charges, their limits and how they are applied;

- (f) How values in the contract can be accessed;
- (g) The death benefit, if available;
- (h) A summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract;
- (i) Impact of any rider, such as a long-term care rider.

C. The disclosure shall include information about the guaranteed rate for new policies and the renewal rate for those same policies for the past five (5) years.

~~CD.~~ The disclosure shall be accomplished by use of appropriate sections of the buyer's guide included as Appendix A. Standard paragraphs describing all aspects of annuity contracts and the sections needed to describe the product being offered shall be followed by questions and answers describing the policy form being offered.

~~DE.~~ Marketing material that contains language describing the non-guaranteed elements shall include ~~balancing language to ensure that both the negatives and positives of product features are described.~~

Section 6. Contracts to be Illustrated

A. An insurer is required to provide a basic illustration that meets the requirements of this regulation to the applicant for an annuity contract in each of the following situations:

- (1) Any non-guaranteed element is ~~included~~ demonstrated in the disclosure materials provided to the applicant;
- (2) For any policy year beyond the tenth, the amount available to the contract owner is different if the contract is surrendered for value ~~then than~~ if it is exchanged for periodic income payments; or
- (3) The annuity contract ~~or rider~~ being offered is an equity-indexed annuity.

B. If the annuity contract is being offered together with a policy or rider that provides separate life insurance protection, the rules contained in [insert state law or regulation equivalent to Life Insurance Illustrations Model Regulation] shall apply.

C. An illustration is optional for all other annuity sales presentations.

Section 7. General Rules and Prohibitions

A. When using an illustration as described in Section 8 of this regulation 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."

B. 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 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 annuitant 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. 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 the annuitization age~~, 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, the insurer guaranteed annuity purchase rates and the guaranteed contract value using the contract guaranteed contract elements; secondly, factors midway between the current purchase rate and the illustrated scale for contract value and the guarantee annuity purchase rates and guarantee contract values; and thirdly, the amount of monthly annuity income on a life annuity with ten-year certain payments using the insurer's current single premium annuity purchase rate and the contract value using the insurer's illustrated scale, ~~and thirdly, factors midway between the current purchase rate and the illustrated scale for contract value and the guarantee annuity purchase rates and guarantee contract values.~~

C. 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~~ producer has told me they are not guaranteed."

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

D. Tabular Detail.

(1) A basic illustration shall include the following for at least each contract year from one (1) to ten (10) and for every fifth contract year thereafter ending at the later of age eighty-five (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 ten-year certain for annuitization ages sixty-five (65) and seventy (70), or if later, for the annuitization age in the tenth and fifteenth contract year, but, in no event later than age ninety (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. 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 10. Delivery of Illustration and Record Retention

A. (1) If a basic illustration is used by a 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 state that the disclosures provided information only about guarantees and shall be submitted to the insurer at the time of contract application.

C. If a 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 11. 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 or charged 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/producer. 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 will 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 7 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 12. 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 Annuity Disclosure and Sales Illustrations Model Regulation 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

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 that the illustration formats meet the requirements of this regulation and that the scales used in insurer-authorized illustrations are those scales certified by the illustration actuary.

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

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

Section 13. 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 14. 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 15. Effective Date

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

ATTACHMENT FOUR

Replacement Issues Working Group
Seattle, Washington
December 6 and 7, 1997

The Replacement Issues Working Group of the Life Insurance (A) Committee met in the Washington State Convention and Trade Center in Seattle, Wash., on Dec. 6 and 7, 1997. Paul DeAngelo (N.J.) chaired the meeting. The following working group members were present: Erin Klug (Ariz.); Richard Rogers (Ill.); Rosanne Mead (Iowa); Lester Dunlap (La.); Cindy Martin (Mass.); Robert Commodore (Minn.); Steve Stark (Mo.); Barbara Morales Burke (N.C.); Phil Bisesi (Ohio); Joel Ario (Ore.); Ted Becker (Texas); and Tom Van Cooper (Vt.).

1. Discuss Comments on Draft of Life Insurance and Annuities Replacement Model Regulation

Paul DeAngelo (N.J.) suggested that the working group go through the draft (Attachment Four-A) section by section, particularly noting the comments on the drafts received from Marybeth Stevens (American Council of Life Insurance—ACLI), Ron Panneton (National Association of Life Underwriters—NALU), and Wanda Smith (Primerica Life).

Section 1. Purpose

Mr. DeAngelo noted that the draft discusses financed purchase transactions and suggested changing the reference to financed sale transactions in Subsection B. The working group agreed with that suggestion.

Section 2. Definitions

The working group reviewed a suggestion from the ACLI for a new definition of “direct response solicitation” to replace the drafted “direct response sales” definition. Tom Van Cooper (Vt.) said he was concerned that the ACLI definition was too broad because it referred to a solicitation individually through the mails. He said such a broad definition would reduce the utility of the model regulation. Mr. DeAngelo suggested adding the word “solely” so that the phrase reads “solicitation through a sponsoring or endorsing entity and individually solely through mails...”

Discussion next turned to the definition of financed purchase (Subsection D). Ms. Stevens said that the phrase “and is known by the company” is ambiguous and troublesome to insurers because of the potential penalty and suggested “and is reported to the company” instead. Mr. DeAngelo noted that, with the ACLI change, if the insurer knew that money had been taken from the policy, but not through a report, it would have no obligation. He said a funded purchase is still a funded purchase even if it is not reported, and asked if the whole phrase should be taken out of the subsection. Cindy Martin (Mass.) asked if an external replacement will be part of the insurer’s record and Mr. DeAngelo responded that it would be only if it was reported. He said that if an internal replacement takes place, the company should be aware of it if the company has proper record keeping mechanisms in place. Mr. Van Cooper suggested deleting the entire phrase with the understanding that its effect throughout the entire model would be reviewed. Maureen Adolph (Prudential) suggested deleting the entire second half of the financed purchase definition and inserting the 13-month phrase in the first sentence. Mr. Van Cooper said this is a significant change to the definition, and narrows it substantially. The working group decided to postpone a decision among the three alternatives that had been suggested.

The working group next looked at the definition of a producer that was suggested by the ACLI. The ACLI’s suggestion was to add “who represents the existing or replacing insurer” at the end of the definition. Ms. Martin asked if this would eliminate a producer who had left his company. The working group decided not to add that definition to the model. Ms. Smith suggested adding to the definition of sales materials that it included any other *written or printed* information to make clear that speech is not included. The working group agreed to that suggestion.

Section 3. Exemptions

The ACLI requested that the working group delete from Subsection A(2) the phrase that had been added after the last drafting session to exempt group life insurance or group annuities only where there is no direct solicitation of individuals by an insurance producer. She said the phrase is vague and it is difficult to decide what is direct solicitation. She said she received many calls on this issue from ACLI members. Ms. Stevens said if direct response writers have to comply with this regulation, they will go out of business. Mr. DeAngelo asked for a suggestion on how to resolve his concern that this exemption would be used for a group policy marketed as an individual policy. Ms. Stevens responded that this was a difficult issue and she could provide no answer. Scott Cipinko (National Alliance of Life Companies—NALC) said the answer to this question is somewhere between these two extremes. He suggested that this regulation is not an appropriate vehicle to address the issue. Mr. Van Cooper said the rationale for exempting groups is that they do not need this protection because the group is there to protect the purchaser. He said he was not sure that was true in this case and asked Ms. Stevens if the suggestion from the ACLI could be narrowed. Ms. Stevens responded that it could not. Mr. Panneton said that the exemption had originally been included in the model because the sophisticated purchaser would protect its members. He supported the language in the model draft because of the protection that it provides. He said one of the purposes of this regulation is to give consumers some decent information, rather than waiting for problems to develop. Mr. DeAngelo said he did not see a problem with carving out direct solicitation but he was concerned about a broad exemption for group policies. He suggested adding language similar to that in Paragraph (5)(b) that direct solicitation should not include any meeting held by the insurance producers solely for the purpose of educating or enrolling individuals.

The ACLI suggested adding a new Paragraph (6) under Subsection A to provide an exemption for corporate owned life insurance. The working group agreed to add that new language.

Section 4. Duties of Producers

The working group reviewed suggestions from the ACLI to eliminate the requirement to read the notice to the applicant, and a suggestion from Primerica to waive the reading. Mr. DeAngelo said there have been notices required for many years but they do not seem to be very effective. He suggested reading the notice would make it more effective. Mr. Van Cooper said it was not helpful if the agent read the notice very quickly and suggested it was a good idea to have the opportunity to waive the reading if the individual did not wish the notice read. Richard Rogers (Ill.) said this was a very difficult requirement to enforce. Robert Commodore (Minn.) agreed that it was unwise to pass laws that regulators have no way to enforce. He asked what was

accomplished by such an action. Mr. Van Cooper said a lot of consumers may not want to hear the notice read to them, but they should have that opportunity. The working group agreed to include the waiver language from the Primerica draft.

The ACLI suggested that Section 4C be changed to limit the list to the contracts being replaced. Ms. Stevens said there was no benefit listing all policies owned by the applicant if they will not be used as financing for replacement. She reminded the working group that the application already requires that all existing policies be listed. Mr. Van Cooper said this suggestion made sense to him because the notice currently focuses on replacement. The working group decided to accept the suggestion from the ACLI for revisions to Subsection C but noted that the language was awkward and suggested that it could be reworded.

Mr. DeAngelo asked the working group to turn its attention to Section 4E, which is one of the major issues to resolve. He said the regulation proposed that every document required by this subsection, as well as any other written or printed sales materials used in the presentation, be submitted to the insurer. Mr. DeAngelo suggested a compromise position whereby the agent could identify on the application what materials were used. The number of the company materials could be noted as well as a brief description of other documents used. He said this would eliminate the problem of storing all these documents. Ms. Stevens said that ACLI companies that are being replaced have not indicated a desire to see the sales materials used. Bill Fisher (MassMutual) suggested that, if the notes are made on the application, it may lead to the conclusion that the sales materials are part of the application, and he would not like to see that result. Ms. Martin said the regulators would be interested in determining that illustrations are in compliance with the law, so she would want to see all the illustrations used. George Coleman (Prudential) noted that the sales illustration regulation does require that the company maintain a copy of the signed illustration so that concern has already been addressed. Mr. Cipinko said this material belongs to the insured and it is inappropriate to send to someone else. Mr. Van Cooper said he was comfortable that documents that were identifiable and had not been altered did not need to be sent to the insurer but that customized information should be. Roseanne Mead (Iowa) said she was comfortable with making notes of a list of documents used. The working group reviewed the language submitted by Primerica that asked the producer to submit a copy of each document that was not prepared or approved by the insurer. It was therefore decided that the producer would be required to identify any company approved material and to submit copies of any individualized sales material used.

Section 5. Duty of All Insurers that Use Producers

The ACLI suggested that Subsection A(5) and Subsection B be deleted. These sections ask the company to maintain procedures to effectively detect transactions that are replacements that have not been identified as such by the applicants or producer. Mr. Van Cooper said that it had never occurred to him that this information would be hard to gather and he thought it was essential to the company to have information about the policies that are replacements. He said it is also important for the states to have this information available so that they can discharge their duties. Ms. Stevens said that companies do not want to keep or accumulate this information because it can be misused in anticipation of class action lawsuits. The working group agreed to delete the word *effectively* because of the difficulty of measuring what that word means, but declined to eliminate the whole paragraph. Mr. DeAngelo said he knew that companies had this information. Ms. Adolph said that companies do keep records but not in just this manner. She asked if there could be a generic requirement for keeping records rather than specific language. Mr. DeAngelo asked Ms. Adolph to draft some language that could be included in the next draft of the regulation.

Ms. Martin said to the extent the person has numerous policies, a list of them would help point out the suitability issue of whether the individual needs this new policy. She asked the working group to keep this issue in mind for next year.

The ACLI suggested revisions to the language of Subsection C to delete the requirement for a complete list of policies and to replace that with a signed statement as to whether the applicant has existing policies. The ACLI suggested that Subsection E be revised to preface the requirement with "when the applicant has existing policies or contracts..." The ACLI also suggested the deletion of Subsection F, which requires a separate statement with each application as to whether replacement of a policy or contract is involved. Mr. DeAngelo said this information is on the application and on the notice. Originally, these documents did not require identification of replacement policies so Subsection F is no longer necessary. The working group agreed to delete that provision from the draft.

The ACLI suggested that Subsection H be changed to eliminate the requirement to examine every proposal used in the replacement including sales materials and illustrations. Ms. Stevens said that the companies should not be required to look at the sales materials it has already reviewed and prepared. The working group decided to change the language to require the insurer to ascertain that the sales materials and illustrations used in the replacement meet the requirements of this regulation.

Primerica suggested that Subsection I be revised to eliminate the requirement that the producer fulfill any outstanding requirements. Ms. Smith said that it does not matter who fulfills the requirements, whether the insurer or producer. The working group agreed to this suggestion.

Section 6. Duties of Replacing Insurers that Use Producers

The ACLI suggested changing Subsection D so that, rather than furnishing a copy of sales material, the company offer a policy illustration or policy summary. Mr. Van Cooper asked how much trouble it would be for the company to send copies of materials. Mr. Panneton said that the consumer often loses the sales material and would not have it available. Mr. DeAngelo responded that a conservation effort would be made rather quickly, if at all, so the consumer should still have the materials at that point. He said he would be willing to eliminate this requirement to reduce the burden on the insurer. He said if there were many requests it would be more of an issue. Mr. Panneton suggested that the notice include a suggestion to the consumer that he or she should keep all of the sales material for a period of time. Mr. DeAngelo responded that this was a good idea and would

also alleviate concerns about the materials containing confidential information that the consumer would not want to send away to someone else.

The discussion turned to the appropriate length of the free-look period provided in Subsection D. Mr. DeAngelo suggested that the number be left blank with the addition of a drafting note recommending 30 to 60 days. The note should also comment that the longer period of time could create a problem with registered products. Ms. Stevens said it is rare that anyone would exercise the free-look after the first few days, so there is really no need for a 60-day free look. Donna Claire (Claire Thinking) said the AAA supports the suggestion of the ACLI. There are actuarial implications to a longer free look. If the company has invested the funds and then after 60 days the individual wants them back, it could be costly to the insurer. Joel Ario (Ore.) noted that few people exercise the right to return the policy during the free-look period, so there will be little impact on the insurer. Mr. Cipinko said the regulators cannot really address the probabilities, because no one currently has a 60-day free look period. Mr. Van Cooper said that he has never received a complaint that an individual did not have a long enough free look. Mr. Commodore moved and Mr. Van Cooper seconded a motion to fix the free-look period at 30 days. The motion passed.

The ACLI suggested the elimination of Subsection E regarding the contestability and suicide clause. Lester Dunlap (La.) asked for insurance underwriters to explain why they were concerned about these provisions. John Hurley (Equitable) offered to have his company's vice president of underwriting write a detailed explanation of the reason this is not acceptable. Mr. Dunlap said he was in favor of including these provisions, but was willing to listen to the opposing view point. Bill Geiger (Aegon) said waiver of the incontestability period could allow a savvy consumer to make a material representation and get away with it. Mr. DeAngelo responded that he did not really understand that comment. He said the company could always contest on the basis of fraud. Interested parties responded that this varied by state. They said it was also difficult to prove after the individual had died. Mr. Ario said he did not understand why anyone would be inclined to do so. The person would not get anything more than he already had in the previous policy. Mr. DeAngelo pointed out that he would, in addition, pay a higher premium because of a higher issue age. Mr. DeAngelo noted that Kentucky already requires this and asked the interested parties if they had experienced gaming and fraud within the state of Kentucky. Barbara Lautzenheiser (Lautzenheiser & Associates) pointed out that there is a significant increase in risk to the insurer because cash value has not built up during the early years of a new policy. Mr. DeAngelo responded that he just could not figure out why an individual would go out and replace his life insurance policy and then commit suicide. Mr. Van Cooper suggested that the working group postpone a decision on this until it had received comments from the industry on this issue. Mr. Dunlap added that statistics providing support for interested parties' arguments would be helpful. Mr. Ario added that he would also like to see arguments as to how consumers could gain from gaming the system.

Discussion next turned to Subsection F, which the ACLI also recommends deleting. Mr. DeAngelo said the requirement to offer a full refund of premiums without term charges plus interest is already New Jersey law. Mr. DeAngelo did agree that the section is inappropriately placed. Ms. Stevens said this section contains no materiality standard. Minor mistakes could be used to penalize the insurer. She agreed to submit language that would address her concerns. Ms. Mead suggested that Subsection F be moved into the penalty section of the model.

Section 7. Duties of Existing Insurer

The working group decided to change Subsection B so that it said that information regarding the existing policy or contract values including, *if available*, an in force illustration rather than *where appropriate*. The ACLI suggested deleting all of Subsection C that required a separate notice upon the request to borrow, surrender or withdraw any policy values. Ms. Stevens said this should apply across the board and did not belong in a replacement situation only. Mr. DeAngelo's response was that it is vital here and should be in this regulation until regulators have the opportunity to put it elsewhere. Mr. DeAngelo explained that the notice form prepared by Ms. Martin was not intended to be a part of the draft but was simply circulated with the draft. Ms. Martin spoke about the document she drafted, saying she realized it went beyond the requirement for the existing insurer to provide information and tried to look at the impact on the new policy as well. She agreed to meet with interested parties and discuss how her concerns might be addressed. Ms. Mead suggested that, if regulators were interested in developing something as detailed as Ms. Martin had drafted, it should be in a regulation of its own. If the working group endorsed Mr. DeAngelo's idea of simply requiring a notice, it could be a part of this regulation. Mr. DeAngelo said he had not envisioned a form for the notice but if the working group has time, it could prepare a form. Ms. Stevens said if a notice is required, her association would prefer that it be generic rather than included in another appendix. Mr. Van Cooper said he had looked at many notices that were difficult to read and convoluted. He would prefer to see one written in clear and simply language. Mr. DeAngelo invited working group members to draft suggestions that could be circulated for comment. The working group decided not to delete Subsection C or change its provisions.

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

Mr. DeAngelo said he was mystified by the response from the ACLI recommending deletion of the entire Section 8 and replacing it with different language. He said he worked very hard to create a level playing field and it appeared to him that the suggestion from the ACLI did damage to that concept. Ms. Stevens said there is no market conduct problem with direct market sales and the ACLI recommends language similar to what is in the old model. Keith Morse (J.C. Penney Life) said the company first had to find out if there would be a replacement, and if there is not a replacement, there is no need to get information on other policies. If the answer is yes, his company generally does not sell another policy. Mr. DeAngelo said he did not think it was overly burdensome to send the notice and he did not think it would cut into sales. Glenn Joppa (Union Fidelity Life) said the list of policies is the problem. He said his company would prefer to just mail the replacement notice to everyone, rather than trying to get a list of policies. Mr. DeAngelo responded that they could just ask if there are any existing policies, rather than asking for a list. Members of the working group liked Mr. Joppa's suggestion and Mr. DeAngelo asked for further comments from the industry on this suggestion. The working group agreed to leave Section 8 as drafted by the regulators.

Section 9. Violations and Penalties

Mr. DeAngelo noted that both ACLI and Primerica suggest deletion of the phrase "the letter and the spirit of" in referring to violations of the regulation. The working group agreed that was appropriate. The ACLI also suggested deleting the list of examples of violations. Ms. Adolph said agents do not need the information and the language in Section 9 is superfluous. Mr. Van Cooper said he thought a little specificity in the examples serve a useful purpose. Ms. Martin asked the interested parties if any of these items were things they would not be discussing with their agents. The industry responded that these all were examples that they would discuss. The working group decided to leave the examples as part of the regulation. The ACLI recommended deleting the parenthetical in Subsection C relating to the amount of interest to be included in a refund. Mr. DeAngelo agreed that it might not be appropriate to set a specific rate, but that some guidance should be given. Perhaps it could be tied to some index. The interested parties were invited to submit suggested language.

2. Adopt Minutes of Oct. 21, 1997, Conference Call

Mr. Van Cooper moved and Mr. Ario seconded a motion to adopt the minutes of the conference call of Oct. 21, 1997. The motion passed (Attachment Four-B).

3. Review 1998 Charges and Discuss Charges for 1999

The working group reviewed its charge for 1998 and agreed that with a small technical change the language was appropriate to recommend to the Life Insurance (A) Committee.

4. Any Other Matters Brought Before the Working Group

Mr. DeAngelo recommended that the working group schedule a conference call on Jan. 15, 1998, to complete the issues remaining. He committed to prepare a revised draft of the model regulation as soon as possible after the conference call.

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

ATTACHMENT FOUR-A

Life Insurance And Annuities Replacement Model Regulation Draft 10/27/97

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Section 1. Purpose

The purpose of this regulation is:

- A. To regulate the activities of insurers and ~~agents~~ producers with respect to the replacement of existing life insurance and 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. "Agent," for purposes of this regulation, shall be defined to include agents, brokers and producers.~~

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

~~CB.~~ "Existing insurer" means the insurance company whose policy or contract is or will be changed or affected in ~~such a manner as~~ described within the definition of "replacement."

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

~~ED.~~ "Financed purchase" means the purchase of a new policy or contract involving the actual or intended use of funds obtained by the withdrawal or surrender of, or by borrowing from the policy or contract values of an existing policy or contract to pay all or part of any premium or consideration due on the new policy or contract. If a withdrawal, surrender or borrowing involving the policy or contract values of an existing policy or contract on the life of the intended insured occurs within thirteen (13) months before or after the effective date of the new policy and is known by the company, or if the withdrawal, surrender or borrowing is shown on any illustration of the existing and new policies or contracts made available to the prospective policyowner by the insurer or its representatives, it will be deemed *prima facie* evidence of a financed purchase.

~~FE.~~ "Illustration" means a presentation or depiction that includes non-guaranteed elements of a policy of life insurance over a period of years as defined in [insert reference to state law equivalent to the NAIC Life Insurance Illustrations Model Regulation].

F. "Producer," for the purpose of this regulation, shall be defined to include agents, brokers and producers.

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 policy or contract.

H. "Registered contract" means a variable annuity contract or variable life insurance policy subject to the prospectus delivery requirements of the Securities Act of 1933.

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

- (1) Lapsed, forfeited, surrendered or partially surrendered, annuitized, 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;
- (4) Reissued with any reduction in cash value; or
- (5) Used in a financed purchase.

J. "Sales material" means a sales illustration and any other information used in the presentation to the policyholder or contractholder.

Section 3. Exemptions

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

- (1) Credit life insurance;
- (2) Group life insurance or group annuities where there is no direct solicitation of individuals by an insurance producer;
- (3) An application to the existing insurer that issued the existing life insurance policy or contract when a contractual change or a conversion privilege is being exercised; or, when the existing policy or contract is being replaced by the same insurer pursuant to a program filed with and approved by the commissioner;
- (4) Proposed life insurance that is to replace life insurance under a binding or conditional receipt issued by the same company; and
- (5) ~~Policies or contracts issued in connection with pension and welfare plans as defined by the Federal Employee Retirement Income Security Act of 1974, 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, where there is no direct~~

~~solicitation of individual employees by an insurance agent. However, for any plan described in this paragraph, full and complete disclosure of all material facts shall be given to the administrator of any policy or contract to be replaced.~~

~~(5) (a) Policies or contracts used to fund (i) an employee pension plan that is covered by the Employee Retirement and Income Security Act (ERISA); (ii) a plan described by Sections 401(a), 401(k) or 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer; (iii) a governmental or church plan defined in Section 414 or a deferred compensation plan of a state or local government or tax exempt organization under Section 457 of the Internal Revenue Code; or (iv) a nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor.~~

~~(b) Notwithstanding Subparagraph (a), this regulation shall apply to policies or contracts used to fund any plan or arrangement that is funded solely by employee contributions and where the insurance company has been notified that plan participants may choose from among two (2) or more fixed annuity providers or policy providers and there is a direct solicitation of an individual employee by an insurance producer for the purchase of a contract or policy. As used in this subsection, direct solicitation shall not include any meeting held by an insurance producer for the purpose of educating or enrolling employees.~~

B. 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 instead.

Section 4. Duties of ~~Agents~~ Producers

A. ~~An agent producer~~ who initiates an application shall submit to the insurer, with or as part of the application, a statement signed by both the applicant and the ~~agent producer~~ as to whether the applicant has existing policies or contracts. If the answer is "no," the ~~agent's producer's~~ duties with respect to replacement are complete.

B. If the applicant answered "yes" to the question regarding existing coverage referred to in Subsection A, present and read to the applicant, not later than at the time of taking the application, a notice regarding replacements in the form as described in Appendix A or other substantially similar form approved by the commissioner. The notice shall be signed by both the applicant and the ~~agent producer~~ attesting that the notice has been read aloud by the ~~agent producer~~ and left with the applicant.

C. The notice shall list all existing life insurance policies or annuities, properly identified by name of insurer, the insured, contract number and include a statement whether each policy or contract will be replaced. If a contract number has not been issued by the existing insurer, alternative identification, such as an application or receipt number, shall be listed.

D. ~~The producer shall~~ leave with the applicant the original or a copy of all sales material.

E. ~~The producer shall~~ submit to the insurer to which an application for life insurance or annuity ~~a policy or contract~~ is presented, a copy of each document required by this subsection, as well as any written or printed sales 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~~ Producers

Each insurer shall:

A. Maintain a system of supervision and control to insure compliance with the requirements of this regulation that shall include at least the following:

- (1) Inform its ~~agents producers~~ of the requirements of this regulation and incorporate the requirements of this regulation into all relevant ~~agent producer~~ training manuals prepared by the insurer;
- (2) Provide to each ~~agent producer~~ a written statement of the company's position with respect to the acceptability of replacements providing guidance to its ~~agents producer~~ as to the propriety of these transactions;
- (3) A system to review the propriety of each replacement transaction that the ~~agent producer~~ does not indicate is in accord with Paragraph (3) above;
- (4) Procedures to confirm that the requirements of this regulation have been met; and
- (5) Procedures to effectively detect transactions that are replacements as defined in this regulation but that have not been identified as such by the applicant or ~~agent producer~~.

~~B. Pay the normal commission to an agent in connection with a replacement or financed sale if the transaction is consistent with the insurer's written statement issued pursuant to Section 4B 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 (3) years after the termination of the policy or contract. Compile and make available to the Insurance Department upon request records of each producer's:~~

- ~~(1) Replacements, including financed purchases, as a percent of the producers' total annual sales;~~
- ~~(2) Number of lapses of policies and contracts by the producer as a percentage of the producer's total annual sales; and~~
- ~~(3) Number of unidentified replacements detected by the company's monitoring system as required by Subsection A(6) of this section.~~

C. Require with or as a part of each application for life insurance or an annuity a complete list of all the applicant's existing policies or 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;

D. Require with each application for life insurance or an annuity that indicates an existing policy or contract a completed notice regarding replacements as contained in Appendix A.

E. Retain completed and signed copies of the notice regarding replacements in its home office for at least three (3) years after the termination or expiration of the policy.

F. Require with each application a separate statement signed by the agent producer as to whether, to the best of his or her knowledge, replacement of a policy or contract is involved in the transaction.

G. 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 notice regarding replacements, the basic illustration and any supplemental illustrations used in the sale and the ~~agent's producer's~~ and applicant's signed statements with respect to financing and replacement in its home office for at least three (3) years after the termination or expiration of the proposed policy or contract. The insurer shall maintain a replacement register, cross indexed by replacing agent producer and existing (or replacing) insurer.

H. Examine any proposal used in a replacement, 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.

I. If an application does not meet the requirements of this regulation, notify the agent producer and applicant and require the agent producer to fulfill the outstanding requirements.

~~J. Upon receipt of a request to borrow, surrender or withdraw any policy values, send to the applicant a notice, 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. The notice shall be sent separate from the check if the check is sent to anyone other than the policy or contract owner.~~

Section 6. Duties of Replacing Insurers that Use Agents Producers

Where a 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 (5) business days of receipt of an application indicating replacement or when the replacement is identified if not indicated on the application, notify any other existing insurer of the proposed replacement and within five (5) business days of a request from an existing insurer 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 producer in its home office or regional office for at least five (5) years or until the next regular examination by the insurance department of a company's state of domicile, whichever is later;
- D. Provide to the policy or contract owner notice of the right to return the policy or contract within ~~thirty~~ sixty (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 provided under the policy or contract plus the fees and other charges deducted from the gross premiums or considerations or imposed under such policy or contract;~~
- 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. With regard to financed purchases the credit may be

limited to the amount the face amount of the existing policy or contract is reduced by the use of existing policy or contract values to fund the new policy or contract;

F. 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 notice regarding replacements and an offer of a full refund of premiums without term charges plus interest.

Section 7. Duties of the Existing Insurer

Where a 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 the notification, indexed by replacing insurer, notifying it of the replacement for at least five (5) 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 five (5) days of receipt of a request from a policyholder or contractholder, send an in force illustration or policy summary if an in force illustration cannot be produced to the policy or contractholder. Within five (5) days of receipt of a notice that an existing policy or contract is being replaced, send a letter to the policy or contractholder of the right to receive information regarding the existing policy or contract values including where appropriate, an in force illustration or policy summary if an in force illustration cannot be produced. The information shall be provided within five (5) business days of receipt of the request from the policyholder or contractholder.~~

~~C. Within thirty (30) days of the date of delivery of the proposed policy or contract, reinstate or restore, without underwriting or imposition of a new contestable or suicide period, the 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.~~

~~C. Upon receipt of a request to borrow, surrender or withdraw any policy values, send to the applicant a notice, advising the policyowner or contract owner of the effect 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. The notice shall be sent separate from the check if the check is sent to anyone other than the policy or contract owner.~~

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 contracts and their policy numbers; and

(b) A statement as to whether any existing policy will be replaced. If the answer is "yes," require the applicant to complete and sign the notice referred to in Paragraph (2) of this subsection.

(2) ~~Whenever the applicant indicates existing policies or contracts, forward with the policy the "Important Notice Regarding 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 or contract that is to be replaced.

(2) Provide the applicant with notice of the right to return the policy or contract within ~~thirty sixty (30 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 plus the amount of all fees and other charges deducted from the gross premiums or considerations imposed under the policy or contract.~~

(3) Retain completed and signed copies of the notice regarding replacements in its home office for at least three (3) years after the termination or expiration of the policy. The insurer shall maintain a replacement and financed sales register, cross indexed by replacing ~~agent producer~~ 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 section of state's unfair trade practices act]. ~~Such failure shall include but not be limited to:~~ Examples of violations include:

- (1) Any deceptive or misleading information set forth in sales material;
- (2) Failing to ask the applicant 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-producer~~ or company.

B. Policyholders and contractholders 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 replacement is not their intention~~; however, patterns of such action by policyholders or contract owners of the same ~~agent-producer~~ shall be deemed prima facie evidence of the ~~agent's producer's~~ knowledge that replacement was intended in connection with ~~such the identified~~ transactions, and ~~such these~~ patterns of action shall be deemed prima facie evidence of the ~~agent's producer'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 a producer's~~ or company's license, monetary fines and the forfeiture of any commissions or compensation paid to an ~~agent or broker a producer~~ 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% 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 its~~ 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].

Appendix A

Important Notice Regarding Replacements

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

~~A financed purchase 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 or contract to pay the premiums due on the new policy or contract or the existing policy or contract?~~

~~YES _____ NO _____~~

~~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 _____~~

~~A policy replacement 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 costs 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 or contract and continue to pay the premiums due on the policy?~~

~~YES _____ NO _____~~

~~If this transaction is a replacement, you may reconsider within 30 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 are accurately recorded.~~

Agent's Signature

All new material.

IMPORTANT NOTICE:

REPLACEMENT OF LIFE INSURANCE OR ANNUITIES

This document must be signed by the applicant and the producer, if there is one

You are contemplating the purchase of a life insurance policy or annuity contract. In some cases this purchase involves discontinuing or changing an existing policy or contract. If so, a replacement is occurring. Financed purchases, described more fully below, are also considered replacements.

You should carefully consider whether a replacement is in your best interests. You will pay acquisition costs and there may be surrender costs deducted from your policy or contract. You may be able to make changes to your existing policy or contract to meet your insurance needs at less cost. A financed purchase will reduce the value of your existing policy or contract and may reduce the amount paid upon the death of the insured.

A replacement occurs when a new policy or contract is purchased and, in connection with the sale, you discontinue making premium payments on the existing policy or contract, or an existing policy or contract is surrendered, forfeited, assigned to the replacing insurer, or otherwise terminated or used in a financed purchase as described below.

A financed purchase occurs when the purchase of a new life insurance policy or annuity contract involves the use of funds obtained by the withdrawal or surrender of or by borrowing some or all of the policy values, including accumulated dividends, of an existing policy or contract, to pay all or part of any premium or payment due on the new policy. A financed purchase is a replacement.

We want you to understand the effects of replacements before you make your purchase decision and ask that you answer the following questions and consider the questions on the back of this form.

1. Are you considering discontinuing making premium payments, surrendering, forfeiting, assigning to the insurer, or otherwise terminating your existing policy or contract? ☐ YES ☐ NO
2. Are you considering using funds from your existing policies or contracts to pay premiums due on the new policy or contract? ☐ YES ☐ NO

If you answered yes to either of the above questions, list each existing policy or contract (include the name of the insurer, the insured, and the contract number if available) and whether each policy will be replaced or used as a source of financing:

	INSURER NAME	CONTRACT OR POLICY #	INSURED	REPLACED (R) OR FINANCING (F)
1.				
2.				
3.				

Make sure you know the facts. Contact your existing company and its producer for information about the old policy or contract. [If you request one, an in force illustration or policy summary must be sent to you by the existing insurer.] Be sure that you are making an informed decision.

The existing policy or contract is being replaced because:

I certify that the responses herein are, to the best of my knowledge, accurate:

Applicant's Signature and Printed Name Date

Producer's Signature and Printed Name Date

Although a replacement may not be in your best interest, your decision could be a good one. You should make a careful comparison of the costs and benefits of your existing policy and the proposed policy. One way to do this is to ask the company or producer that sold you your existing policy to provide you with information concerning your existing policy or contract. This may include an illustration of how your existing policy is working now and how it would perform in the future based on current and guaranteed assumptions. Illustrations should not, however, be used as a sole basis to compare policies. You should discuss the following with your producer to determine whether replacement or financing your purchase makes sense:

For Life Insurance

PREMIUMS: Are they level or will they increase? Are they affordable?

Are they guaranteed or could they change?

You're older—are premiums higher for the proposed new policy?

How long will you have to pay premiums on the new policy? On the old policy?

POLICY VALUES: New policies usually take longer to build cash values and to pay dividends.

Acquisition costs for the old policy may have been paid, you will incur costs for the new one.

What surrender charges do the policies have?

What expense and sales charges will you pay on the new policy?

Does the new policy provide more insurance coverage?

INSURABILITY: If your health has changed since you bought your old policy, the new one could cost you more, or you could be turned down.

You may need a medical exam for a new policy.

Claims on most new policies for up to the first two years can be denied based on inaccurate statements.

Suicide limitations may begin anew on the new coverage.

IF YOU ARE KEEPING THE OLD POLICY AS WELL AS THE NEW POLICY:

How are premiums for both policies being funded?

How will out-of-pocket premiums be affected on the existing policy?

Will a loan have to be paid off prior to death?

What values from the old policy are being used?

IF YOU ARE SURRENDERING AN ANNUITY OR INTEREST SENSITIVE LIFE PRODUCT:

Will you pay surrender charges on your old contract?

What are the interest rate guarantees for the new contract?

Have you compared the contract charges or other policy expenses?

OTHER ISSUES TO CONSIDER FOR ALL TRANSACTIONS:

What are the tax consequences of buying the new policy?

Is this a tax free exchange? (See your tax advisor.)

Is there a benefit from favorable "grandfathered" treatment of the old policy under the federal tax code?

Will the existing insurer be willing to modify the old policy?

How does the quality and financial stability of the new company compare with your existing company?

ATTACHMENT FOUR-B

Replacement Issues Working Group Conference Call October 21, 1997

The Replacement Issues Working Group of the Life Insurance (A) Committee met by conference call on Oct. 21, 1997. Paul DeAngelo (N.J.) chaired the meeting. The following working group members participated: Erin Klug (Ariz.); Richard Rogers (Ill.); Rosanne Mead (Iowa); Lester Dunlap (La.); Cindy Martin (Mass.); Cindy Amann (Mo.); Carrie Dorman and Bill Stevens (N.C.); Adam Barkley (Ohio); Joel Ario (Ore.); Ted Becker and Bill Goodman (Texas); and Tom Van Cooper (Vt.).

Paul DeAngelo (N.J.) reviewed the work completed so far. He said the working group discussed numerous aspects of the Life Insurance and Annuities Replacement Model Regulation and reviewed the issues upon which the working group reached consensus: 1) Eliminate reference to financed sales; define financed purchase; 2) Notice required only when the applicant has an existing life insurance policy; 3) Provide exemption for pension plans; 4) The corporate record keeping requirements; 5) Copies of sales material provided to replaced insurer only when requested; 6) Removed requirement for payment of normal commission on replacement; and 7) Waiver of the suicide and incontestability periods.

Mr. DeAngelo said he would like to revisit the issue of the length of the free-look period and saw two other issues that still needed to be resolved: whether to require an illustration or policy summary from the insurer being replaced and automatic reinstatement after the free-look period.

Cindy Martin (Mass.) suggested that, after the working group completed its discussion of these issues, members be given an opportunity to raise additional issues, such as suitability. Peg Vandrisse (American Express Financial Advisors) said there had been some discussion at the prior meeting about the group exemption. She asked for clarification of whether the policies that were individually marketed were exempt. Mr. DeAngelo pointed out the language in Section 3A(5) that exempted policies only where there is no direct solicitation of individual employees by an insurance agent. Mr. DeAngelo said the revised draft would use the language suggested by the American Council of Life Insurance (ACLI) and Ms. Vandrisse said that the ACLI is still reviewing its suggested language. Mr. DeAngelo suggested that additional comments could be made when the revised draft is released for comments. Ms. Martin said she had volunteered at the last meeting to research the impact on IRC Section 457 plans. She said these usually are individually marketed so she did not believe they were included in the exemption. Marybeth Stevens (ACLI) said that at the Sept. 3, 1997, meeting she had pointed out that the notice in Section 5N is inappropriate in a replacement regulation. In the letter to the working group the ACLI suggested this was more reasonably located in the Unfair Trade Practices Act. Mr. DeAngelo responded that that is a statute and most states can handle this issue by regulation.

1. Length of Free Look

Mr. DeAngelo said he had asked at the Fall National Meeting whether the language in the New York proposed regulation resolves problems that the ACLI brought up in regard to the Securities and Exchange Commission (SEC). Ms. Stevens said the New York regulation requires an insurer to return all fees and charges and the SEC would not allow this to be taken out of the separate account because it would harm other policyholders. The company would have to find this money elsewhere. Mr. DeAngelo responded that he felt uncomfortable with the vague information the working group received about what the SEC might not allow. He opined that the working group needed more definitive information in order to make a decision on whether the 60-day free-look period would cause problems with the SEC. Mr. DeAngelo asked if it was the position of the ACLI that there would be no problems with the SEC on a 30-day free look. Ms. Stevens said that problems had not yet occurred. Mr. DeAngelo responded with a question as to whether the ACLI could say that 60 days is in violation of the SEC rules. Ms. Stevens said she could not represent that fact to the working group. Ms. Martin said she read the New York regulation as requiring for a variable or market value adjusted product that the policyholder receive the cash surrender value plus the fees and charges deducted. She noted this might be greater than the consideration paid.

Ms. Stevens asked what benefit the additional 30 day free-look period would have for a consumer. She opined that most consumers would just let the policy sit on their desk for an additional 30 days and a decision would be better made while the facts were fresh in their minds. Ron Panneton (National Association of Life Underwriters—NALU) spoke in favor of the 60-day free look and said it does provide a benefit to consumers. He pointed out that if the individual would want to ask for assistance from an expert, the additional time would allow for that. Scott Cipinko (National Alliance of Life Companies—NALC) saw absolutely no benefit to adding another 30 days to the free look. He said that if a consumer cannot get to an expert in 30 days, more time will not help. He asked if he should presume that going to 60 days for the free-look period would also be tied to a reinstatement provision. Mr. DeAngelo responded that he was not sure those two go together, but the working group would make that decision.

Cindy Amann (Mo.) said she would like to see the 60-day free look in the model because she thought it gave more time for the individual to seek advice. Joel Ario (Ore.) agreed that the 60-day period should be included in the draft and the interested parties could comment on that during the formal exposure period. Mr. DeAngelo said he would revise the draft to include the 60-day free-look period with the language similar to that in the New York proposed regulation. Ms. Stevens pointed out that the New York law provides 60 days after the *issuance* of the policy whereas the regulation draft is 60 days after policy *delivery*. Mr. DeAngelo opined that 60 days from the date of issue is worthless because the agent might not deliver the policy during that 60-day period. He recommended the use of the date of delivery in the regulation and the working group members agreed.

2. Conservation Efforts by the Insurer Being Replaced

Mr. DeAngelo said the working group noted from the Life Insurance Marketing and Research Association (LIMRA) study that companies make very little conservation effort. He said if consumers had not talked to their own insurance agent for some time, the deal being proposed by the new agent will seem much better. He suggested that regulators will not get a handle on the replacement problem until they encourage conservation and said that the working group needs to include controls in the model to help regulators achieve that goal. He recommended some minimal conservation activity be required. Mr. Ario said that he was in favor of providing information so that the consumer knows he can request an in force illustration or a policy summary but he did not think it made sense to require this to be distributed with every replacement. Mr. DeAngelo responded with the argument that the replacing agent will convince the individual that the prior agent did not have his best interests at heart and that he should not talk to him. Mr. Ario said if consumers felt that way, they would not even look at materials they got in the mail. Mr. DeAngelo agreed that they may not, but at least they have the opportunity to compare cash value, etc. Tom Van Cooper (Vt.) said that only a small number will look at the illustration, let alone compare two illustrations. He said those who request an illustration will be more likely to look at them. Ms. Amann expressed the opinion that regulators owe it to consumers to at least put the information in their hands. Ms. Martin agreed with Ms. Amann and went further to wonder if the insurer should not follow up also with a telephone call and ask for an appointment to discuss the replacement activity. Mr. Van Cooper said this is a private contract and if the consumer is taking the initiative to replace the policy perhaps regulators ought not interfere. He also said that he did not think it was practical to place too great a burden on the insurer.

Mr. DeAngelo suggested incorporating a provision that, when the existing insurer gets notice of the replacement, it sends a letter to the insured offering an in force illustration and a visit by the agent. Mr. Ario opined that this was much superior to the original proposal because it was not cost effective to send the material without a request. Ted Becker (Texas) pointed out that the 60-day free-look period upon which the working group had settled would also allow more time for conservation efforts. Mr. DeAngelo said replacement activity is a problem of the entire industry to the extent it is inappropriate and the whole industry

should share the burden of reducing that inappropriate replacement activity. He noted that where a policy has been in place for eight to ten years, the insurer may welcome its replacement so that the risk of paying on the policy is shifted elsewhere. The company will have already recovered its costs by that time. Ms. Stevens said the ACLI is against mandatory conservation. She suggested that the notice attached to the model as an appendix contain the information that the consumer has the right to request an illustration to eliminate one more piece of paper from the company. Mr. Ario pointed out the power of the agent to contradict that language and suggested it was better to get a letter after the agent had gone home.

3. Automatic Reinstatement of the Replaced Policy

Mr. DeAngelo said that the New York proposed regulation includes a provision for automatic reinstatement of a policy. He asked if this was a large burden to place on the insurer. Mr. Van Cooper opined that this type of provision was an attempt to insulate the consumer from the results of his own decision. He said that at some point the consumer needs to take responsibility for his own decisions. Mr. Ario suggested that it was backwards to put the burden on the company being replaced. Bob Plybon (NALU) said that, if policyholders are given a 60-day free-look period, but do not have the right to reinstate the replaced policy, they have not been given anything. Mr. DeAngelo said that most companies do have a reinstatement provision, but it might require underwriting and repayment of the dollars owed in premium. Maureen Adolf (Prudential) said the tax consequences to the individual might also reduce the ability to reinstate the policy. Mr. DeAngelo said if the model regulation included a requirement for reinstatement, but the policyholder could not use it, it was not meaningful. He said that perhaps the consumer would prefer the tax penalty to not having insurance. Mr. Van Cooper pointed out that the second carrier would have replaced the coverage so the consumer would not be left without insurance. Mr. Ario reinforced that an individual who does not want to go without insurance would not cancel the first policy until he was sure that he wanted the second one. Mr. Plybon said the reinstatement provision would only take effect in rare circumstances to protect the individual did not make a prudent decision.

Mr. DeAngelo opined that this could create a sense of comfort that could be used by the replacing agent: "Get this new policy and if you don't like it, you can always go back to your old one." Mr. Dunlap (La.) said he was not in favor of including an automatic reinstatement provision, and Rosanne Mead (Iowa) agreed. Ms. Amann said the only reason she could see to keep the provision in the draft was to solicit comment. Mr. DeAngelo pointed out that it had been in the prior two versions, and no positive comments had been received.

4. Additional Issues

Ms. Martin asked the working group to consider a suitability requirement for the model. She inquired whether any NAIC models contain suitability requirements. Erin Klug (Ariz.) said the long-term care insurance regulation does contain suitability requirements. Mr. DeAngelo said that suitability goes to all sales, not just replacements. He also pointed out the difficulty in enforcing a suitability requirement because it is such a subjective determination, although it apparently has been enforced in securities transactions for some time. Ms. Amann suggested that the working group look at the suitability requirements in the long-term care insurance regulation and those of the SEC.

Mr. Cipinko pointed out that, since the working group had settled on a 60-day free-look period, this allowed additional time to get advice on whether the purchase was suitable. He suggested it was an incredible burden to place on the insurer, and would be very difficult for small companies. Mr. DeAngelo said he could incorporate a provision in the draft that the company must review the policy, but without parameters to determine whether it is suitable, that may not add any value to the model. He noted that the charge of the working group goes beyond developing a replacement regulation. He said the charge is to propose amendments to a model but also to make recommendations on other issues. He suggested one potential area for a recommendation is suitability. Mr. Ario agreed that it would be appropriate to deal with this as a separate issue rather than to include it in the replacements model regulation. Mr. Van Cooper said he thought it was fair to burden the company with some responsibility to determine suitability. He suggested a review for a policy that is clearly unsuitable, which is a lower standard for the company to meet.

Ms. Martin said that the working group did not talk much about the form for the notice. Mr. DeAngelo said the form recommended by the ACLI is effective and it is his intent to replace the one in the working group draft with the industry form. He said this is a two-page form, which may be too long to read aloud as originally proposed. Mr. Becker asked how the notice would apply if the proposed replacement was with the same company. Mr. DeAngelo said it was the intent of the regulation to apply to internal and external policies in the same manner. Ms. Martin offered to develop the notice required in Section 5J.

Mr. DeAngelo said that he intends to prepare a revised draft using the decisions the working group made at the Fall National Meeting and during the interim conference call. He asked if the working group would be comfortable sending that draft to the interested parties for comments, or whether it would be appropriate to hold another conference call for the working group to review the draft. Mr. Ario said he was comfortable exposing the draft prepared by Mr. DeAngelo. Ms. Mead noted that the working group had come to consensus on the issues and could revise wording at the Winter National Meeting. She suggested that, if an interested party wanted the working group to change some language, bringing suggested language would be helpful. Mr. Ario moved and Ms. Mead seconded a motion to designate the new draft prepared by Mr. DeAngelo as a draft for exposure and solicit comments before considering adoption. Mr. DeAngelo asked that all comments on the draft be sent to Carolyn Johnson (NAIC/SSO) by Dec. 1 so that they could be distributed to the working group members for review prior to the Winter National Meeting. Mr. DeAngelo asked that interested parties limit their comments to issues upon which they had not previously commented. If they felt it necessary to reemphasize an earlier comment, they could refer to that earlier letter.

Having no further business, the Replacement Issues Working Group adjourned at 3:45 p.m.

ATTACHMENT FIVE

Synthetic GIC Working Group
Seattle, Washington
December 7, 1997

The Synthetic GIC Working Group of the Life Insurance (A) Committee met in the 611 Room, Level 6 of the Washington State Convention and Trade Center in Seattle, Wash., at 11 a.m. on Dec. 7, 1997. Larry Gorski (Ill.) chaired the meeting. The following working group members or their representatives were present: Sheldon Summers (Calif.); Jack Gies (Conn.); and Lynda Klebold (N.J.).

Larry Gorski (Ill.) said that the sole purpose of this meeting is to decide whether to expose for comment the Nov. 26, 1997, draft of the Synthetic Guaranteed Investment Contracts Model Regulation from the technical advisors (Attachment Five-A, which contains minor revisions to the submission from the technical advisors to make it consistent with NAIC formatting standards). Mr. Gorski noted that, relative to Section 10 (Reserves) of the draft, the Life and Health Actuarial (Technical) Task Force had voted to endorse the proposed language (which includes a prospective approach for reserves). He also noted that Hal Phillips (Calif.) had submitted a memo to the Task Force expressing support for a retrospective approach similar to that in effect in California.

A brief discussion then ensued regarding whether the working group should disband at this point or remain in existence through the end of the process of receiving comments and revising the draft. A consensus emerged that the working group should stay intact through the completion of this project.

Next, Blaine Shepherd (Minn.) referred to Subsection 10(b)(4)(i) and asked 1) when cash flow testing would not be appropriate and 2) what would substitute for cash flow testing in those circumstances? Robert Brown (CIGNA) stated that the primary point of this subsection is that sufficiency of assets must be demonstrated. However, the language was also attempting to make clear that there are other acceptable methods for demonstrating that sufficiency beyond just cash flow testing. Jack Gies (Conn.) asked if a company could combine its synthetic GICs with other products in demonstrating sufficiency. Mr. Brown responded that the language seemed to require the synthetic GICs to "stand on their own merits." Mr. Gorski noted that this was "somewhat stronger" than the normal asset adequacy analysis. Sheldon Summers (Calif.) suggested the subsection be rephrased as follows:

4. The actuarial memorandum shall:
 - (i) Substantially conform with those portions of Section [insert reference to the state's version of the Actuarial Opinion and Memorandum Regulation] of these regulations that are applicable to testing, and either 1) demonstrate 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.

Mr. Shepherd suggested that the last phrase be modified to read "set forth the alternative methodology of asset adequacy testing used to determine the sufficiency of account assets." Mr. Gorski responded by saying that it would be preferable at this point to insert the words suggested by Mr. Summers, and any further changes in language should be deferred and considered with any other comments received.

Mr. Shepherd then commented that, other than the first sentence, the language in Subsection 10(a)(5) seemed inappropriate for inclusion in the model. Mr. Brown responded that this is another matter that could be considered during the exposure period for possible revisions in wording. Next, Doug Barnert (Barnert & Associates) stated that the National Alliance of Life Companies (NALC) would comment on two issues. First, Mr. Barnert said that the asset and surplus requirements would exclude most of the NALC members, and he was not sure how those requirements were determined. Second, Mr. Barnert stated that the portions of the model relating to the actuarial opinion should be removed, and that consideration of what the type of actuarial opinion to require should be transferred to the Life and Health Actuarial Task Force.

Mr. Gies moved and Mr. Summers seconded a motion to expose the draft for comment, with a comment deadline of Feb. 1, 1998. The working group adopted the motion. Mr. Gorski asked that comments be sent to Mark Peavy (NAIC/SSO).

Mr. Gies moved and Mr. Summers seconded a motion to recommend to the Life Insurance (A) Committee the following charge for 1998: Expose for comment and finalize recommendations regarding the Synthetic Guaranteed Investment Contracts Model Regulation. Complete this project by the Summer National Meeting. The estimated cost of mailings and conference calls is \$1,000.

Mr. Gies moved and Lynda Klebold (N.J.) seconded a motion to adopt the minutes of Nov. 12, 1997 (Attachment Five-B). The working group voted to adopt the minutes.

Having no further business, the Synthetic GIC Working Group adjourned at 11:20 a.m.

Synthetic Guaranteed Investment Contracts Model Regulation
Draft: 11/26/97

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Section 1. Authority

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

Section 2. Purpose

A. The purpose of this regulation is to prescribe:

- (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 obligation by reference to a segregated portfolio of assets that is not owned by the insurer;
- (2) The essential operational features of the segregated portfolio of assets; and
- (3) The reserve requirements for these group annuity contracts and agreements.

B. This regulation is intended to aid in the timely approval of such products by the commissioner, and recognizes that timely approval is essential given the competitive nature of the market for these products.

Section 3. Scope and Application

This regulation applies to that portion of a group annuity contract or other agreement described in Section 4C and issued by a life insurer that functions as an accounting record for an accumulation fund and has benefit guarantees relating to a principal amount and levels of interest at a fixed rate of return specified in advance. The fixed rates of return will be constant over the applicable rate periods, and may reflect prior and current market conditions with respect to the segregated portfolio but may not be referenced to future changes in market conditions. It applies to all contracts issued after the effective date of this regulation. Contracts that have been negotiated prior to the effective date need not be refiled with the commissioner.

Drafting Note: This explanation of the fixed rate of return is intended to clarify the fact that the regulation excludes products such as those that guarantee the future performance of a stated index. It is recognized that versions of synthetics other than those described in the scope section may evolve over time; the intent of the regulation is not to preclude the issuance of such products, but rather to describe how a specific set of synthetics (those described in the scope) should be regulated.

Drafting Note: It is expected that individual regulators, where applicable, will retain the right to withdraw approval of previously filed contract forms for new issuance if they do not conform to the regulation. Therefore, no language explicitly withdrawing approval of previously filed forms was included.

Section 4. Definitions

As used in this regulation, the following terms shall have these 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 10B 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. "Synthetic guaranteed investment contract" or "contract" means a group annuity contract or other agreement that in whole or in part establishes the insurer's obligations by reference to a segregated portfolio of assets that is not owned by the insurer.

D. "Contract value record" means an accounting record, provided by the contract in relation to a segregated portfolio of assets, that is credited with a fixed rate of return over regular periods, and that 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 or declared at the inception of the contract and valid for the entire term of the contract.

E. "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 difference between the contract value record and the market value record amortized over an appropriate period. The fixed rate of return calculated by means of this formula may reflect prior and current market conditions with respect to the segregated portfolio, but may not anticipate future changes in market conditions.

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 an asset would be willing to accept, for the asset without duress in an arm's length transaction. In the case of a publicly traded security, the fair market value is the price at which the security is traded or, if no price is available, a price that appropriately reflects the latest bid and asked prices for the security. In the case of a debt instrument that is not publicly traded, the fair market value is 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 customarily used within the financial industry.

H. "Guaranteed minimum benefits" means contract benefits on a specified date that may be either:

- (1) A principal guarantee, with or without a fixed minimum interest rate guarantee, related to the segregated portfolio;
- (2) An assurance as to the future investment return or performance of the segregated portfolio; or
- (3) The fair market value of the segregated portfolio, to the extent that the fair market value of the assets determines the contractholder's benefits.

I. (1) "Hedging instrument" means:

- (a) An interest rate futures agreement or foreign currency futures agreement, an option to purchase or sell an interest rate futures agreement or foreign currency futures agreement, or any option to purchase or sell a security or foreign currency, used in a bona fide hedging transaction; or
- (b) A financial agreement or arrangement entered into with a broker, dealer or bank, qualified under applicable federal and state securities or banking law and regulation, 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 that, when added to the portfolio, reduces the risk of changes in market valuation.

- (2) An instrument shall not be considered a hedging instrument or a part of a bona fide hedging transaction 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 risk.

J. "Investment guidelines" means a set of written guidelines, established in advance by the person with investment authority over the segregated portfolio, to be followed by the investment manager. The guidelines shall include a description of:

- (1) The segregated portfolio's investment objectives and limitations;
- (2) The investment manager's degree of discretion;
- (3) The duration, asset class, quality, diversification, and other requirements of the segregated portfolio; and
- (4) The manner in which derivative instruments may be used, if at all, in the segregated portfolio.

K. "Investment manager" means the person (including the contractholder) responsible for managing the assets in the segregated portfolio in accordance with the investment guidelines in a fiduciary capacity to the owner of the assets.

L. "Market value record" means an accounting record provided by the contract to reflect the fair market value of the segregated portfolio.

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

Drafting Note: When adopting this regulation, individual regulators may wish to review their applicable state laws to ensure that this definition hasn't inadvertently authorized an entity to act as a custodial institution that it would not wish to do so.

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 an individual who meets the qualification standards set forth in [insert statutory reference].

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

Q. "Segregated portfolio" means:

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

R. "Spot rate" corresponding to a given time of benefit payment means the yield on a zero-coupon non-callable and non-prepayable 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 and non-prepayable United States government obligations in accordance with a formula set forth in the plan of operation. To the extent that guaranteed contract liabilities are denominated in the currency of a foreign country rated in one of the two (2) 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 the foreign country, the spot rate may be determined by reference to substantially similar obligations of the government of the foreign country. For liabilities other than those described above, the spot rate shall be determined on a basis mutually agreed upon by the insurer and the commissioner.

S. "Unilateral contract termination event" means an event allowing the insurer to unilaterally and immediately terminate the contract, without future liability or obligation to the contractholder.

T. "United States government obligation" means a direct obligation issued, assumed, guaranteed or insured by the United States of America or by an agency or instrumentality of the United States government.

Section 5. Financial Qualification of Insurer; Synthetic Guaranteed Investment Contract Filing and Approval Requirements

A contract may not be delivered or issued for delivery in this state unless the issuing insurer is licensed as a life insurance company in this state and has satisfied the financial qualification requirements and the filing and approval requirements of this section. A domestic insurer may not deliver or issue for delivery a contract outside of this state unless the insurer has satisfied the financial qualification requirements of this section and satisfied the requirements of Subsection B.

Drafting Note: While the filing approach established in this regulation should over time improve the filing process in many states, it was not intended to eliminate variable filings. Although filings with appropriately limited variability may be useful to an insurer, it is expected that individual regulators will retain the authority to reject filings that request overly broad variability with respect to material contract provisions.

A. An insurer will be financially qualified under this section if:

- (1) Its most recent statutory financial statements reflect at least \$9 billion in admitted assets or \$100 million in capital and surplus, and its risk-based capital results do not place it at a regulatory level of action; or
- (2) It satisfies other financial qualification requirements set forth by the commissioner.

B. A domestic insurer satisfies 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 the contract, with the commissioner and the filing has been affirmatively approved or has not been disapproved within sixty (60) days following the filing, in which event the plan of operation and the form of contract shall be deemed approved.

C. A non-domestic insurer satisfies the filing and approval requirements of this section if the insurer has filed a form of the contract together with a copy of the plan of operation pertaining to the contract with the commissioner, and the form and the plan of operation have been affirmatively approved or have not been disapproved within sixty (60) days following the filing, in which event the form of contract and the plan of operation shall be deemed approved. The filing and approval of the plan of operation shall be waived:

(1) Upon notice by the insurer in the event that the insurer's domiciliary insurance department has promulgated regulations governing synthetic guaranteed investment contracts that are substantially similar to this regulation, and has affirmatively approved the plan of operation. Evidence of affirmative approval shall be included in the submission; or

(2) At the discretion of the commissioner.

D. A contract subject to this regulation may not 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.

E. (1) The plan of operation shall include at least:

(a) A statement that the plan of operation will be administered in accordance with the requirements prescribed by the commissioner pursuant to this regulation, along with a statement that the insurer will comply with the plan of operation in its administration of the contract.

(b) A description of how the contract value record will be determined, and, where applicable, adjusted by a crediting rate formula;

(c) A statement describing the methods and procedures used to value statutory liabilities for purposes of Section 10;

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

(e) A description of how information concerning the assets in the segregated 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. The report shall be prepared no less frequently than quarterly, and shall include a complete statement of segregated portfolio holdings and their fair market value;

(f) A description of how the investments in the segregated portfolio reflect provision for benefits insured by the contract, including any advances made by the insurer to the contractholder;

(g) A description of the crediting rate formula, if any, and how it will operate to take into account differences between the market value and contract value 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, as well as any advances made by the insurer to the contractholder. The demonstration shall include at least three (3) hypothetical return scenarios (level, increasing and decreasing) and for each of these scenarios, at least three (3) withdrawal scenarios (zero, moderate and high) shall be modeled. The commissioner may require additional scenarios if deemed necessary to fully understand the risks under the contract. The demonstration period shall be the greater of five (5) years or the minimum period the insurer must underwrite the risk;

(h) A description of all termination events, discontinuation triggers and options, notice requirements, corrective action procedures and all other contract safeguards, including a list of events that give the insurer the right to terminate the contract immediately;

(i) A description of the procedures to be followed when a unilateral contract termination event occurs;

(j) A description of the allowable investment parameters applicable to a contract issued subject to the submitted plan of operation (such as the objectives, asset classes, quality, duration and diversification requirements applied to the assets held within the segregated portfolio), and a description of the procedures that will be followed by the insurer in evaluating the appropriateness of any specific investment guidelines submitted by the contractholder. If the insurer chooses to operate the contract in accordance with investment guidelines not meeting the criteria established in this subparagraph, approval of each non-conforming set of investment guidelines shall be obtained pursuant to Subsection B and C of this section as appropriate;

(k) A description of the criteria used by the insurer in approving the investment manager, if the investment manager is an entity other than the insurer, or its wholly-owned subsidiary;

(l) A statement certified by an actuary with expertise in such matters as to the adequacy of the consideration charged by the insurer for the risks it has assumed with respect to synthetic guaranteed investment contracts;

(m) A statement that the actuarial opinion and memorandum required by Section 10 shall include:

(i) 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, and the aggregate amount of any losses incurred; and

(ii) 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.

(2) 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. Replies made in compliance with this subsection 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 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 contract.
- C. For contracts that do not have a fixed maturity schedule, 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 has occurred.
- D. The contract shall state the maximum rate period between crediting rate formula recalculations that will be permitted, if any.
- E. The contract shall grant the insurer 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 with prior notice of and the right to approve any change of investment managers.
- G. The contract shall include a waiver provision stating, or substantially similar to, the following:

No waiver of remedies by the insurer that is a party to this agreement, following the breach of any contractual provision of the agreement or of the investment guidelines applicable to it, or failure to enforce the provisions or guidelines, which constitutes grounds for termination of this agreement for cause by the insurer, and is not cured within thirty (30) days following the insurer's discovery of it, shall be effective against an insurance commissioner in any future rehabilitation or insolvency proceedings against the insurer unless approved in advance in writing by the commissioner.

- H. The insurer shall have the right to refuse to recognize any new deposits to the segregated portfolio unless there is a written agreement between the insurer and the contractholder as to the permissible levels and timing of new deposits.

Drafting Note: An adopting state may wish to add an "entire contract" provision in this section if such a provision is not required elsewhere in the adopting state's insurance code.

Section 7. Investment Management of the Segregated Portfolio

- A. The investment manager must have full responsibility for, and control over, the management of all segregated portfolio assets within the constraints specified in the investment guidelines.

Drafting Note: In the event that the segregated portfolio has multiple managers, all of these managers will be covered by the investment guidelines.

- B. The investment guidelines shall be submitted to the insurer for underwriting review before the contract becomes effective.
- C. 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 5E(1)(j), approval of the non-conforming investment guidelines must be obtained pursuant to Section 5B and Section 5C as appropriate.

Section 8. Purchase of Annuities

For contracts that are group annuity contracts, and that make available to the contractholder the purchase of immediate or deferred annuities for the benefit of individual members of the group, an annuity may not be purchased without the delivery of the contractually agreed upon consideration in cash to the insurer from the segregated portfolio for allocation to the insurer's general account or a separate account. The insurer shall collect adequate consideration for the cost of annuities purchased under contract option by transfer from the segregated portfolio.

Section 9. Unilateral Contract Terminations

A contract subject to this regulation shall allow the insurer to unilaterally and immediately terminate, without future liability of the insurer or obligation to provide further benefits, upon the occurrence of any one of the following events that is material and that is not cured within thirty (30) days following the insurer's discovery of it:

- A. The investment guidelines are changed without the advance consent of the insurer and the investment manager is not controlling, controlled by or under common control with the insurer;
- B. The segregated portfolio, if managed by an entity that is not controlling, controlled by or under common control with the insurer, is invested in a manner that does not comply with the investment guidelines; or
- C. Investment discretion over the segregated portfolio is exercised by or granted to anyone other than the investment manager.

Section 10. Reserves

- A. Asset maintenance requirements for segregated portfolios governed by this regulation.

(1) At all times an insurer shall hold minimum reserves in the general account or one or more separate accounts, as appropriate, equal to the excess, if any, of the value of the guaranteed contract liabilities, determined in accordance with Paragraphs (6) and (7) of this subsection, over the market value of the assets in the segregated portfolio, less the deductions provided for in Paragraph (2) of this subsection. The reserve requirements of this subsection shall be applied on a contract-by-contract basis.

(2) In determining compliance with the asset maintenance requirement and the reserve for guaranteed contract liabilities specified in Paragraph (1) of this subsection, the insurer shall deduct a percentage of the market value of an asset as follows:

- (a) For debt instruments, the percentage shall be the NAIC asset valuation reserve "reserve objective factor," but the factor shall be increased by fifty percent (50%) percent for the purpose of this calculation if the difference in durations of the assets and liabilities is more than one year.
- (b) For assets that are not debt instruments, the percentage shall be the NAIC asset valuation reserve "maximum reserve factor."

(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 the foreign country, the percentage deduction for these assets under Paragraph (2) of this subsection shall 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 Paragraph (2) of this subsection shall be increased by fifteen percent (15%) of the market value of the assets unless the currency exchange risk on the assets has been adequately hedged, in which case the percentage deduction under Paragraph (2) of this subsection shall be increased by one-half percent (.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 paragraph, the currency exchange risk on an asset is deemed to be adequately hedged if:

- (a) It is an obligation of
 - (i) A jurisdiction that is rated in one of the two (2) highest rating categories by an independent nationally recognized United States rating agency acceptable to the commissioner;
 - (ii) Any political subdivision or other governmental unit of such a jurisdiction, or any agency or instrumentality of jurisdiction, political subdivision or other governmental unit; or
 - (iii) An institution that is organized under the laws of any such jurisdiction; and
- (b) At all times the principal amount of the obligation and scheduled interest payments on the obligation are hedged against the United States dollar pursuant to contracts or agreements that are:
 - (i) 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 of Canada;
 - (ii) Entered into with a United States banking institution that has assets in excess of \$5 billion and that has obligations outstanding, or has a parent corporation that has obligations outstanding, that are rated in

one of the two (2) highest rating categories by an independent, nationally recognized, United States rating agency, or with a broker-dealer registered with the Securities and Exchange Commission that has net capital in excess of \$250 million; or

(iii) Entered into with any other banking institution that has assets in excess of \$5 billion and that has obligations outstanding, or has a parent corporation that has obligations outstanding, that are rated in one of the two (2) highest rating categories by an independent, nationally recognized, United States rating agency and that is organized under the laws of a jurisdiction that is rated in one of the two (2) 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:

(a) That portion of the amount needed to meet the asset maintenance requirement that has been allocated to separate accounts; less

(b) The amounts contributed to separate accounts by the contractholder in accordance with the contract and the earnings on the contract.

(6) For purposes of this section, the minimum value of guaranteed contract liabilities 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, prepared pursuant to Section 5E, except that if the expected time of payment of a contract benefit is more than thirty (30) years, it shall be discounted from the expected date of payment to year thirty (30) at a rate of no more eighty percent (80%) of the thirty-year spot rate and for thirty (30) 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:

(a) All guaranteed benefits potentially available to the contractholder on an ongoing basis shall 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.

(b) 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, shall be used in the projections of future cash flows.

B. Actuarial opinion and memorandum 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 the accounts as of the prior Dec. 31. The actuarial opinion and memorandum shall be in form and substance satisfactory to the commissioner.

Drafting Note: The state may wish to include the information contained in the actuarial opinion and memorandum as a part of its overall filing requirements, rather than mandating a separate filing for synthetic guaranteed investment contracts.

(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 the segregated portfolios, describing the extent to and manner in which during the preceding year:

(a) Actual benefit payments conformed to the benefit payment estimated to be made as described in the plan of operation;

(b) 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;

(c) 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;

(d) The determination of the fair market value of the segregated portfolio conformed to the valuation procedures described in the plan of operation, including a statement of the procedures and sources of information used during the year;

(e) The fixed-income segregated portfolio conformed to and justified the rates used to discount contract liabilities for valuation pursuant to Section 10A(6);

(f) Any rates used pursuant to Section 10A(6) to discount guaranteed contract liabilities and other items applicable to the segregated portfolio were modified from the rates described in the plan of operation filed pursuant to Section 5E; and

(g) 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:

(a) Either substantially conform to those portions of Section [insert regulatory reference] to these regulations that are applicable to testing and demonstrating the sufficiency of assets based upon cash flow analysis, or demonstrate why cash flow analysis is not appropriate and set forth the procedures used to determine the sufficiency of account assets;

(b) 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 the techniques;

(c) 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;

(d) 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 10A(6) conservatively reflect expected investment returns, taking into account any foreign exchange risks;

(e) 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 these circumstances occurred;

(f) State the amount of reserves and supporting assets as of December 31 and where the reserves are shown in the annual statement; and

(g) State the amount of any contingency reserve carried as part of surplus.

C. When the insurer issues a synthetic guaranteed investment contract and complies with the asset maintenance requirements of Section 10A, it need not maintain an asset valuation reserve with respect to those assets.

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:

(a) The amounts determined as the minimum reserves as required under Section 10A(1);

(b) 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

(c) Any additional amount determined as necessary by the commissioner due to the nature of the benefits.

(2) The amount of any reserves required by Paragraph (1) of this subsection may be established by either:

(a) Allocating sufficient assets to one or more separate accounts; or

(b) Setting up the additional reserves in the general account.

Section 11. Severability

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

Section 12. Effective Date

This regulation shall take effect [insert date].

ATTACHMENT FIVE-B

Synthetic GIC Working Group
Conference Call
November 12, 1997

The Synthetic GIC Working Group of the Life Insurance (A) Committee met by conference call on Nov. 12, 1997. Larry Gorski (Ill.) chaired the meeting. The following working group members or their representatives were present: Jack Gies and Allen Elstein (Conn.); Hal Phillips representing Woody Girion (Calif.); and Lynda Klebold (N.J.).

Larry Gorski (Ill.) stated that the purpose of the call is to discuss the Oct 28, 1997, draft Synthetic Guaranteed Investment Contracts Model Regulation from the technical advisors, excluding the section on reserves. The first item discussed was the issue of whether the scope of the regulation was too broad. Brian Haendiges (Aetna) stated that it was the common understanding of the technical advisors that this model is not intended to cover equity-indexed products. He specifically noted that the words "in whole or in part" were intended to address situations where insurers issued contracts which contained both synthetic GICs and general account/separate account products. After a lengthy discussion, none of the working group members proposed any changes to the "Purpose" or "Scope" section. Mr. Gorski suggested that adding the word "segregated" in front of "portfolio of assets" in the definition of "synthetic guaranteed investment contract" would reinforce the intent of the drafters.

The next point discussed was the last sentence in the "Purpose" section ("The regulation is intended..."). After a brief discussion, no working group member objected to its inclusion.

The next issue discussed was the financial qualification requirements in Section 5. Mr. Gorski stated that he thought these requirements were included out of a desire to be consistent with existing state standards. He noted that these standards would upset some of the excluded companies, and that it might be desirable to rely on the marketplace to determine the "players." Mr. Haendiges said that both regulators and industry personnel should take comfort from knowing that "fly-by-night" insurers would not be permitted to market a product that is relatively new and evolving. Mr. Haendiges noted that the proposed language did allow some commissioner discretion to establish other financial standards. Hal Phillips (Calif.) stated that the provision allowing commissioner discretion "destroys the uniform nature of the regulation." He said he had initially read that language as allowing the commissioner to set higher standards, not lower the explicitly listed financial standards. Mr. Gorski asked Mr. Phillips why he was concerned about lowering the standards, since he had previously stated there was minimal risk to the insurer under these contracts. Mr. Phillips said these were minimal risks for sophisticated insurers, but "it could be quite risky if you don't know what you're doing." Jack Gies (Conn.) asked how the contracts could be structured so as to pose a substantial risk to the insurer. Mr. Haendiges said an insurer might offer a contract with a high interest guarantee, combined with high yield/low quality securities and generous withdrawal provisions. Mr. Phillips stated that his department would be very concerned about a contract that offered full book value withdrawal rights. Mr. Gies asked if the model adequately addressed the underwriting provisions that should/should not be contained in the contracts, or would it fall back to the state's judgement when reviewing each contract. Mr. Gies also asked how prevalent such financial standards were in other NAIC models. Mr. Gorski stated that he believed it was very unusual to impose this requirement at a product level. Lynda Klebold (N.J.) noted that: (1) New Jersey requires that insurers be authorized to write separate account business in order to write synthetic GICs, and (2) the provision allowing commissioner discretion would never be approved by the New Jersey attorney general because it is "too arbitrary." Ms. Klebold also stated that she would prefer to have consistency with the financial requirements for writing separate account business, and she did not want to eliminate sophisticated companies through excessive financial requirements. Mr. Gorski concluded the discussion by saying that since there was no clear consensus as to how to proceed, further discussion should be postponed until after a review of the filing requirements.

Mr. Haendiges then reviewed the proposed filing requirements in the model relative to the plan of operations. A specific discussion ensued as to the conditions under which the commissioner in the state of filing should accept the domiciliary commissioner's approval of the plan of operations. Ms. Klebold stated that she would want: 1) the domiciliary state to have a regulation in place, and 2) an approval letter from the domiciliary department regarding both the contract and the plan. Mr. Gorski stated that he would like to modify the language in Section 5C(1) to allow the commissioner to apply an "acceptability standard" to the evidence of approval that is provided. Mr. Haendiges stated that he would have a concern if the "acceptability standard" imposed anything more than proof of domiciliary state approval. By consensus, the working group requested that the technical advisors expand the sentence in Section 5C(1) to read: "Evidence of such affirmative approval shall be included in the submission." A discussion then occurred relative to Section 5C(2): "at the discretion of the commissioner." Mr. Gorski stated that he would prefer to leave it in. Ms. Klebold stated that she would prefer to take it out since it seems to contradict Section 5C(1) and, in reality, the commissioner always has a certain level of discretion. Mr. Haendiges said the advantage of leaving the language in is that it gives the state of filing the ability to waive the filing requirement when the domiciliary state's standards are adequate, even if not "substantially similar." A consensus was reached to leave this language in the draft. Ms. Klebold requested that the provisions of Section 7C be made consistent with Section 5C.

Mr. Haendiges then addressed the issue Mr. Gies had raised earlier regarding the underwriting standards imposed by the model. He characterized the situation as a "mixed bag." He said that relative to investments, what is allowed and not allowed is managed through the plan of operations. However, Mr. Haendiges said relative to withdrawal hierarchies or benefits paid to participants, one has to look to the reserve requirements to provide appropriate constraints. He said "it would be going overboard" to create a regulation which, for example, required approval of individual withdrawal hierarchies. Mr. Gies said the degree to which the suggested formula reserves (in addition to asset adequacy analysis) were appropriate for these products was an important topic for the Life and Health Actuarial (Technical) Task Force.

Mr. Haendiges then reviewed recent changes to the draft regulation. First, he noted that changes had been made to Section 4H to make it clear that in order for there to be an interest guarantee there has to be a principal guarantee. Jeff Mohrenweiser (CNA) stated that a lot of synthetic GICs do not cover defaulted securities, and he asked if Section 4H would eliminate such provisions. Mr. Haendiges agreed that there are provisions in many synthetic GICs that remove the principal guarantee from assets that do not maintain minimum requirements, and he said the model language was not intended to preclude those provisions. Mr. Gorski asked if, typically, the "bad asset" would be replaced by a "good asset." Mr. Mohrenweiser said there could be replacement, or the "bad asset" could simply "evaporate." Mr. Gorski said he believed the language in Section 4H was broad enough to cover either situation. Mr. Phillips said that he "had difficulty with the basic structure" of what was being talked about. He said that a guarantee of principal in a synthetic GIC is "a contradiction in terms." Mr. Gorski stated that insurers do guarantee principal, but that they protect themselves against default risk by the mechanisms previously discussed. Mr. Phillips responded that, as a practical matter, the mechanisms previously described did not function as principal guarantees. Mr. Gorski disagreed, saying it was a principal guarantee as to benefits to policyholders as opposed to principal guarantees as to the underlying securities. Mr. Haendiges said the guarantees related to "the extent to which the principal amounts held by individual participants will perform, regardless of the underlying assets." Mr. Haendiges stated that if the underlying assets go bad but there are no benefits to be paid, there is no obligation on the part of the insurer. Mr. Phillips said he still did not understand why the words "principal guarantee" were included in Section 4H. He said what had just been discussed was "replacement" or elimination, not a "principal guarantee." He further stated if this language was intended to apply only to guarantees for individual participants, it should more explicitly say so. Mr. Gorski stated that "contract benefits" implied "contract benefits for individual participants."

Mr. Haendiges then noted that the phrase "in a fiduciary capacity to the owner of such assets" had been added to Section 4K, per a request from Reginald Berry (D.C.).

A lengthy discussion then ensued regarding the word "fixed." Specifically, Mr. Phillips said it as a "red herring" to use the phrase "fixed rate or rates of return" in the "Scope" section, and that it "complicated and convoluted the language" in the definition of "crediting rate formula." Mr. Haendiges said the thinking of the drafters had been that, in the absence of the word "fixed," readers may mistakenly assume that equity-indexed products are covered by the model. Mr. Gies expressed agreement with Mr. Phillips; he stated he was not sure what was meant by "fixed." Mr. Gorski asked if the drafting note at the bottom of page 2 provided any clarity; no one responded to that question. Mr. Haendiges stated that he did not know how to insert additional words that would make the meaning clearer, and he thought taking "fixed" out would create more confusion than leaving it in. Mr. Gorski suggested that perhaps other adjectives could be used in lieu of "fixed," such as "stipulated" or "declared."

Mr. Phillips then questioned the phrase "may not anticipate future changes in such market conditions" in the "Scope" section. He stated that, literally read, he "didn't know if anyone could really live with that." Mr. Haendiges said that, again, the intent was to differentiate these products from indexed products. Mr. Phillips asked if the intent really was to preclude any ability to anticipate how interest rates might move when determining the rate of return for the upcoming rate period. Mr. Haendiges said that that was, in fact, the intent; no prediction of interest rate movements would be allowed in the crediting rate formula. Mr. Gorski expressed agreement with Mr. Phillips. He said that the crediting rate formula should be permitted to recognize elements such as the rollover and reinvestment of funds. Mr. Haendiges disagreed; he stated that, to the extent what Mr. Gorski described was occurring, the company was creating a risky guarantee relative to an unpredictable future environment.

Mr. Gorski then posed the question that, if Mr. Haendiges' position prevailed, would a contract which did anticipate future changes in market conditions fall outside the scope of the model? He said that would make no sense if the contract otherwise met the conditions for a synthetic GIC. Ms. Klebold said that, in that situation, the regulator should argue that the contract should not be issued. Mr. Gorski disagreed, stating that "just because you don't have a regulation in place doesn't mean you can't issue a product." Mr. Phillips stated that the language was too restrictive, and should be amended to allow insurers to anticipate future market conditions up to one year. Mr. Gorski stated that, rather than being too restrictive, this was a loophole that would allow insurers to escape regulation. Bob Brown (CIGNA) suggested that the language be modified to make clear that what was being prohibited was a linking or a reference to an outside index. Mr. Haendiges said the technical advisors would attempt to incorporate that suggestion.

Mr. Gorski then asked if an insurer could issue a product that was linked to an external index. Mr. Haendiges said an insurer could only issue that product under another regulation. Mr. Gorski said the insurer could issue the product if there were no regulation prohibiting it; he said that the industry is issuing synthetic GICs now without the benefit of specifically enabling legislation. Mr. Gies said this may point out the need to more explicitly prohibit non-complying product designs.

Mr. Haendiges asked "where all of the preceding discussion leaves us." Mr. Gorski said there may be no real problem to address, since this regulation is dealing with a specific subset of synthetic GICs. He said if there were other products that needed to be dealt with, then regulators would simply have to go through this process again. He said his concern was whether creating exceptions in the model would encourage companies to move towards those exceptions when developing new products.

Mr. Haendiges said that he would provide the next revised draft directly to the working group members in time for them to review it prior to the Winter National Meeting in Seattle.

Having no further business, the Synthetic GIC Working Group adjourned at 12:45 p.m.

1998 Charges
Life Insurance and Annuities (A) Committee

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

Life Disclosure Working Group

1. Complete development of Annuities Disclosure and Sales Illustrations Model Regulation, including Buyer's Guide/disclosure documents. Complete by Fall National Meeting. Approximate cost is \$
2. Review Life Insurance Illustrations Model Regulation for possible changes necessitated by revision of the Life Insurance Nonforfeiture Law development of equity-indexed life insurance products and state experience in implementing the model. Complete by Winter National Meeting. Anticipate no extra cost. Approximate cost will be \$1,500.
3. Establish model requirements for policy illustrations or ledger information disclosed or made available to consumers of variable life insurance and variable annuities by the Fall National Meeting, subject to coordination with regulatory initiatives of the Securities and Exchange Commission and the National Association of Securities Dealers. Approximate cost will be \$6,000.
4. Review other NAIC models for potential conflicts with the Life Insurance Illustrations Model Regulation. Revise as needed. Identify areas for change and begin amendment process by Winter National Meeting. Consider disclosure issues related to advertising model rules. Approximate cost will be \$2,000. Anticipate no additional cost.

Viatical Settlements Working Group

5. Complete amendments to the Viatical Settlements Model Act by the Spring National Meeting and the Viatical Settlements Model Regulation by the Winter National Meeting. Complete an actuarial study to determine appropriate minimum payouts, and include results in amendments to the model regulation. Approximate cost will be \$2,400.

Synthetic GIC Working Group

6. Expose for comment and finalize recommendations regarding the Synthetic Guaranteed Investment Contracts Model Regulation. Complete this project by the Summer National Meeting. The estimated cost of mailings and conference calls is \$1,000.

Replacement Issues Working Group

7. Make recommendations for changes to Life Insurance Replacements Model Regulation and Life Insurance Advertising Model Regulation. Consider replacement issues related to advertising and coordinate with group working on disclosure issues. Develop new model language recommendations to deal with issues of suitability, agent compensation and using policy values for financing. Complete by Fall National Meeting. Approximate cost will be \$3,500.

(A Committee will assign responsibility)

8. Consider issues related to marketing and suitability of sales of life insurance and annuities, particularly in regard to replacements and sales of annuities to seniors. Consider the need for amendments to the Rules Governing the Advertising of Life Insurance. Make recommendations by Winter National Meeting. Approximate cost will be \$3,500.

9. Consider issues related to sales of equity-indexed products, such as marketing and agents' licensing requirements. Make recommendations by Summer National Meeting. Approximate cost will be \$2,000.

10. Determine whether the Q&A document developed by the Life and Health Actuarial (Technical) Task Force and referred to the Financial Condition (EX4) Subcommittee for consideration in the codification project contains accounting guidance, and whether it is an interpretation of, or amendment to, the Life Reinsurance Agreements Model Regulation. If changes are made to the model regulation by the Life Insurance (A) Committee during its subsequent review, the amended model regulation will be referred to the Codification Maintenance Group. Anticipate cost of \$1,000.

11. Review various types of annuities and suggest to the parent committee where resolution, if necessary, should be sought. This is an on-going charge. Approximate cost will be \$1,000.

12. Oversee changes and provide technical assistance as appropriate for the production of the Market Share Reports for the Top 125 Life and Fraternal Insurance Groups and Companies by State. This is an on-going charge. Anticipate no additional cost.

1999 Charges
Life Insurance (A) Committee

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

Life Disclosure Working Group

1. Review Life Insurance Illustrations Model Regulation for possible changes necessitated by revision of the Life Insurance Nonforfeiture Law and state experience in implementing the model. Complete by Winter National Meeting. Anticipate no extra cost.
2. Continue review and amendment process for model laws with potential for conflict with the Life Insurance Illustrations Model Regulation. Approximate cost \$3,000.
3. Review other NAIC model laws for potential conflicts with the Annuities Disclosure and Sales Illustrations Model Regulation and revise as necessary. Approximate cost is \$1,500.
4. Review Universal Life Model Regulation and revise as necessary. Approximate cost is \$4,000.

ATTACHMENT SEVEN

Life Insurance (A) Committee
Conference Calls
Nov. 6 and Nov. 17, 1997

The Life Insurance (A) Committee met by conference call Nov. 6, 1997, and Nov. 17, 1997. A quorum was present and Terri Vaughan (Iowa) chaired the meeting. The following committee members or their representatives participated: Neil D. Levin (Vice Chair) represented by William Carmello (N.Y.); James H. Brown represented by Lester Dunlap (La.); Steven B. Larsen represented by Howard Max (Md.); Linda Ruthardt represented by Cindy Martin (Mass.); Chris Krahling represented by Jerry Fickes (N.M.); Glenn Pomeroy represented by Tom Foley (N.D.); and John Crawford represented by Dan Keating and Dalora Schafer (Okla.).

Commissioner Terri Vaughan (Iowa) said the purpose of the conference call on Nov. 6 was to review a preliminary draft of a response to the Securities and Exchange Commission (SEC) request for information on equity-indexed products. She said the committee would review the draft to see if it adequately covers what regulators do, address the more global question of whether regulators should take a position in the letter on whether equity-indexed products should be regulated by the SEC, and schedule a second conference call.

1. What the NAIC and State Regulators Are Doing in Terms of Equity-Indexed Products

Jerry Fickes (N.M.) suggested adding some information under the market conduct section to explain that there would be more requirements other than just disclosure. Larry Gorski (Ill.) said this was already addressed in Sections 1 and 2 on disclosure and illustrations. He said he thought of market conduct issues as what department staff look for in an examination, rather than rules regarding advertising etc. Mr. Fickes agreed that the standards described in Sections 1 and 2 would be the standards for the market conduct examiners to test against. Commissioner Vaughan suggested adding some clarifying language to the disclosure section on this issue.

Attention next turned to Section 7 on guaranty fund coverage. Mr. Fickes said that Jack Blaine (National Organization of Life and Health Guaranty Associations—NOLHGA) suggested at the Annuities Working Group meeting that there should be some discussion at the Insolvency (EX5) Subcommittee on the extent of guaranty fund coverage. Mr. Gorski cautioned that the position taken on guaranty fund coverage needed to be consistent with the position taken in the reserving section. Dan Keating (Okla.) asked if this would affect smoothness and minimum cash values and Mr. Gorski responded in the affirmative. Mr. Fickes said that until the contract ends, the exact figures will not be known.

Attention turned next to Section 8 on licensing. Commissioner Vaughan asked if there was more information that could be added to this section and Mr. Fickes agreed to draft more language to add under the future plans section.

Cindy Martin (Mass.) asked whether the investments section should consider risk-based capital requirements. Mr. Gorski agreed that more sophisticated methods of measuring for risk-based capital would point out a mismatch of hedging instruments. He said the Risk-Based Capital (EX4) Task Force had already discussed equity-indexed products and agreed that they should be treated for risk-based capital purposes like any other annuity product. Commissioner Vaughan suggested adding a Section 10 to the paper on risk-based capital requirements. Ms. Martin asked about the application of the Investments of Insurers Model Act to this issue and Mr. Gorski responded that the Investments of Insurers Model Act does recognize derivatives for hedging and that aspect of the model is better guidance than the laws in most of the states. The committee agreed to add information on the model act to the paper.

Ms. Martin made some suggestions for strengthening the paper to remove tentative sounding language. Commissioner Vaughan suggested that the paper talk more about what is going on in the states. Mr. Fickes said the regulators do not always know what is happening in other states. He said New Mexico asks all who are selling equity-indexed products to include their advertising material in the filing. Mr. Gorski said the Illinois filing requirements are attached as one of the appendices and he suggested that was probably typical of state activity for review of equity-indexed products.

2. Conclusion

Commissioner Vaughan said the paper does not yet contain a conclusion. First, the regulators need to tackle the issue of whether to say this is an insurance product alone and whether to say that the SEC should not regulate it. Mr. Gorski said that most regulators are confident that it is an insurance product and should be regulated by the insurance department, however, some regulators say that it should also be regulated by the SEC. Mr. Keating said he thought the paper should say that states will regulate this product and the SEC does not need to do so. Mr. Gorski said that if the SEC regulated, it would regulate advertising and market conduct issues but not functional regulation. He said this works for variable products but the SEC does not deal with reporting and financial issues. Mr. Gorski said one area he felt uncomfortable with the state regulators' position is licensing. He said he would like to see an NAIC group discuss the licensing issues, and perhaps develop questions for a licensing examination specific to equity-indexed products. Ms. Martin said she thought there was more to SEC oversight of variable products than just disclosures and advertising. Donna Claire (Claire Thinking) said the SEC regulation does get into the issue of loads, which is really rate regulation. Ms. Martin said another distinct difference in SEC regulation is that there cannot be future projections of returns, but only purely historical illustrations. Mr. Gorski asked if insurance regulators would want to require an historical illustration; that might be exactly the wrong thing to do. Commissioner Vaughan asked if there were any other areas where there might be a potential conflict between what the SEC would require and what insurance regulators would require. Ms. Claire said that the SEC requires investments to be in a separate account, whereas the equity-indexed products usually are sold through the general account. Mr. Gorski said that if they were considered variable products, that would eliminate guaranty fund coverage. If dual regulation occurred, the products would be required to be sold through a separate account and he suggested that the industry would probably eliminate the minimum guarantees if that were the case. He said that would be a negative for dual regulation. Mr. Fickes said the existence of the floor guarantees is the distinction between this product and variable products.

The committee members agreed to prepare a conclusion to the paper that says that the minimum guarantees, the guaranty fund coverage, and the fact that these are general account products lead regulators to conclude that these are appropriate for state regulation only. The group decided to include a recognition that the agents licensing requirements are an area that still needs work.

3. Schedule Second Conference Call

The committee agreed to meet by conference call again on Nov. 17 to review a revised draft. When the group reconvened, Commissioner Vaughan asked for comments on the revised draft. Howard Max (Md.) suggested that the second sentence in the concluding comments implied that if there were no minimum guarantees, guaranty fund coverage, and general account location, these would not be subject to state regulation. He did not think that was appropriate. Commissioner Vaughan agreed that the implication was there and suggested the paragraph needed to be rewritten. Tom Foley (N.D.) asked if regulators want to say in this document that these products are appropriate for state regulation only. Commissioner Vaughan responded that at the last conference call there was consensus that regulators should say these are products that should be regulated solely by the states. Mr. Foley said he had not participated in the last conference call, but would have to abstain from voting on a document with such a conclusion. He said he did not have a problem with saying that insurance regulators should regulate equity-indexed products, but he did think regulators should not take a position on whether the SEC should be regulating them. Commissioner Vaughan said the NAIC has taken this type of position in regard to banks and insurance, and that state regulators have a bias against dual regulation because it does not work well. Mr. Gorski said this document addresses every aspect of state regulation, and it seems that the logical conclusion from this is that the committee should support in the document single regulation by insurance regulators. Mr. Foley said that some product designs and some marketing methods look very much like variable products. Mr. Gorski suggested that this problem could be addressed at the state level by not approving those products. He said Illinois had recently refused to approve a filing that looked very much like an equity rather than an insurance product. Commissioner Vaughan said the problem might not be the way the product is designed, but rather the way it is marketed. She suggested that the response to the SEC talk about the importance of reviewing marketing materials because they should not emphasize too greatly the equity features. She suggested redrafting the last page of the paper to lay out the case more strongly that some product designs and marketing methods may not be appropriate for only state regulation. She suggested the closing remarks start by emphasizing the differences from variable products, then speak of the conflicts that might occur in a dual regulation system, and then recognize that there are unique marketing issues and that this product should not be marketed with an excessive attention to its equity features. Mr. Gorski agreed that it was important to get across the point that there is a line beyond which regulators will disapprove the product and that it will then fall within the preview of the SEC.

Ms. Martin questioned whether the paper should make a statement that there are products that qualify for joint federal and state regulation. She said products her department has seen clearly fit under the exemption of SEC Rule 151. Mr. Gorski said he recently saw a product that he could not call an equity-indexed product because it had no participation guarantees. Therefore, it was much more like a security and he disapproved the filing. He suggested the company could then turn around and register the product with the SEC.

The committee requested that Carolyn Johnson (NAIC/SSO) revise the draft using the comments received during the conference call and fax a new draft to the committee members to review. Commissioner Vaughan said the deadline for filing this with the SEC was Nov. 20. Mary Jane Wilson-Bilik (Sutherland, Asbill & Brennan) said she had just spoken to someone

from the SEC and had been notified that the deadline for comment was extended to Jan. 5, 1998. Commissioner Vaughan said this would allow time for this document to be discussed at the Winter National Meeting of the Plenary. This would allow the comments to come from the whole NAIC rather than just from the A Committee and would present a stronger position. The committee members agreed to present the document as revised to the Plenary for adoption (Attachment Seven-A).

ATTACHMENT SEVEN-A

Adopted by Plenary 12/8/97. This version includes an amendment adopted by Plenary. Appendices are not attached.

To: Jonathan G. Katz, Secretary, Securities and Exchange Commission
From: Glenn Pomeroy (N.D.), NAIC President
Date: December 16, 1997
Re: File S7-22-97 (SEC Request for Information on Equity-Indexed Products)

The purpose of this submission is to provide information to the Securities and Exchange Commission relative to an insurance product known in the marketplace as an equity-indexed product. State insurance regulators are engaged in extensive activities related to these products, both on a state level and through the National Association of Insurance Commissioners (NAIC). The NAIC is a not-for-profit association consisting of the regulators of insurance in the 50 states, the District of Columbia, and four territories. The commissioners work together on issues whenever appropriate to develop a body of information on new topics and to develop a consensus position. The positions developed are helpful to the states when implementing their own policies.

The information that is being provided shows steps that insurance regulators are taking to regulate equity-indexed products for the protection of consumers. Much of the activity discussed in this document has taken place at the meetings of the NAIC through the leadership of the Life Insurance (A) Committee. In addition states have been studying this issue and formulating policies. After extensive study, the regulators have concluded that a properly structured equity-indexed annuity or life insurance policy is a fixed product and should not be subject to SEC regulation.

The information provided in this document will cover these major areas of state insurance regulation: 1) Disclosures; 2) Illustrations; 3) Suitability; 4) Approval of Contract Forms; 5) Market Conduct Enforcement; 6) Nonforfeiture and Reserves; 7) Guaranty Fund Coverage; 8) Licensing; 9) Investment Risk; 10) Risk-Based Capital Requirements.

Early in 1996 discussion began in several committees of the NAIC regarding a new fixed life insurance or annuity product where excess interest credits are tied to an outside equity index, such as the Standard & Poor's 500. First the regulators received information on the types of equity-indexed products being offered, and learned how insurers could manage their risk through their own investments. Discussions took place on the appropriate levels of reserving for these products and the appropriate methods of financial reporting. Regulators asked what types of disclosure would be necessary to be sure consumers understood the products so they could make wise decisions as to whether these products were appropriate for them. During 1997, the NAIC has been developing model regulations on the numerous issues of concern to regulators. Following is a list of the issues insurance regulators are discussing, and the status of the decision-making process on a state level and the NAIC level.

1. Disclosures

Background:

During 1996, the Life Disclosure Working Group of the Life Insurance (A) Committee considered development of a rule for annuity illustrations. As discussion progressed, regulators came to the conclusion that the most important part of an annuity sale was appropriate disclosure to the potential purchaser of the annuity. A disclosure is considered to differ from an illustration in that the former provides generic information, while the latter is "personalized" to reflect such items as the premiums and benefits anticipated to be paid relative to a specific consumer. While discussing the disclosures of surrender charges, rates of return and other issues during 1997, the regulators tentatively agreed that special disclosures are needed for equity-indexed products because of the variety of product designs and features. Review of advertising materials is important so that regulators can ascertain that the material presents equity-indexed products appropriately by describing the insurance features, rather than placing too much emphasis on the tie to the equity index.

Current Status:

The working group is developing a buyers' guide specifically for equity-indexed products that provides information about the product in general. Questions are included so the applicant can get specific information about how the product design under consideration works. The current draft of the buyers' guide is Appendix A.

Future Plans:

The working group expects to make a recommendation to the Life Insurance (A) Committee at its December meeting. States have indicated in surveys that they plan to adopt an NAIC model governing annuity disclosure and illustrations.

2. Illustrations

Background:

During the discussion on annuity disclosures and illustrations undertaken by the NAIC during the past year, discussions of the Life Disclosure Working Group focused on whether illustrations should be required for all annuity sales, whether they should be required for some products, or whether they should be optional for all sales. When considering the option to require illustrations for only some products, the regulators identified equity-indexed products as a form of fixed annuity for which an illustration might be required for every sale.

Current Status:

The Life Disclosure Working Group is drafting a model regulation that will serve as a pattern to states as they consider appropriate rules for their own states. In a similar process concluded at the end of 1995, a rule was prepared for life insurance illustrations. It has already been adopted or is far along in the process of adoption as a requirement in over half of the states. It can be anticipated that experience with an annuity illustration and disclosure regulation will proceed in a similar fashion. A copy of the current version of the pending regulation is Appendix B.

Future Plans:

The NAIC expects to complete development of the regulation on disclosures and illustrations for annuities and present it to the Life Insurance (A) Committee for adoption by the NAIC in March 1998. The regulators plan to revisit the Life Insurance Illustrations Model Regulation at the conclusion of that project and will consider whether additional provisions need to be included for equity-indexed life insurance.

3. Suitability

Background:

The NAIC has not established suitability standards in the past for non-variable life insurance or annuity products. The only model regulations developed by the NAIC that contain suitability standards are those for variable life insurance and for long-term care insurance. However, a survey of state insurance departments on annuity issues pointed out that many states experience complaints from citizens who were sold an annuity inappropriate for their situation. Those states urged the NAIC to develop a model on suitability of sales of annuities, particularly suitable sales to senior citizens. Some states have already developed their own suitability standards applying to life insurance and annuity sales. See for example, the Iowa standards in Appendix C.

Current Status:

The Annuities Working Group is considering issues related to suitability and will make recommendations to the Life Insurance (A) Committee regarding an appropriate regulatory response. The Replacement Issues Working Group is working on a model regulation for replacements and will also address the issues of suitable sales and disclosure in the case of replacements of individual life insurance policies or annuity contracts.

Future Plans:

The Annuities Working Group will make a recommendation to the Life Insurance (A) Committee at the NAIC meeting in December. At that time the Life Insurance Committee will make a recommendation for 1998 to address suitability of annuity and life insurance sales. The Replacement Issues Working Group has exposed its regulation for comment and expects to present a final copy to the Life Insurance (A) Committee by March 1998. There are enough concerns expressed to make sure this issue will receive consideration from the Life Insurance (A) Committee quickly.

4. Approval of Contract Forms

Background:

When the first contracts for equity-indexed products were filed with the state insurance departments in 1995 and 1996, some regulators hesitated to approve the contracts until they had a better understanding of the financial impact on the insurer, and a comfort level with the disclosure and advertising materials being provided to consumers. The Life Disclosure Working Group was asked in early 1997 to provide an educational program to help regulators familiarize themselves with the issues of importance in approval of equity-indexed products. Several states took the lead in developing requirements for materials to include in a filing.

Current Status:

The Life Disclosure Working Group sponsored a Symposium on Equity-Indexed Products in June 1997. The session was video taped and distributed to those responsible for review of form filings in each state. Written resource material has also been provided to each state. A copy of the symposium video is available upon request of the NAIC library.

The state of North Dakota, chair of the Life Disclosure Working Group, made the development of a bulletin on contract review procedures an example for other states. Comments on the draft bulletin were solicited through the NAIC, and the bulletin became a part of the NAIC record in March 1997. The final regulatory bulletin includes a product filing checklist for disclosure materials, advertising, illustrations, the marketing plan, agents training, and a required illustration. It is Appendix D to this document.

Illinois also created extensive filing requirements to be used in Illinois, before approval of an equity-indexed product. The Illinois contract approval guidelines for submissions to the insurance department are Appendix E.

Future Plans:

The NAIC will continue to review material such as the North Dakota and Illinois contract filing standards to identify elements that are appropriate to include in model regulation standards. States will continue to share their contract review standards with each other. Many other states have indicated to insurers that additional information is required for filings of equity-indexed products. See the Vermont filing requirements, which are included as Appendix F.

5. Market Conduct Enforcement

Background:

The equity-indexed product standards being developed will be enforced by the states through state laws related to agents licensing, unfair trade practices, and market conduct examinations and enforcement.

Current Status:

States have standards in place to deal with many market conduct issues. For example, the Unfair Trade Practices Act, adopted in all the states in some form, prohibits misrepresentations in advertising or the sales process. It is an unfair trade practice to misrepresent the benefits and advantages of an equity-indexed product or to make a false or misleading statement as to the excess interest that will be credited. As standards are developed under the auspices of the Life Insurance (A) Committee, market conduct concerns are being considered and addressed. Specific standards are being developed for defining a misleading or inaccurate statement about the benefits of an equity-indexed product.

States have standards in place to address concerns regarding agents who do not sell equity-indexed products appropriately so that an agent's license may be terminated or not renewed if indicated. The states utilize the NAIC Regulatory Information Retrieval System (RIRS) to identify agents who have had their licenses terminated in another state or who have been penalized for violations of state law.

States have procedures in place and regularly conduct market conduct examinations of life insurers selling life insurance and annuities of all types. Mechanisms are in place to enforce standards relative to equity-indexed products. Inappropriate conduct that comes to light during a market conduct examination can be addressed. States also have cooperated in the conduct of multistate examinations and have shared with each other information gleaned in examinations.

States have procedures in place to assist consumers with complaints or concerns. Consumer divisions will explain equity-indexed products where the purchaser has questions and will address complaints about inappropriate sales activity of insurers.

Future Plans:

As standards developed by the NAIC Life Insurance (A) Committee are put in place, more specific market conduct standards may be needed to address the particular issues related to product designs. For example, market conduct enforcement may be necessary for specific standards related to advertising, solicitation, and agent training.

6. Nonforfeiture and Reserves

Background:

During the latter part of 1996 the NAIC Life and Health Actuarial (Technical) Task Force recognized the need to study equity-indexed products. It therefore added the review of various aspects of equity-indexed products to its charges for 1997. Additionally, at the December 1996 NAIC Commissioners Roundtable meeting the chair of the Life and Health Actuarial Task Force gave a presentation on equity-indexed products and encouraged the regulatory audience to pay close attention to the issues and concerns regarding these products. The American Academy of Actuaries, at the request of the NAIC Life and Health Actuarial Task Force, formed its own Equity-Indexed Products Task Force to provide technical assistance to the Life and Health Actuarial Task Force and has since done much, particularly in the area of reserve valuation.

Current Status:

Regarding statutory minimum reserves, the Life and Health Actuarial Task Force has determined that the Commissioners Reserve Calculation Method (CRVM) and the Commissioners Annuity Reserve Valuation Method (CARVM) should apply to equity-indexed life insurance and annuities, respectively. This is true whether the products are written as part of the insurer's general account (where assets are commingled and are available to fund all general account liabilities) or the separate account

(where assets are segregated and are available to fund only specified liabilities). CARVM is the statutory minimum valuation standard for individual and some group annuities.

CARVM defines the minimum reserve as the greatest of the present values of guaranteed benefits at each future policy duration. The literal application of CARVM to equity-indexed annuities is complex due to the nature of the guarantees in such products. The typical product guarantees that the policyholder will receive a benefit at the end of a defined period of time based on the greater of two amounts: (1) an accumulation, at a guaranteed rate of interest, of a specified percentage of premiums paid, and (2) the initial premium increased by a guaranteed percentage of the increase in some equity based index, possibly subject to a cap. Interim benefits such as death or withdrawal benefits may also reflect some or all of the increase in the equity based index. The second component of the benefit amount contains guarantees that cannot be precisely evaluated at the date of policy issue.

The Life and Health Actuarial Task Force has developed and exposed for comment an actuarial guideline that identifies three computational methods that are consistent with CARVM and properly reflect the nature of the product guarantees. The guideline applies to both new and in force business as of the date of adoption by a state. Although the earliest the guideline could be adopted by the NAIC is June 1998, it is expected that some states will start applying the guideline with the year-end 1997 reserve valuation. The guideline is titled "The Application of the Commissioners Annuity Reserve Method to Equity-Indexed Annuities" and is attached to this document as Appendix G. The Life and Health Actuarial Task Force is continuing to study how CRVM should be applied to equity-indexed products.

Minimum statutory formula reserves are only part of the regulatory reserving requirements applicable to equity-indexed annuities. These products, like traditional annuity products, are subject to an asset adequacy analysis. The basic idea behind asset adequacy analysis is that the insurer's appointed actuary evaluates the adequacy of formula reserves by analyzing the interplay of asset cash flows and product cash flows under different economic scenarios. The analysis considers all of the insurer's general account business and assets equal in amount to the reserves being tested for adequacy in the aggregate; a similar test is made for the insurer's separate account. The insurer then submits to its regulators an opinion prepared by the actuary as to the adequacy of reserves.

Regarding nonforfeiture values, the American Academy of Actuaries' Equity-Indexed Products Task Force recommended in its Aug. 4, 1997, interim report to the Life and Health Actuarial Task Force that minimum nonforfeiture values should be such that equity-indexed product designs can be as flexible as possible to meet the differing needs of the consumer. However, it is also important for the nonforfeiture requirements to be consistent with the intent of the existing nonforfeiture laws, which provide guaranteed minimums for nonforfeiture values for both general and separate account products (possibly subject to market value adjustments). In order to achieve both goals the Academy task force recommended that existing nonforfeiture requirements be supplemented by additional disclosure and filing requirements. While the Life and Health Actuarial Task Force believes that existing nonforfeiture laws apply to equity-indexed products, it has not yet taken an official position as to the precise manner in which the laws should be applied.

Future Plans:

The Life and Health Actuarial Task Force expects to consider the Academy task force recommendations regarding nonforfeiture values and will address valuation and nonforfeiture issues with regard to equity-indexed life insurance products.

7. Guaranty Fund Coverage

Background:

The Life and Health Guaranty Association Model Act provides coverage for the guaranteed portion of an annuity or life insurance contract, up to statutory maximums. See coverage provisions of the model in Appendix H.

Current Status:

The Insolvency (EX5) Subcommittee is being asked to issue a formal declaration that equity-indexed products are included in the coverage. Informal discussion with members and with representatives from the guaranty association has generated assurances that coverage is provided. In all product designs, coverage would be present for the policy guarantees. The amount of the guarantee may depend on product design. All other things being equal, a design with an annual ratchet could have a higher guaranteed amount during the term of the contract than a design with a point-to-point or high-water approach to interest crediting.

Future Plans:

The Insolvency (EX5) Subcommittee level of the NAIC will need to discuss the impact of different product designs on the guarantees provided under state guaranty fund laws. There is some sentiment that the excess interest is guaranteed at least to the date of insolvency, even though its amount is not known prior to the end of the contract term.

8. Licensing

Background:

Discussion of whether there should be any specific licensing requirements for producers selling equity-indexed products has been very informal.

Current Status:

No recommendations have been made as to whether producers selling equity-indexed products should have any different licensing requirements or educational standards.

Future Plans:

Upon completion of the disclosure standards and illustration requirements by the Life Disclosure Working Group, the Life Insurance (A) Committee will oversee a review of other models dealing with marketing issues. This includes models addressing advertising and solicitation. If necessary other rules will be developed to supplement the disclosure standards and illustration requirements. A review of the agent licensing requirements may be made to determine if the standards for agent licensing need to be strengthened or even made similar to those required for the sale of variable products.

9. Investment Risk

Background:

The Life and Health Actuarial Task Force began gathering information on investments related to equity-indexed products in 1996. Of particular concern was the hedging required so an insurer would have the money available to pay the guarantees in a falling market, as well as the investments to support the excess interest that would be required in an rising market.

Current Status:

The Life and Health Actuarial Task Force has heard reports from the Equity-Indexed Products Task Force of the American Academy of Actuaries on investment strategies. In addition, the task force heard a presentation from an investment firm with its recommendations for insurer investment strategies. Although insurers currently hedge their risks for other excess interest products, the hedging requirements for equity-indexed products appears to be different. The section on reserves includes further information on this issue.

Some of the states have addressed concerns about investment strategies in the contract filing materials requested before contract approval. See the material included in Appendix D and E. States have expressed concern that insolvencies may increase if insurers are not adequately invested for a sharp downturn or a dramatic upswing in the market. States are being asked to adopt the portions of the NAIC Investments of Insurers Model Act (Defined Limits Version) that deal with derivatives for hedging. The provisions are more useful for this purpose than many state laws previously in place on hedging.

Future Plans:

The NAIC has requested that the American Academy of Actuaries develop more sophisticated methodologies for detection of mismatching between hedging strategy and exposure.

10. Risk-Based Capital Requirements

Background:

The Risk-Based Capital Task Force of the NAIC discussed whether special rules are needed for equity-indexed products and has decided that equity-indexed products should be treated for RBC purposes the same as any other life insurance or annuity product, and be reported in the same manner on the annual statement.

Current Status:

The risk-based capital instructions were amended to say that consideration is needed for products with credited rates tied to an index as the risk of lack of synchronization of asset and liability cash flows is tied not only to changes in interest rates but also to changes in the underlying index.

Future Plans:

The NAIC Risk-Based Capital Task Force plans to consider within the interest rate risk components of the risk-based capital formula, factors specific to various equity-indexed products for future years' calculations.

Concluding Comments

It should be clear from the preceding discussion that the NAIC, and the states individually, have engaged in a significant effort during the last year to address regulatory issues surrounding equity-indexed products. The NAIC also believes that state regulators should be the exclusive regulators of equity-indexed products. We take this position based on two considerations:

First, equity-indexed products are fundamentally different from variable products, which the SEC currently regulates. Variable products are separate account products, have no minimum guarantees and are not subject to guaranty fund coverage. By contrast, equity-indexed products contain minimum guarantees, are subject to guaranty fund coverage and are backed by the insurer's general account assets. In these respects, equity-indexed products are closer to fixed products than to variable products.

Second, it appears that some SEC regulation, if applied to equity-indexed products, would conflict with insurance regulation. For example, SEC restrictions on loads could conflict with the minimum nonforfeiture benefits established by the states. The requirements for policy illustrations could conflict with the SEC's prospectus requirements.

Certainly the states recognize that there are unique marketing issues related to equity-indexed products. Insurers need to emphasize the insurance characteristics and not over-emphasize the investment characteristics when marketing these products. We believe, however, that these issues can be addressed during the product approval process, by reviewing the products and marketing materials. Where an equity-indexed product over-emphasizes the investment features in marketing, does not provide a minimum guarantee, or in some other way functions as a security, it may be appropriate to subject it to SEC regulation. Ordinarily, however, the state insurance regulator could be expected to reject such a product. Equity-indexed products, properly designed and marketed, normally should not be subject to SEC regulation.

State regulators recognize that there are special and unique qualities to equity-indexed products and they continue to develop standards to better protect the insurance-buying public.

We thank you for the opportunity to provide information on this issue.