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 at the Salt Palace Convention Center in Salt Lake City, Utah, at 8 a.m. on March 17, 1998. A quorum was present and Terri Vaughan (Iowa) chaired the meeting. The following committee members or their representatives were present: Martin Carus representing Neil D. Levin, Vice Chair, (N.Y.); John Wallace representing Patrick E. Kelly (D.C.); Lester Dunlap representing James H. Brown (La.); Cindy Martin representing Linda Ruthardt (Mass.); Jerry Fickes representing Chris P. Krahling (N.M.); Dan Keating representing John Crawford (Okla.); and Leslie Jones representing Lee P. Jedziniak (S.C.).

1. Report of the Replacement Issues Working Group

Paul DeAngelo (N.J.) said he was excited to report on the Replacement Issues Working Group's progress. The group held conference calls in January and March and met for a total of four hours at the Spring National Meeting. He was proud to report that the working group completed the Life Insurance and Annuities Replacements Model Regulation. He said the working group received excellent cooperation from insurance companies and the National Association of Life Underwriters (NALU).

Commissioner Terri Vaughan (Iowa) commended Mr. DeAngelo and the working group for an excellent job of finding the right balance. Commissioner Vaughan said her preference is to expose the model adopted by the working group for a limited time period and have a conference call in early May to adopt the model.

Lester Dunlap (La.) said he was prepared to offer an amendment to the language in the model to add a sentence to Section 7C. Mr. Dunlap asked the committee to consider adding the following language: "In the case of consecutive automatic premium loans or systematic withdrawals from a contract, the insurer is only required to send the notice at the time of the first loan or withdrawal." Mr. DeAngelo said he had no objection to that addition and agreed that the wording was appropriate. Jerry Fickes (N.M.) moved to receive the minutes (Attachment One) and the model with the amendment (Attachment Two) and expose the model for comment to the A Committee until May 1. Mr. Keating seconded the motion.

Scott Cipinko (National Alliance of Life Companies—NALC) said the working group took a practical look to make sure the new policies and procedures in the model do not disrupt the marketplace. He asked Commissioner Vaughan to consider having the conference call after May 2 because his organization is meeting on that date. He also asked that staff send a copy of the model to all of the states. Commissioner Vaughan asked any who are interested in submitting comments to send them to Carolyn Johnson (NAIC/SSO) before May 8, 1998. Commissioner Vaughan said she would review the comments at that time and if no changes other than technical corrections are necessary, a conference call would be scheduled shortly thereafter. If the discussion seems more complicated than could be handled at a conference call, it will be postponed until the next A Committee meeting. Mr. DeAngelo said he would appreciate being included in the call. Hearing no further discussion, Commissioner Vaughan called for a vote and the motion to receive the minutes and the amended model passed.

2. Report of the Viatical Settlements Working Group

Mr. Dunlap reported that the working group reviewed some of the issues it will be discussing during 1998. The group will consider an actuarial study on the appropriateness of the minimum payouts in the Viatical Settlements Model Regulation. He said this project is especially important because policies can now be viaticated by persons who are chronically ill. The working group will develop disclosure material, similar to that used in the New York and Texas Insurance Departments. This will give additional information to viators. Mr. Dunlap said a drafting meeting will occur around May 1 and the draft that is developed will be distributed for comment before the Summer National Meeting. Mr. Keating moved and Ms. Jones seconded a motion to receive the report of the working group. The motion passed (Attachment Three).

3. Consider Adoption of Viatical Settlements Model Act

Mr. Dunlap said the working group discussed again the issue of disclosure of the named insured to a financing entity. He noted that the current version of the NAIC model does not address this issue and the draft under consideration does not specifically address it either. Cindy Martin (Mass.) expressed concern about the confidentiality issue in the secondary market. She said that releasing the name of the insured serves no purpose and opined that the working group should take a close look at this issue in developing the regulation. Mr. Dunlap moved and Ms. Jones seconded a motion to adopt the Viatical Settlements Model Act.

Doug Head (Medical Escrow Society) commended the working group for its hard work and said the suggestion to review the confidentiality issue further during the regulation development process was a good one. He urged the Life Insurance (A) Committee to adopt the model as presented to them. Robert Shear (Accelerated Benefits Capital) said the viatical settlement industry is celebrating the 10th anniversary of its inception. In 1997 the U.S. Congress passed a law that allows for many people viaticating life insurance policies to receive the proceeds tax free. He said there was no evidence of any impropriety in regard to release of the names of viators. He also urged adoption of the model.

Tom Foley (N.D.) said he wanted to go on record in opposition to the motion. If North Dakota were a member of the committee, he would vote against the motion because this was an inappropriate message to send. Mr. Keating said he agreed with Mr. Foley that confidentiality is a key point. He also has a problem with personal contact with the ill person to see if he is still alive. Jim Bracher (Fla.) noted that the Florida Insurance Department voted for the model at the working group. Florida has a large presence of the viatical settlement industry and the department supports the model as it now exists. He encouraged the Life Insurance (A) Committee to adopt the model. Mike McNearny (Mutual Benefits Corporation) said his company structure depends on solicitation of individuals for capital. He said he believed it was very important to allow all types of financial structures in this market. If the financing entities are restricted, there will be less dollars for viators. He emphasized that there was no indication of any abuse of the individuals providing financing.

Ms. Jones asked for clarification of the motion. She said Mr. Dunlap's report suggested ongoing work on the confidentiality issue in development of the regulation, and she asked if this was part of the motion. Mr. Dunlap agreed to amend the motion for adoption of the model act to include a commitment to address the issue of confidentiality further in the regulation. Commissioner Vaughan asked the members to vote and the District of Columbia, Louisiana, New Mexico, New York, South Carolina and Iowa voted in favor of adoption. Massachusetts and Oklahoma voted against the motion. The motion to adopt the Viatical Settlements Model Act passed (Attachment Four). Mr. Fickes said he had a family member who owned a viatical settlement company, so he recused himself from the vote. Tom Rushton (N.M.) voted for New Mexico on this motion.

Commissioner Vaughan commended Mr. Dunlap and the working group members for their hard work and observed that there is more work yet to do on this issue.

4. Discuss Comments on Department of Labor Proposed Regulations on the *Harris Trust* Issue

Commissioner Vaughan asked the A Committee members to review the latest draft of the comment letter to the Department of Labor. Larry Gorski (Ill.) turned the committee's attention to Paragraph V on the last page of the letter that refers to the actuarial opinion and memorandum. Mr. Gorski said that in most states the actuarial opinion is a public document, but the memorandum is confidential. He said the draft as written implies that both the actuarial opinion and the memorandum are confidential documents. The committee agreed to amend that paragraph to clarify this distinction.

Ms. Jones moved and Martin Carus (N.Y.) seconded a motion to approve sending the letter to the DOL with the changes suggested (Attachment Five). The motion passed. Mr. Carus asked staff to send a copy of the letter to all states.

5. Consider Adoption of Charitable Gift Annuities Model Act

Mr. Fickes said this model was developed by the former Annuities Working Group and submitted to the Life Insurance (A) Committee for formal exposure at the Winter National Meeting. He received a comment from the American Council of Gift Annuities, and the American Academy of Actuaries (AAA) responded to that comment. The writer of the original letter was satisfied with the response. Mr. Fickes said because of the issues raised in these letters, he had a few technical changes to the model to suggest. Mr. Fickes asked the working group to consider changing the word "fund" in Section 4C to "account." In addition, the terminology in Section 8B(4) should be changed to allow for annuities based on the age and sex of more than one person. Mr. Fickes moved and Mr. Carus seconded a motion to include these technical amendments in the model regulation. The motion passed. Mr. Fickes asked the working group to consider another amendment, which is perhaps more than a technical amendment. Comments suggested that the A Committee change Section 4B(1)(c) so that the maximum interest rate for charitable gift annuities would not be 100 basis points less than that permitted under the state Standard Valuation Law. The original suggestion had come from the AAA, but that organization agreed that this was an appropriate change. Commissioner Vaughan asked Mr. Fickes if he agreed that the comment of the interested party had merit and Mr. Fickes responded in the affirmative. Commissioner Vaughan asked if the working group had given any thought to differentiating between charities based on whether they used professional investment advisors. Mr. Carus said it will be increasingly the responsibility of management to oversee this area, and he saw that as a mitigating factor. Mr. Fickes moved and Mr. Carus seconded a motion to include the change suggested by Mr. Fickes in the draft. The motion passed.

Mr. Fickes moved and Mr. Keating seconded a motion to adopt the Charitable Gift Annuities Model Act as amended (Attachment Six). The motion passed. Commissioner Vaughan thanked Mr. Fickes and the members of the working group for their hard work on this project.

6. Report of the Equity Indexed Products Working Group

This group held an organizational meeting and reviewed its charge to look at equity-indexed products. Mr. Fickes emphasized that the group would be reviewing issues not already under consideration by other committees. He said the working group identified agents licensing and training, guaranty fund issues, and filing of policy forms as important issues for review. He said the issue of contract filing and agents training by the companies will be the first item for review. He mentioned that staff will request information from companies on the training opportunities that they provide for their agents. Commissioner Vaughan asked if the working group will be looking at the policy filing process and Mr. Fickes responded that they will look at what information states are requesting as they consider approval of the contracts. The group has not yet come to a decision on how to address this. Commissioner Vaughan agreed that it is important to look at agents' training because this is such an important part of helping consumers make good decisions. She asked Mr. Fickes and the working group to consider the letter the A Committee wrote to the Securities and Exchange Commission (SEC) and the issues that were raised in that letter. During the approval process, regulators should think about whether the product should be approved as an insurance product or whether it is a candidate for registration with the SEC. She asked the working group to look at this issue also.

Commissioner Vaughan asked if this group will be looking at advertising. Mr. Fickes responded that he believed that this was under the purview of another group. Mr. Foley noted that the current issue of the *National Underwriter* has an extensive section on equity indexed products. He said an advertisement from a prominent company was included and he opined that it looked more like an invitation to invest in a security. He mentioned that he had recently attended a meeting of a new organization of companies selling equity indexed products and at that meeting speakers often talked about how important it is to be careful what is included in advertising. He said the Life Disclosure Working Group is looking at equity indexed products disclosure, and that could be stretched to include advertising if the charge was expanded. Mr. Fickes said as his working group worked up its plan of activities, other issues might be identified for inclusion. Commissioner Vaughan said a catalogue of the issues would be very helpful so that the Life Insurance (A) Committee could be sure all the issues were covered.

Mr. Fickes moved and Ms. Martin seconded a motion to receive the report of the Equity-Indexed Products Working Group. The motion passed (Attachment Seven).

7. Report of the Life Disclosure Working Group

Mr. Foley reported that the Life Disclosure Working Group met and completed work on the Equity-Indexed Annuities Buyer's Guide. He said there was much support within the industry to adopt it as a stand-alone document at this time and encourage companies to use it voluntarily. Mr. Foley noted that the Deferred Fixed Annuities Buyer's Guide will be extensively updated and the working group hopes that by June that guide will be ready for adoption. At that time the equity-indexed annuity portion will become an appendix to the Deferred Fixed Annuities Buyer's Guide. If the Life Insurance (A) Committee adopts the Equity-Indexed Annuities Buyer's Guide, as the working group recommends, the guide will be placed on the NAIC's Internet site by the end of the week and companies will be encouraged to begin using it voluntarily. Mr. Fickes opined that would significantly enhance disclosure of equity-indexed products. He noted that the American Council of Life Insurance (ACLI) is very supportive of this action.

In addition, the working group had extensive discussion on when and if illustrations should be required for any types of annuity products. The working group will continue revision of the Annuity Disclosure and Illustrations Model Regulation and a new draft will be prepared shortly after the meeting. Ms. Jones moved and Mr. Fickes seconded a motion to receive the report of the Life Disclosure Working Group, and the motion passed (Attachment Eight).

Ms. Martin moved and Mr. Keating seconded a motion to adopt the Equity-Indexed Annuities Buyer's Guide, place it on the NAIC's home page, and encourage companies to use it voluntarily. The motion passed. Commissioner Vaughan said it was a very wise decision for the working group to take this approach.

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

Mr. Foley reported that the Life and Health Actuarial (Technical) Task Force held a significant discussion on Actuarial Guideline ZZZ, which sets reserves for equity-indexed products. The task force also heard a report on the valuation project being developed by the AAA, and held a significant discussion on the Actuarial Opinion and Memorandum Model Regulation.

Jim Van Elsen (Van Elsen Consulting) and Steve Smith (First Colony) made a presentation to the task force on the Valuation of Life Insurance Model Regulation (known as Guideline XXX) and suggested adjustments to that model that might make it more agreeable to the insurance industry. The task force will consider recommendations made by Mr. Van Elsen and Mr. Smith. Mr. Cipinko said that the NALC will host a meeting on this subject on April 2, and members of the audience are welcome to attend.

Mr. Fickes moved and Ms. Jones seconded a motion to receive the report of the Life and Health Actuarial (Technical) Task Force. The motion passed.

9. Report of the Synthetic GIC Working Group

Mr. Gorski said he had been quite optimistic that the working group would have a Synthetic Guaranteed Investment Contract Model Regulation to present for adoption. Since the Winter National Meeting the working group received eight letters of comment and new issues were raised. Several changes to the regulation were made, but some require more thought to accomplish. One issue is most difficult: the filing requirements for the nondomiciliary state. Mr. Gorski explained that the insurance industry favors an approach where the domiciliary state has full control, but the regulators feel it is important for the nondomiciliary state to have some review authority. The working group will spend more time on this issue and Mr. Gorski conjectured that the working group would reach a deadlock with the industry on this issue. He noted that other issues upon which there was disagreement had been resolved to everyone's satisfaction.

A conference call will be held to resolve the remaining issues, which are similar to the issues facing the Separate Accounts (EX4) Working Group. The groups will have a joint conference call so that there is consistency between the models being developed by both groups. Mr. Fickes moved and Ms. Jones seconded a motion to receive the report of the Synthetic GIC Working Group. The motion passed (Attachment Nine).

10. Adopt Minutes of Conference Calls

Leslie Jones (S.C.) moved and Dan Keating (Okla.) seconded a motion to adopt the minutes of the conference calls of the Life Insurance (A) Committee. The motion passed (Attachment Ten).

11. Any Other Matters Brought Before the Committee

Mr. Foley asked for clarification of an issue related to the Codification project that had been discussed by the Executive Committee. Commissioner Vaughan thanked Mr. Foley for reminding her of this issue and she explained that the Executive Committee had adopted the Codification project with the direction to send the reinsurance question and answer document back to the Life Insurance (A) Committee for resolution. She said the A Committee will refer this to the Life and Health Actuarial (Technical) Task Force to resolve four issues that were identified as troubling. She noted that Mr. Gorski and Sheldon Summers (Calif.) have already put in a great deal of hard work on this project and they will be very helpful to the task force. Mr. Foley asked for clarification that the charge is limited to those four issues and Commissioner Vaughan responded in the affirmative.

Dave Brummond (National Fraternal Congress) said his organization is facing a growing problem of small fraternals surviving in today's marketplace. He said the Fraternal Congress is working on solutions and will be soliciting assistance from insurance regulators. He said the purpose of his comment is to alert regulators to the possibility of this future request. Commissioner Vaughan asked Mr. Brummond to keep the A Committee informed of the organization's needs.

Having no further business, the Life Insurance (A) Committee adjourned at 9:30 a.m.

ATTACHMENT ONE

Replacement Issues Working Group
Salt Lake City, Utah
March 14 and 16, 1998

The Replacement Issues Working Group of the Life Insurance (A) Committee met in the Salt Palace Convention Center in Salt Lake City, Utah, on March 14 and 16, 1998. Paul DeAngelo (N.J.) chaired the meetings. The following working group members were present: Richard Rogers (Ill.); Rosanne Mead (Iowa); Lester Dunlap (La.); Cindy Martin (Mass.); Robert Commodore (Minn.); Steven Stark (Mo.); Louis Belo (N.C.); Kip May and Phil Bisesi (Ohio); Joel Ario (Ore.); and Rhonda Myron (Texas).

Paul DeAngelo (N.J.) announced that the working group still needs to address several issues before the Life Insurance and Annuities Replacement Model Regulation would be complete.

1. Waiver of Suicide and Incontestability Provisions

Tom Campbell (Hartford Life), representing the American Academy of Actuaries (AAA), described the comments in the AAA letter to the working group. He said the AAA was concerned that a waiver of the suicide and incontestability provisions by a replacing insurer would allow insureds to misrepresent their insurability. He gave as an example a person who purchases term insurance and then seeks to replace that with different coverage. He said there would be a potential for an uninsurable individual to get lower first-year rates and replace the coverage each year, getting new first-year rates and being uninsurable the whole time. He recommended removing the requirement for the waiver of suicide and incontestability provisions. He said applicants who are fair and accurate will not be harmed. Mr. DeAngelo questioned whether an individual who is uninsurable would change companies to get a little bit lower rate. He also questioned whether an individual who had less than two years to live or is contemplating suicide would plan to switch coverage to get a lower rate. Marybeth Stevens (American Council of Life Insurance—ACLI) said another example is a person who misrepresents the fact that he smokes and happens to die within the two-year incontestability period. He would be protected from having the policy cancelled even though he lied on his application. Mr. Campbell said the company presumes in its rate structure that it will have protection during the first two years and said this provision would require companies to raise the rates for all. Mr. DeAngelo questioned the presumption that this waiver would allow people to game the system.

Joel Ario (Ore.) said he understood these comments to suggest that an uninsurable person would constantly turn over his policy to get lower rates. He asked how many policies were priced to encourage people to turn over their policies every year. He asked if that was a good pricing structure. Richard Rogers (Ill.) asked if consumers really go out and shop this way. Mr. DeAngelo said that three or four states already have the type of provision being considered for the model. He said Vermont has a provision that is limited to internal replacements and Kentucky and West Virginia have provisions similar to the draft. Mr. DeAngelo called Kentucky and West Virginia and asked if they have encountered a situation where a person used the provision to better his situation. Neither state was aware of any such situation. Mr. Campbell asked the working group to think about who is being protected by such a provision. Mr. DeAngelo responded that a provision like this would have protected thousands of people who replaced their policies during the 1980s and early 1990s and later had the company underwrite the policy and rescind it. Jim Van Elsen (Van Elsen Consulting) opined that the working group was underestimating the ability of the ill to hide their condition from underwriting. Mr. DeAngelo said he could understand that contention for new sales, but he did not understand why someone who already had a policy would bother to do so.

Ron Panneton (National Association of Life Underwriters—NALU) said his organization supports the model provisions on suicide and incontestability. He said he called dozens of state associations and asked for their support also. He noted that two agents had personal experience with clients who replaced coverage and then committed suicide. He said they were not aware of the new suicide and incontestability periods and, therefore, had no coverage. He said if we assume that once in a thousand someone will take advantage of the lack of a suicide and incontestability clause on replacement, this might cost the company a little bit more, but other provisions of this regulation will also raise costs that will be spread over all policyholders. He said that this regulation provision protects policyholders, agents and companies in a balanced manner. Mr. Ario said he was contacted by the Oregon NALU chapter with strong support for this provision.

William Fisher (MassMutual) said this is a public policy question and he did not think regulators should encourage or facilitate misrepresentation. Lester Dunlap (La.) said the charge to the working group was precipitated by a level of unnecessary replacements. He said this provision may make companies take a long hard look at an application and may actually reduce unnecessary replacements. Mr. Fisher said there are actually two issues here. One is churning and the other is expecting people to tell the truth on an application. Mr. Fisher noted he was less concerned about internal replacements because the company was already obligated. Mr. DeAngelo explained that his experience was that many times agents encouraged replacement and then told people they did not need to put information on the application. Even though the individual had not intended to replace, his beneficiary would end up without insurance proceeds. Mr. DeAngelo said he recognized it was possible to game the system, but he thought that was of minimal impact and the benefit to others was much more important.

Ms. Stevens said the ACLI has been opposed all along to this provision and said the best defense is education of the consumer. She said it is explained in the replacement notice and the new company should not have to rely on the replaced company's underwriting. She also said this could actually encourage replacement. Ms. Stevens noted that most states' laws on suicide and incontestability are statutory, and a change could not be adopted by the regulation. Mr. Ario queried whether Ms. Stevens would be more comfortable if the provision applied only to internal replacements. Ms. Stevens responded that would be a huge step in the right direction and many fears would be allayed. Cindy Martin (Mass.) said that the regulators have made a huge concession by not putting the insurer on the hook for any more than the amount of the policy being replaced and Ms. Stevens responded that she did not see that as a large concession.

Terry Tiede (American Investors Life) said his company is concerned about how to interpret this provision if life insurance replaces an annuity or if the reverse is true. He noted that most annuity policies do not contain a suicide and incontestability clause. Mr. DeAngelo said he did not see this as a problem. If the annuity has a suicide and incontestability provision, to the extent it had been satisfied, credit will be given. If there is no suicide or incontestability provision, there will be no credit.

Scott Cipinko (National Alliance of Life Companies—NALC) suggested that an individual could purchase a term life policy and as his guaranty period was close to expiration, switch to a new policy with a new guaranty. This would be an opportunity to benefit from the lack of the suicide and incontestability clauses. He asked the working group to request assistance from the Life and Health Actuarial Task Force or the AAA as to the actuarial impact of this provision. Mr. DeAngelo responded that the only information from the AAA was the comment letter that had been discussed earlier in the meeting. Mr. DeAngelo suggested that the regulation of the insurance marketplace must be a continuous process and if a rule that was right for the time becomes problematic, it should be revisited. He noted that back in the early 1980s the regulation exempted internal replacements and regulators now recognize that was not a good idea, so it is being changed. The regulators must constantly look to see what is happening in the marketplace and change the laws and regulations as necessary.

Mr. DeAngelo asked the working group to consider several alternatives: the model could be left as is and require companies to give credit for the suicide and incontestability provisions met by the replaced insurer; the draft could be changed to apply to internal replacements only; it could apply only to the incontestability or only to the suicide exclusion; or the provision could be removed altogether. Mr. Dunlap moved to maintain the language giving credit for the suicide and incontestability clauses met by the replaced insurer. Mr. Ario seconded the motion. Robert Commodore (Minn.) said he would support a distinction between internal and external replacements. Kip May (Ohio) said that in many states this issue is addressed by statute and he is concerned that the states will not be able to change this law by promulgating a regulation. He said he also would favor treating external and internal replacements differently. Mr. DeAngelo asked for a roll call vote on the motion. Those voting in favor of the motion were Louisiana, Massachusetts, Missouri, Oregon and New Jersey. Voting against the motion were Illinois, Iowa, Minnesota, North Carolina, Texas and Ohio. The motion failed.

Mr. Commodore moved to amend the regulation to make the provision applicable to internal replacements only. Mr. Rogers seconded the motion. Illinois, Iowa, Louisiana, Massachusetts, Minnesota, North Carolina, Ohio, Oregon and Texas voted for the motion. Missouri and New Jersey voted against the motion. The motion carried.

2. Direct Response Sales

Mr. DeAngelo said there are two issues to deal with in the area of direct response sales. He noted that some changes in Section 8 language were necessary to clarify the intent of the drafters. Mr. DeAngelo suggested deleting sentences at the end of subsection A and adding a provision to subsection C saying the insurer should request from the applicant a statement asking whether a replacement is intended. The requirements of subsection C would then apply both when the insurer proposed replacement and when an applicant indicated replacement was intended. Appendix B is sent when there is existing coverage and Appendix A when a replacement is involved. Rhonda Myron (Texas) moved and Rosanne Mead (Iowa) seconded a motion to amend Section 8 as outlined by Mr. DeAngelo. The motion passed.

3. Massachusetts Suggestion on Registered Product

Mr. DeAngelo asked the working group to recall Ms. Martin's suggestion at the last conference call for a more extensive disclosure for registered products. Ms. Martin said it was her feeling that more replacements with a variable product would occur and it was appropriate for this group to ask that a policy summary be provided in that instance. She said she was pleased to see the Securities and Exchange Commission (SEC) beginning more plain English requirements and encouraged the working group to consider her recommendation. Ms. Stevens said that the main concern is that any new type of document would require a great deal of programming. She did not think there would be enough benefit from that additional cost, particularly since the SEC is moving toward more readable materials.

Mr. DeAngelo said this suggestion placed him in a difficult position; he is in favor of giving more information, but thought it would require a delayed effective date. During that time, the Life Disclosure Working Group might move forward with its recommendations on variable annuities and variable life insurance. In light of what the SEC is now doing to create more readable documents, he recommended not acting on this provision now. Mr. DeAngelo asked if any working group member is interested in making a motion to adopt this provision, and there was no response. Mr. DeAngelo noted that this is an indication of the importance of the charge to the Life Disclosure Working Group regarding variable life illustration requirements.

Ms. Stevens noted that the requirements of Section 6B cannot be done for variable life insurance and asked that it also be exempted in Section 3B. The working group agreed to that suggestion.

4. Electronically Presented Material

Mr. DeAngelo said another suggestion from Massachusetts that had not been completed on the conference call related to computer demonstrations. He said if the electronically presented material is an illustration, then the life insurance illustrations model regulation will address it. If it is other than an illustration, and there is no mention of it in this model, then there is no requirement to leave a copy with the applicant. Another option would be to change Section 4D to make it consistent with the position of the Life Disclosure Working Group in its illustration regulation and require a copy be sent to the applicant no later than at the time of policy delivery. Ms. Martin said the working group needs to assume that electronic presentations will increase in the future and she was in favor of the working group requiring delivery of material that had been presented electronically. Mr. DeAngelo suggested amending Section 2K to add electronically presented information to the definition of sales material and to amend Section 4D to require electronically presented sales material to be provided in printed form no later than at the time of policy delivery. Kate Schultz (Aegon) said that some of her company's electronic presentations move and so it would be necessary to give the applicant a diskette, which they would not be able to use. Mr. Commodore suggested that if the information that moves is just cute graphics, it does not need to be placed in printed form. Ms. Schultz said it would be helpful to articulate that in the model. Mr. DeAngelo said the regulation requires sales material related to the contract being purchased. Only information that mirrors the policy or contract actually purchased needs to be provided in printed form and he thought that addressed the issue. Linda Lanam (Life of Virginia) said she was not sure the language was clear enough to address that concern. Mr. DeAngelo asked Ms. Lanam to write a drafting note that explains the intent for the working group's consideration. Ms. Lanam agreed to present that to the working group at its next meeting. Ms. Mead moved to include the suggestions for changes to Sections 2K, 4D and 4E and Steven Stark (Mo.) seconded the motion. The motion passed.

5. Group Exemption

Howard Greene (TIAA) asked the working group to consider an amendment for the group exemption. He asked that Section 3A(5)(a) have added after "Section 414" a provision saying "a governmental or church welfare benefit plan." Ms. Mead said that most of the language in Section 5A had been given to the working group by interested parties and asked if anyone was uncomfortable with the suggestion. Bob Brown (Cigna) said the concept sounded all right to him and noted that the language for this provision had been put together very carefully. Mr. DeAngelo asked the interested parties to consider this and tell the working group at its next meeting if there was any problem with that language.

6. Consideration of Appendices

Mr. DeAngelo asked the working group members to consider the format suggestions from Massachusetts for the appendices. Ms. Stevens said the Massachusetts revised appendix does not make many substantive changes but is different in its format. She opined that the current version is much more consumer friendly, easier to read and more concise. Mr. DeAngelo asked Ms. Martin to explain the changes in her draft. She agreed that the first page was very similar in content to the one currently attached to the draft but said the second page added important information. Ms. Mead said she thought the second page contained significantly different content to require the working group to spend some time with it before approving the model. Mr. DeAngelo asked if there was a motion to amend the appendix and no member of the working group responded.

7. Reorganization of the Model Regulation

Mr. DeAngelo said the suggestion from Massachusetts for a reorganization of the model might also provide some benefit but would require the working group to postpone adoption to consider it more thoroughly. He asked for reaction from interested parties to the Massachusetts suggestion. Ms. Stevens responded that her brief review indicated that it did not look substantively different, but she would want to give it further thought if the working group decided to go that route. Mr. May agreed that additional time would be necessary and suggested that waiting until the Summer National Meeting to adopt the model might not even be enough time for a thorough review. The working group decided not to reorganize the model regulation.

8. Other Comments

Mr. DeAngelo said another comment that had been received from interested parties suggested that there may be neither an illustration nor a policy summary for an annuity sale, but rather a disclosure document. The working group agreed to add language referencing the disclosure document when referring to an annuity.

Mr. Cipinko asked about the provision in Section 6B that require the existing insurer to furnish a copy of the available illustration. He asked if that meant to mail the document within five days or whether the individual should have received it within five days. Mr. DeAngelo suggested clarifying that by changing it to require the insurer to mail the document within five business days. Mr. Cipinko said that five days was a very short time period and asked the working group to consider a longer period of time. Mr. DeAngelo said there is a 30-day free-look period and that is a very short window so he did not want to consider lengthening the period of time.

Mr. Cipinko suggested that preneed coverage is much like credit life and asked that it also be exempted from the regulation. Mr. DeAngelo said he was not sure how to include such a provision and Mr. May suggested adding a drafting note to alert states to the possibility of exempting preneed coverage. Mr. Cipinko agreed to present wording at the next meeting.

Mr. DeAngelo endorsed a suggestion from Primerica to add a space on the Appendix for an individual to initial if he is not interested in having the appendix read to him. The working group agreed that was appropriate.

The working group adjourned and reconvened on March 16, 1998.

9. Comment on Group Language

Mr. DeAngelo asked if there were any concerns about the suggestion from TIAA to amend the group exemption. Those in attendance said they had reviewed the language and did not see any problem. Ms. Mead moved and Mr. Ario seconded a motion to incorporate the language in the draft. The motion passed.

10. Drafting Note on Record-Keeping Medium

Mr. DeAngelo suggested adding a drafting note in Section 5 where the first record-keeping requirements appear. The drafting note explains the media that are appropriate for meeting the record-keeping requirement. Mr. DeAngelo said he took most of the language from the Market Conduct Record Retention Model Regulation. In that way those who were not part of the discussion will understand the intent of the drafters. Jim Mumford (Equitable of Iowa) said that sometimes drafting notes get lost in the process and suggested that the information be added to the actual language of the regulation. Mr. DeAngelo responded that there was not a specific record-keeping section, so that would require putting the information in many locations. Ms. Mead moved and Mr. Commodore seconded a motion to incorporate the drafting note in Section 5. The motion passed.

11. Drafting Note on Sales Material

Mr. DeAngelo reminded Ms. Lanam that she had offered to write a drafting note explaining the intent of the working group's requirement for keeping copies of sales material. Ms. Lanam deferred to Ms. Stevens to read the drafting note. Ms. Stevens offered a drafting note that questioned the need to file sales material containing sensitive personal or financial information. After Ms. Stevens read her suggestion, Mr. DeAngelo said the drafting note she had drafted opened up issues already resolved and he asked her to redo the note in a more acceptable fashion. Ms. Stevens said this issue had not been resolved on the part of the industry and there was still concern about this issue. Mr. DeAngelo pointed out that the working group had already agreed to eliminate the requirement that sales material be provided to the existing insurer in recognition of that concern. He thought the agreement was to insert a drafting note to deal with the issue where several types of sales material and illustrations are used before the applicant decides what he wants to buy. Mr. DeAngelo declined to open the issue again and Ms. Stevens said the working group did not need to consider adding another drafting note.

12. Drafting Note for Preneed Funeral Plans

Mr. Cipinko recommended to the working group that a new section be included instead of a drafting note. Mr. Cipinko read his suggestion, which involved individual sales. Mr. DeAngelo responded that the original request had been limited to group preneed plans. That led Mr. DeAngelo to believe that these were covered under the group exemption so a drafting note was appropriate. He expressed concern about making the exemption cover individual plans too. Mr. DeAngelo suggested changing the words from Mr. Cipinko into a drafting note form and placing them beneath Section 3A(2). Mr. Ario moved and Mr. Dunlap seconded a motion to include the drafting note as described by Mr. DeAngelo. The motion passed.

13. Technical Corrections

Ms. Mead went through the entire regulation and looked for consistent use of terminology and listed technical corrections for the working group. She said none of the changes were substantive but were rather consistent use of the term "policy or contract owner" rather than "policyholder and contractholder" and "policyholder and contract owner" and "policy owner." She also suggested that wherever the word "policy" appears alone it should be changed to read "policy or contract."

One of the suggestions on Ms. Mead's list was to change the term "agent" to "producer" in the appendix because that was the term used in the regulation. Mr. Commodore opined that consumers would know this individual as an agent rather than a producer so he recommended leaving those. Ms. Mead moved and Ms. Martin seconded a motion to include the other technical amendments suggested by Ms. Mead. The motion passed.

Ms. Martin also suggested a technical correction to Section 3A(5)(b). She suggested that the last sentence of that paragraph was not necessary. Ms. Mead reminded her that the working group had added that sentence recently because the group thought it clarified the language. Mr. Fisher said the sentence was added to eliminate ambiguity. Mr. DeAngelo wondered if it was appropriate to add in that section the term "group" in front of meeting as had been done in an earlier section. He said he was comfortable leaving the last sentence in and did not believe it was merely a technical correction. Ms. Martin moved to add the word "group" prior to the word "meeting" to parallel the language in Section 3A(5)(b). There was discussion regarding the possible problems a literal interpretation of "group meetings" might create. It was agreed that a discussion with an individual who stops to ask a question after a group meeting or providing information to an individual that was absent the day of the group meeting would not be considered direct solicitation. Ms. Myron seconded the motion and it passed.

Mr. DeAngelo noted that he had received comments in regard to the suggestion from Kentucky to include reference to the statutory rate. He suggested that the language within the brackets say "a rate set by the state based on applicable statutory rate or regulation." Ms. Mead moved and Mr. Commodore seconded a motion to incorporate the language described by Mr. DeAngelo. The motion passed.

Ms. Mead said she had another sentence she would like to add to the regulation at the end of Section 7C to deal with the case where consecutive automatic premium loans were being taken from the account. Her suggestion would eliminate the obligation of the insurer to send a notice every month. Mr. Tiede asked if this would also be true of systematic withdrawals from an annuity. George Coleman (Prudential) said this provision did not address the abbreviated payment plan, which an individual could put in place when he purchased the product. He suggested that notice should not be required in this instance either. Mr. DeAngelo responded that was exactly the situation where the individual should receive notice. When other interested parties indicated an interest in commenting on this provision, Mr. DeAngelo decided to table the motion so that the working group could complete its task in the time allotted.

14. Consider Adoption of Life Insurance and Annuities Replacement Model Regulation

Mr. Commodore moved and Mr. Dunlap seconded a motion to adopt the model as amended. The motion passed.

15. Adopt Minutes of March 5, 1998 Conference Call

Mr. Ario moved and Louis Belo (N.C.) seconded a motion to adopt the minutes of the March 5, 1998 conference call. The motion passed (Attachment One-A).

Having no further business, the Replacement Issues Working Group adjourned at 10:15 a.m.

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ATTACHMENT ONE-A

Replacement Issues Working Group
Conference Call
March 5, 1998

The Replacement Issues Working Group of the Life Insurance (A) Committee met by conference call at 1 p.m. on March 5, 1998. Paul DeAngelo (N.J.) chaired the meeting. The following working group members participated: Erin Klug (Ariz.); Mike Hessler (Ill.); Roseanne Mead (Iowa); Cindy Martin (Mass.); Robert Commodore (Minn.); Cindy Amann (Mo.); Louis Belo (N.C.); Adam Barclay (Ohio); and Joel Ario (Ore.).

1. Adopt Minutes of Jan. 20, 1998 Conference Call

Lester Dunlap (La.) moved and Joel Ario (Ore.) seconded a motion to adopt the minutes of the Jan. 20, 1998, conference call. The motion passed (Attachment One-A1).

2. Consider Comments on Life Insurance and Annuities Replacement Model Regulation

Paul DeAngelo (N.J.) announced the plan for the conference call is to address some of the more technical comments the working group received on the Life Insurance and Annuities Replacement Model Regulation. The issues that cannot be addressed during the two hours allotted for the conference call will be discussed at the Spring National Meeting in Salt Lake City. Mr. DeAngelo said it was his expectation to address the suicide and incontestability clauses in Salt Lake City. He said an hour of that meeting will be allotted to testimony from the insurance industry as to the effect of this provision on their policies. He said the other two hours of the meeting will be spent on issues not addressed during the conference call.

a. Technical Corrections

Mr. DeAngelo said that the American Council of Life Insurance (ACLI) submitted a comment letter with a number of technical corrections and he supports all of those up to, but not including, the comments on the suicide and incontestability issues, or to those that follow. Mr. Ario moved and Rosanne Mead (Iowa) seconded a motion to adopt the specified technical amendments included in the ACLI comment letter.

Mr. DeAngelo said Primerica Life had also submitted comments that were basically of a technical nature. He said he supported all of those related to the body of the regulation (not the appendices) except the comment on the sales material. Cindy Amann (Mo.) moved and Cindy Martin (Mass.) seconded a motion to adopt the technical changes in the Primerica letter, with the exception of the comment on sales material. Marybeth Stevens (ACLI) asked if the comment on Section 6C was specifically included in the motion. That comment suggested that materials or a record of those materials should be retained by the insurer. Mr. DeAngelo said he was not comfortable with seeing a record rather than the actual document. Ms. Amann agreed that she would want to see a copy of the actual document. A representative from Primerica Life questioned whether it was acceptable to have the ability to reconstruct the material that was sent out or whether an actual reproduction of the original, such as a photocopy or microfiche, was required. Mr. DeAngelo responded that he would want to see a copy of what was actually sent rather than a reconstruction.

b. Massachusetts Changes

Mr. DeAngelo asked the working group members to turn next to suggestions prepared by Ms. Martin and Eleanor Perry (Mass.). Ms. Martin's comments are divided into a number of different levels. Mr. DeAngelo suggested going first to the last set of comments, which are quite technical. Other suggestions from Massachusetts included a complete reorganization of the document, and he said that discussion could not be completed on a conference call, but would be continued at the meeting in Salt Lake City. The working group members reviewed the technical edits proposed by Massachusetts and Ms. Amann moved and Mr. Dunlap seconded a motion to incorporate the edits into the model regulation. The motion passed.

Mr. DeAngelo next asked the working group members to consider Attachment D to the Massachusetts comment letter and whether those issues should be included in the model regulation. Massachusetts' first suggestion was to change Section 2A, the definition of direct response solicitation. Ms. Martin suggested that the description of direct response have "the Internet" added to the types of media available. The working group members agreed that would be appropriate. In addition, Ms. Martin suggested adding to the end of definition Subsection A "...except in cases where a replacement or a financed purchase is discussed by the insurer and the applicant, whether the discussion is verbal, written or electronic." Mr. DeAngelo pointed out that, at any time there was such a contact, the rules applicable to direct response would not apply. Ms. Stevens said that additional language was unnecessary. Ms. Martin said one of her concerns was instances where the direct response insurer is proposing replacement. Mr. DeAngelo suggested that the working group spend some time on the direct response section at the Spring National Meeting because there are a significant number of comments. He agreed to set aside a half-hour of the meeting then to review the direct response section. Maureen Adolph (Prudential) said many companies anticipate increased sales in this area, but they are not yet sure the form the solicitation will take. Mr. DeAngelo asked if any member of the working group wanted to make a motion to add that language at the end of Section A. There was no response.

Ms. Martin asked why 13 months was selected as an appropriate time for the definition of financed purchase. Mr. DeAngelo explained that, if the individual had just made an annual payment, he might not see the effect of a loan until the next payment is due. Thirteen months covers the next payment's due date plus the grace period. He asked if there was any sentiment to extend this 13-month period. There was no response.

Ms. Martin suggested a new paragraph to add to the definition of policy summary reading, "(3) For registered products, means a written statement that shall contain at least the following information: The beginning and end date of the current report period and the expect date of interest or dividend crediting or payout; the policy value at the end of the previous report period; the current and guaranteed values of the death benefit and its cash surrender value, the amount of outstanding loans, if any; surrender charges, if any; and the identification of the appropriate prospectus or offering circular." Mr. DeAngelo said he would like to hear a reaction from the insurance industry as to whether this suggested language was doable. Ms. Adolph asked Ms. Martin why she thought the language was necessary and Ms. Martin responded that there are more variable products coming into the market place and state insurance regulators need to be in the forefront of the issue. She said the federal requirements are not very user-friendly. Mr. DeAngelo asked if this issue was on the agenda for the Life Disclosure Working Group. Jim Ellis (General American) said it was in the future, when that working group had completed its project on fixed annuity illustrations. Ms. Martin agreed to set that issue aside for now, but asked the members of the working group to consider it for the future.

Ms. Martin's next suggestion was to add some language to the definition of sales material, Section 2K. Her suggestion was to add to the definition "...any other written, printed <u>or electronically presented</u> information created, completed <u>or provided</u> by the company...." Scott Cipinko (National Alliance of Life Companies—NALC) asked whether an agent providing a copy of an article from the *Wall Street Journal* would have to provide that information to the insurer. Mr. DeAngelo responded in the affirmative. Ms. Stevens pointed out that, if the presentation is made in an electronic media, the agent may not be able to leave a copy. Galen Ullstrom (Mutual of Omaha) said this issue had been discussed at length in the development of the Life Insurance Illustration Model Regulation and that the working group that developed that model made a concession because of the number of agents that are not able to print documents in the field. Mr. Ario pointed out that even though the agent may not have a printer in the field, he can bring a paper copy that he prints in his office prior to the appointment. Mr. Ullstrom responded that the difference here is that there is no requirement to have an annuity illustration and they will be printed proposals rather than on the computer. Mr. Ario agreed that the Replacement Issues Working Group needed to look at what the Life Disclosure Working Group had done. Mr. DeAngelo said he was not going to call for a motion on this issue because so many concerns had been expressed. Bill Summers pointed out that an article from the *Wall Street Journal* has nothing to do with the contract and suggested that the definition of sales material might not reach as far as some may have thought. Mr. DeAngelo asked Ron Panneton (National Association of Life Underwriters—NALU) for his reaction from an agent's viewpoint. Mr. Panneton responded that he saw no problem with the agent leaving a copy of everything he brings to his meeting with a consumer. He said there needs to be an accounting of the sales process. Bill Geiger (Aegon) asked if this would include an estate planning work sheet. Mr. DeAngelo suggested language to amend the definition of sales material to clarify that the materials being considered were those related to the sale of the policy or contract purchased. Mr. Ario moved and Ms. Amann seconded a motion to include the suggested language from Mr. DeAngelo in the definition of sales material.

The next point raised in Ms. Martin's letter was a suggestion to revise Section 3A(6). She said when someone other than the entity paying the cost is the beneficiary, the sale would not be exempt. She asked if this section was talking about key men insurance. Ms. Stevens responded that this provision was designed to cover corporate owned life insurance (COLI). Ms. Adolph clarified that the purpose was to exempt large employers that purchase life insurance on their employees to fund retirement benefit plans. She said the proceeds are generally paid to the employer's trust. Mr. DeAngelo asked whether the suggestion from Ms. Martin to add at the end of that paragraph "...and all benefits of the insurance will accrue to the entity which is bearing the cost of the insurance..." was appropriate. Ms. Adolph asked if she could consult with her COLI experts and respond at the Spring National Meeting. Dennis Herschel (MassMutual) said he thought the purpose of the exemption was to provide disclosure to people without access to a team of financial planners, attorneys, etc., to assist them. Mr. DeAngelo also noted that in this type of coverage the individual really has no say over whether the policy will be replaced.

The next suggestion in the Massachusetts letter was to add a new Section 4F, which would require the producer to give an applicant information regarding the values of existing policies or contracts previously issued by the replacing insurer including an in force illustration or policy summary within five days. Mr. Cipinko pointed out that many companies will not have the ability to give an in-force illustration on an older policy, and are prohibited by the illustrations regulation from giving an in-force illustration within one year of the policy sale. Ms. Martin noted there is also an alternative of a policy summary. Mr. Geiger said that, where an agent represents several companies, he may not have access to the type of information being required. Ms. Stevens said this requirement is not necessary; if the agent knows of the existing policy he must put it down. But this is quite an administrative burden to get illustrations on all of the policies without knowing whether the individual will replace them. Mr. Ario suggested that this be a request rather than an automatic requirement. Mr. DeAngelo responded that the paragraph is not needed in that event. Mr. Ario suggested that the working group not move forward with this suggestion, and Ms. Martin agreed to table that issue for now.

Ms. Martin also suggested that a phrase be added to Section 9D that said "...the insurer may be required to make restitution to be determined by the commissioner depending on the circumstances of the violation. Restitution may include, but is not limited to, restoration of policy values and payment of interest...." Mr. DeAngelo opined that this new language does not add anything to the regulation because it has already been written to give the commissioner discretion. Ms. Martin withdrew the suggestion to add the new language. Mr. DeAngelo said several comments had been received by the working group suggesting that the 10% rate of interest was not appropriate. A comment letter from Commissioner George Nichols (Ky.) suggested changing the language to incorporate the statutory rate. Mr. Commodore moved and Ms. Amann seconded a motion to change the reference to the rate of interest to the statutory rate and to make provision for states that did not have a statutory rate.

Mr. DeAngelo said one other issue upon which several comments had been received is Section 3A(2) in regard to the group life insurance exemption. The comment letter from Massachusetts suggested deleting the middle sentence in Paragraph (2). Ms. Steven complained that the working group added this sentence on its last conference call and now the issue is being opened again. Mr. DeAngelo responded that this issue had been opened by interested parties and he thought it was worth discussing. He suggested adding the word "group" in front of the word "meeting" to make clear that this does not include a meeting just because an individual comes up afterwards and asks a question. Mr. Commodore moved to delete the entire sentence and there was no second to the motion. Ms. Martin made a friendly amendment to leave the sentence and add the word "group" and Mr. Commodore agreed to that alteration. Ms. Martin seconded the motion and it passed.

Ms. Martin pointed out that she submitted a draft regulation for the working group consideration with a dramatically altered Appendix A from the current version. She said the language was similar but it had been reformatted to be easier to read and buyer's guide type explanations had been added to make the document more user-friendly. Mr. DeAngelo thanked Ms. Martin for the time spent in the reorganization and asked the working group to consider whether this reorganization made the document easier to read.

Mr. DeAngelo also decided to address some of the record maintenance issues raised in Ms. Martin's letter. She noted some inconsistencies where in some cases a three-year retention period was used and other times a five-year period. She also noted that in some cases records must be kept at the home office whereas in other cases they can be kept at the home office or regional office. Ms. Martin moved and Mr. Ario seconded a motion to address the inconsistencies pointed out by Massachusetts. The motion passed.

Mr. Ario asked the intention of Mr. DeAngelo as far as finishing the replacements regulation. Mr. DeAngelo said that, if the working group makes enough changes to necessitate further exposure, the document will not be ready to adopt until the Summer National Meeting. Ms. Stevens asked if the document will be further exposed by the Life Insurance (A) Committee after the working group adopts it. Carolyn Johnson (NAIC/SSO) said that is not a required procedure. Ms. Stevens responded that many changes already were being made and she did not have time to get comments from the ACLI members before the Spring National Meeting. Ms. Mead said she had not yet decided whether she could support the expanded Appendix A, but she thought it needed to have extensive consideration by the working group.

Having no further business the Replacement Issues Working Group adjourned at 3:10 p.m.

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ATTACHMENT ONE-A1

Replacement Issues Working Group
Conference Call
Jan. 20, 1998

The Replacement Issues Working Group of the Life Insurance (A) Committee met by conference call at 2 p.m. on Jan.. 20, 1998. Paul DeAngelo (N.J.) chaired the meeting. The following working group members were in attendance: Erin Klug (Ariz.); Richard Rogers (Ill.); Roseanne Mead (Iowa); Eleanor Perry (Mass.); Robert Commodore (Minn.); Cindy Amann (Mo.); Louis Belo (N.C.); Kip May (Ohio); Ted Becker (Texas); and Tom Van Cooper (Vt.).

Paul DeAngelo (N.J.) said the purpose of the conference call was to resolve several issues left over from the Winter National Meeting so that a new draft of the Life Insurance and Annuities Replacement Model Regulation could be prepared incorporating the decisions made by the working group at the prior meeting and at this conference call. He said the one issue that would be reserved for the Spring National Meeting or an interim meeting would be the waiver of the contestability and suicide clause. Eleanor Perry (Mass.) said she and Cindy Martin (Mass.) did not think the draft was nearly ready for adoption. Mr. DeAngelo asked her to prepare written comments about her concerns that could be distributed to the working group members for their consideration.

1. Definition of Policy Summary

The American Council of Life Insurance (ACLI) submitted a document at Mr. DeAngelo's request with comments with respect to issues remaining from the Winter National Meeting (Attachment One-A1a). The first issue that Mr. DeAngelo asked the ACLI to address was a definition of policy summary to be added to Section 2 (Definitions). Ms. Perry suggested taking out the phrase "to the extent applicable" and using the ACLI definition suggested. The working group members agreed to add the definition of policy summary as suggested by the ACLI with the change in wording mentioned.

2. Group Exemption

Mr. DeAngelo said he was struggling with the addition to Section 3A(2) regarding direct marketed annuities. He suggested deletion of the sentence "group life insurance or group annuities certificates marketed through direct response solicitations shall not be considered direct solicitation as used in this subsection." Cindy Amann (Mo.) suggested leaving that sentence in but deleting the word not so that it was an affirmative statement of what regulators believe should be covered. Marybeth Stevens (ACLI) said this provision was extremely important to direct response carriers, many of whom market to individuals through the mails or telephone solicitations. She said they have always been exempt from the replacement regulation and she was not aware of any marketing abuse by the direct response companies. She predicted that a change to this section would put direct response companies out of business. Mr. DeAngelo responded that he had never heard specific reasons why this would put companies out of business. He opined that, if they called individuals, they should follow the rules that apply to direct solicitation of individuals. Ms. Stevens said these are typically low face amount policies with a narrow profit margin and little underwriting. To the extent that there are more regulatory requirements, the sales will not be profitable. Mr. DeAngelo responded that if, in fact, it is not a replacement, there are no additional requirements. Tom Van Cooper (Vt.) said his memory of the discussion at the Winter National Meeting was that companies that sell these products would send a notice of replacement as part of the solicitation information. Mr. DeAngelo said one company had suggested that, but the issue was left open for further discussion. Once a company sends out a notice and makes a diligent effort to get it back with the information on existing policies, it has met the requirements. He did not see how that would put anyone out of business. Mr. DeAngelo suggested changing the last sentence to instead refer to Section 8 and say that policies marketed through direct response solicitation would be subject to the provisions of Section 8. Robert Commodore (Minn.) agreed that the change to the last sentence of that paragraph was appropriate and also suggested deleting the second sentence. He said it was hard to draw a line for a meeting solely for the purpose of educating or enrolling. Peg VanDrisse (American Express Financial) agreed that the sentence opens up the possibility of creative decisions of what is education and what is a sale. Deletion of that sentence would avoid muddying the waters. Ms. Stevens urged the working group not to delete that sentence. Maureen Adolph (Prudential) said the initial decision on a group annuity is made by the employer. If the second sentence is deleted, the exemption has been significantly narrowed. Mr. DeAngelo asked if the regulators were in favor of deleting the second sentence. Massachusetts, Minnesota and Missouri were in favor of deletion of the second sentence and the states of Illinois, Iowa, New Jersey, North Carolina, Texas and Vermont were against that idea. The working group members decided to leave the paragraph as drafted except for changing the last sentence to refer to Section 8.

3. Pension and Welfare Benefit Plan Exemption

There were no comments from the working group on the suggested definition from the ACLI. A decision was made to include the language from the ACLI comment letter in the draft.

4. Submission of Sales Material by Agent

Ms. Stevens said her understanding of the discussion at the Winter National Meeting was that the agent did not have to send in sales materials prepared by the company and that the appendix would contain a notice urging the applicant to retain all sales materials left with him or her. Mr. DeAngelo agreed that the requirement would only be for the agent to identify the company-prepared materials and send in copies of individually prepared materials. Charlotte Liptak (TransAmerica) said the definition of sales material is very broad and could sweep in more than intended. Mr. DeAngelo said he had no problem with tweaking the definition of sales material to make clear that it is material created by the agent, not to include, for example, estate planning materials created by an attorney for the client. Ms. Liptak said she also assumed that only the information prepared for the policy actually selected would have to be sent in.

Roseanne Mead (Iowa) said she was still troubled with how the company would keep track of all these pieces of paper. She said this was a particularly burdensome requirement. Mr. Commodore said he shared the same concern. Mr. Van Cooper said that almost every complaint received in Vermont on life insurance revolves around a customized sales presentation. He suggested that if an agent wants to use a specialized presentation, he must bear the extra burden. Mr. DeAngelo agreed that it was the most critical information to have in determining the validity of the complaint. Ron Panneton (National Association of Life Underwriters—NALU) agreed that this was important information. Mr. DeAngelo agreed to narrow the definition of sales material to address these two concerns. The working group members agreed to include the revised Section 4E with the understanding that the definition of sales material would be revised.

5. Record-Keeping Requirements

Mr. DeAngelo said he was comfortable with the suggestions from the ACLI on the record-keeping requirements. He recommended that the working group accept the language proposed by the ACLI. Mr. Commodore suggested that it would be clearer instead of saying "subject to this regulation" to say that it covered contracts "not exempt from this regulation." The working group members agreed to accept the ACLI suggestion for Section 5 with the change proposed by Mr. Commodore. The working group also agreed to an ACLI suggestion for a minor wording change to Section 5A(5).

6. Duties of Insurers With Respect to Direct Response Solicitation

The working group reviewed the suggestion from the ACLI for a revised Section 8. Ms. Stevens reminded the working group that under certain circumstances the shorter form of the notice (Appendix B) is required to be sent. The working group members were comfortable accepting the suggestion from the ACLI and Mr. DeAngelo said he would incorporate that language into the draft.

7. Violations and Penalties

Mr. DeAngelo recommended that the working group not use the recommended language from the ACLI. He said he was not comfortable with the ACLI's suggestions and suggested changing the draft to incorporate the issue of materiality without losing the concept of specific penalties. Mr. DeAngelo said he would redraft the section and the working group could review his language at its next meeting.

8. Next Meeting of Working Group

Mr. DeAngelo asked the working group members if they thought it would be advisable to hold an interim meeting at the end of February or early in March. An alternative would be to schedule a working session at the Spring National Meeting. Ms. Mead said before she would commit to attending an interim meeting she would want to be assured that a significant number of working group members would be in attendance. Mr. DeAngelo asked Carolyn Johnson (NAIC/SSO) to poll the working group members on their interest in attending an interim meeting. Ms. VanDrisse asked if review of the draft could be done by conference call. Mr. DeAngelo said the waiver of suicide and incontestability clause is important enough to discuss face to face.

Having no further business the Replacement Issues Working Group adjourned at 3:30 p.m.

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ATTACHMENT ONE-A1a

To: Carolyn Johnson, NAIC
From: Marybeth Stevens, American Council Life Insurance
Date: January 15, 1998
Re: Comments with Respect to Certain Issues Discussed in Seattle

I am writing to you on behalf of the American Council of Life Insurance (ACLI), a national trade association with 580 member companies. Our members write 90.6% of the legal reserve life insurance in force in the United States. We want to thank you for this opportunity to comment on the issues set forth below.

During your Dec. 7 and 8 meetings in Seattle, the NAIC Replacement Issues Working Group requested the ACLI to provide additional comments on several issues concerning the NAIC Life Insurance and Annuities Replacement Model Regulation. These issues included a definition of policy summary; suggested amendments to the group insurance and annuity exemption; the pension and welfare benefit plan exemption; the proposed requirement relating to the submission of sales materials by an agent to a company; record-keeping requirements; amendments to the penalty section; and suggested revisions to the direct response solicitation section. Our comments on each of those issues are presented below.

- Addition of a definition of "Policy Summary" to Section 2 Definitions

To avoid ambiguity where the rule references "policy summary," we suggest the following language:

> "Policy Summary," for the purposes of this regulation for policies or contracts other than universal life policies, means a written statement regarding a policy or contract which shall contain to the extent applicable, but need not be limited to, the following information: current death benefit; annual contract premium; current cash surrender value; current dividend; application of current dividend; and amount of outstanding loan. For universal life policies, it shall mean a written statement which shall contain to, the extent applicable, but need not be limited to, the following information: the beginning and end date of the current report period; the policy value at the end of the previous report period and at the end of the current report period; the total amounts that have been credited or debited to the policy value during the current report period, identifying each by type (e.g., interest, mortality, expense and riders); the current death benefit at the end of the current report period on each life covered by the policy; the net cash surrender value of the policy as of the end of the current report period; and the amount of outstanding loans, if any, as of the end of the current report period.

- Section 3A(2) - Group Exemption

The ACLI continues to support the exemption for group life insurance and group annuities as it currently exists in the NAIC Replacement Model Regulation. As we have expressed in both our previous letters and testimony, we are unaware of any market conduct abuses in this area that would warrant a change to the exemption.

With respect to the compromised language developed in Seattle, it is our understanding that it is as follows:

> 3A(2) Group life insurance or group annuities where there is no direct solicitation of individuals by an insurance producer. As used in this subsection, direct solicitation shall not include any meeting held by an insurance producer solely for the purpose of educating or enrolling employees or members. Group life insurance or group annuity certification marketed through direct response solicitations shall not be considered direct solicitation as used in this subsection.

While the ACLI does not support the amendments to the exemption, at a minimum, we oppose any further restrictions to the exemption.

- Section 3A(5) - Pension and Welfare Benefit Plan Exemption

It is our understanding that in Seattle your Working Group agreed to include welfare benefit plans in the exemption; delete the reference to "fixed" annuities in 3A(5)(b); add the word "solely" in the last sentence before "for the purpose of"; and change the last word from "employees" to "individuals." We understand the exemption to read as follows and support it in this form:

> (5)(a) Policies or contracts used to fund (i) an employee pension or welfare benefit 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 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 annuity providers or policy providers and there is a direct solicitation of an individual employee by a producer for the purchase of a contract or policy. As used in this subsection, direct solicitation shall not include any meeting held by a producer solely for the purpose of educating individuals about the plan or arrangement or enrolling individuals in the plan or arrangement.

- Section 4E - Submission of Sales Material By Agent

In Seattle, your Working Group requested comment on the following alternative amendment to Section 4E:

> 4E - In connection with a replacement transaction, the producer shall submit to the insurer to which an application for a policy or contract is presented a copy of each document required by this subsection, a statement identifying any preprinted company approved sales materials used in the sales presentation and

copies of any individualized sales materials used in the presentation including any basic or supplemental illustrations.

While the above language is an improvement over the suggested language in your previous drafts, the ACLI must continue to oppose the requirements in the provision that relate to an agent providing a statement setting forth what approved sales materials were used in the sale and the requirement to provide to the company copies of individualized sales materials used in the presentation.

We continue to feel strongly that this requirement, even as modified, would be extremely costly and burdensome to companies. Furthermore, we assert that it is unnecessary as Section 5 of the draft rule requires insurers to "maintain a system of supervision and control to insure compliance with the requirements of this regulation." This requirement, together with the existing requirements found in current advertising rules, solicitation rules, the NAIC Model Illustration rule, and states' Unfair Trade Practices Acts, more than adequately ensure that appropriate and compliant presentations will be made in replacement sales. Furthermore, there continue to be very practical concerns with respect to the implementation of such a requirement. For instance, many agents run a variety of computer analyzes with the applicant on approved company software. Each analysis would be individualized; however, these are not necessarily printed. In addition, a problem remains with respect to the potential inclusion of items found in a consumer's file such as estate planning and other items used for fact finding and needs analysis that would be considered individualized, yet personal and confidential. Consumers would not want copies of that type of information passed along to anyone.

For the above reasons, and those expressed previously in our oral and written comments, we urge the Working Group to reconsider this burdensome, costly and unnecessary requirement. We continue to assert that the appropriate party to retain these materials is the consumer.

- Section 5B – Record-keeping Requirements

As you are aware, the ACLI opposes the record-keeping requirements found in Section 5B of your latest draft. We agreed, however, to develop and consider alternative language. Please consider the following language:

> 5B: Have the capacity to produce, upon request, and make available to the Insurance Department upon request records of each producer's:
>
> > (1) Replacements, including financed purchases, as a percentage of the producer's total annual sales for life insurance and annuity contracts subject to this regulation;
> >
> > (2) Number of lapses of policies and contracts by the producer as a percentage of the producer's total annual sales for life insurance and annuity contracts subject to this regulation; and
> >
> > (3) Number of transactions that may be unidentified replacements of existing policies or contracts by the existing insurer detected by the company's monitoring system as required by subsection A(5) of this section.

The above language attempts to address industry's concerns with "compiling" records of this type of information that could easily be misused in litigation matters. In addition, it attempts to clarify of what the percentages should be. Otherwise, the percentages would not be meaningful.

We would also like to make a related suggestion with respect to Section 5A(5). Rather than use the term "internal" replacements, as was agreed in Seattle, we suggest using the words "existing policies or contracts by the existing insurer" to describe the replacements contemplated by that provision. This is more appropriate as "internal replacements" is not a defined term. The provision would read as follows:

> 5A(5): Procedures to detect transactions that are replacements of existing policies or contracts by the existing insurer but that have not been identified as such by the applicant or producer.

- Section 8 - Duties of Insurers with Respect to Direct Response Solicitation

Your Working Group requested us to provide alternative language to that submitted in our Nov. 26, 1997, letter. We believe the following language satisfies any concerns raised during your Seattle meeting:

> A. To comply with its duties regarding replacement, an insurer shall require with or as part of each completed application for life insurance or annuity a statement as to whether the applicant has existing policies or contracts. If the answer is "no," the duties of the insurer with respect to replacement are complete. If the answer is "yes," and the insurer elects to proceed with the replacement, the insurer shall comply with the requirements of Subsection B or C. However, an insurer is under no obligation to replace an existing policy or contract.
>
> B. In the case of an application that is initiated as a result of a direct response solicitation, if the insurer did not propose a replacement, and the applicant answered "yes" to the question in A, the insurer shall send to the applicant with the policy a Notice Regarding Replacement as described in Appendix B or other substantially similar form approved by the commissioner.

C. In the case of an application that is initiated as a result of a direct response solicitation, if the insurer proposed the replacement it shall:

(1) Provide to applicants or prospective applicants with the policy a Notice, as described in Appendix A, or other substantially similar form approved by the commissioner. In such instances the insurer may delete the references to the producer, including the producer's signature without having to obtain approval of the form from the commissioner. The insurer's obligation to obtain the applicant's signature shall be satisfied if it can demonstrate that it has made a diligent effort to secure a signed copy of the notice referred to in this paragraph. 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 notice referred to herein;

(2) Comply with the requirements of Section 6B, if the applicant furnishes the names of the existing insurers, and the requirements of Section 6C.

D. Comply with the requirements of Section 6D and 6E.

- Section 9 - Violations and Penalties

In Seattle your Working Group agreed that the provisions in Section 6F of your latest draft more appropriately belong in Section 9, Violations and Penalties. In addition, you agreed to consider a materiality standard so that unintentional and technical violations of the rule would not trigger the penalties. Finally, we suggest not setting forth specific penalties which may be imposed, but to leave that to the discretion of individual insurance departments that may be limited by their Unfair Trade Practices Act as to what type of penalties they may impose.

Please consider the following language for Section 9:

9C: Where it is determined that the requirements of this regulation have not been met the replacing insurer shall provide to the policy or contract owner an in force illustration or policy summary and the Notice Regarding Replacements found in Appendix A.

9D: Violations of this regulation shall subject violators to penalties and other remedies the Commissioner may deem appropriate. Penalties shall take into account the materiality of the violations, the frequency of the violations, the length of time the policy or contract has been in force, and other relevant factors.

We hope you find these comments and suggestions useful and look forward to discussing them on Jan. 20, 1998. As always, if you have questions or comments, please do not hesitate to call. I can be reached at (202) 624-2187.

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ATTACHMENT TWO

Life Insurance and Annuities Replacement Model Regulation
Draft 3/17/98
Adopted by Replacement Issues Working Group
Exposed for Comments by Life Insurance (A) Committee

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Section 1. Purpose

The purpose of this regulation is:

A. To regulate the activities of insurers and 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 purchase 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. "Direct-response solicitation" means a solicitation through a sponsoring or endorsing entity or individually solely through mails, telephone, the Internet or other mass communication media.

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

C. "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.

D. "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 or contract and is known by the replacing insurer, 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 producers, it will be deemed *prima facie* evidence of a financed purchase.

E. "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. "Policy summary," for the purposes of this regulation;

(1) For policies or contracts other than universal life policies, means a written statement regarding a policy or contract which shall contain to the extent applicable, but need not be limited to, the following information: current death benefit; annual contract premium; current cash surrender value; current dividend; application of current dividend; and amount of outstanding loan.

(2) For universal life policies, means a written statement that shall contain at least the following information: the beginning and end date of the current report period; the policy value at the end of the previous report period and at the end of the current report period; the total amounts that have been credited or debited to the policy value during the current report period, identifying each by type (e.g., interest, mortality, expense and riders); the current death benefit at the end of the current report period on each life covered by the policy; the net cash surrender value of the policy as of the end of the current report period; and the amount of outstanding loans, if any, as of the end of the current report period.

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

H. "Replacing insurer" means the insurance company that issues or proposes to issue a new policy or contract and which replaces or is financed by an existing policy or contract.

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

J. "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 producer, or to the proposing insurer if there is no 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.

K. "Sales material" means a sales illustration and any other written, printed or electronically presented information created, or completed or provided by the company or producer and used in the presentation to the policy or contract owner related to the sale of the policy or contract purchased.

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. Direct solicitation shall not include any group meeting held by an insurance producer solely for the purpose of educating or enrolling individuals. Group life insurance or group annuity certificates marketed through direct response solicitation shall be subject to the provisions of Section 8;

Drafting Note: This exemption is intended to include group life insurance and annuities used to fund formal prepaid funeral contracts.

(3) An application to the existing insurer that issued the existing 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;

(5) (a) Policies or contracts used to fund (i) an employee pension or welfare benefit 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, a governmental or church welfare benefit plan, 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 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 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 group meeting held by an insurance producer solely for the purpose of educating individuals about the plan or arrangement or enrolling individuals in the plan or arrangement;

(6) Where new coverage is provided under a life insurance policy or contract and the cost is borne wholly by the insured's employer or by an association of which the insured is a member; or

(7) Existing life insurance that is a non-convertible term life insurance policy that will expire in five (5) years or less and cannot be renewed.

B. Registered contracts shall be exempt from the requirements of Sections 6B and 7B with respect to the provision of illustrations or policy summaries; however, premium or contract contribution amounts and identification of the appropriate prospectus or offering circular shall be required instead.

Section 4. Duties of Producers

A. A 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 producer as to whether the applicant has existing policies or contracts. If the answer is "no," the 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, the producer shall 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 producer attesting that the notice has been read aloud by the producer and left with the applicant or that the applicant did not wish the notice to be read aloud (in which case the producer need not have read the notice aloud). In either event, the notice shall be left by the producer with the applicant.

C. The notice shall list all life insurance policies or annuities proposed to be replaced, properly identified by name of insurer, the insured or annuitant, and contract number if available; and shall include a statement whether each policy or contract will be replaced or whether it will be used as a source of financing. 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. With respect to electronically presented sales material, it shall be provided to the policyholder in printed form no later than at the time of policy or contract delivery.

E. In connection with a replacement transaction, the producer shall submit to the insurer to which an application for a policy or contract is presented, a copy of each document required by this section, a statement identifying any preprinted or electronically presented company approved sales materials used, and copies of any individualized sales materials, including any illustrations used in the transaction.

Section 5. Duties of All Insurers that Use Producers

Each insurer shall:

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

(1) Inform its producers of the requirements of this regulation and incorporate the requirements of this regulation into all relevant producer training manuals prepared by the insurer;

(2) Provide to each producer a written statement of the company's position with respect to the acceptability of replacements providing guidance to its producer as to the propriety of these transactions;

(3) A system to review the propriety of each replacement transaction that the producer does not indicate is in accord with Paragraph (2) above;

(4) Procedures to confirm that the requirements of this regulation have been met; and

(5) Procedures to detect transactions that are replacements of existing policies or contracts by the existing insurer, but that have not been identified as such by the applicant or producer.

B. Have the capacity to produce, upon request, and make available to the Insurance Department, records of each producer's:

(1) Replacements, including financed purchases, as a percent of the producer's total annual sales for life insurance and annuity contracts not exempted from this regulation;

(2) Number of lapses of policies and contracts by the producer as a percentage of the producer's total annual sales for life insurance and annuity contracts not exempted from this regulation;

(3) Number of transactions that may be unidentified replacements of existing policies or contracts by the existing insurer detected by the company's monitoring system as required by Subsection A(5) of this section; and

(4) Replacements, indexed by replacing producer and existing insurer.

Drafting Note: Records required to be retained by this regulation may be maintained in paper, photograph, microprocess, magnetic, mechanical or electronic media or by any process which accurately reproduces the actual document.

C. Require with or as a part of each application for life insurance or an annuity a signed statement by both the applicant and the producer as to whether the applicant has existing policies or contracts;

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. When the applicant has existing policies or contracts, retain completed and signed copies of the notice regarding replacements in its home or regional office for at least five (5) years after the termination or expiration of the policy or contract;

F. When the applicant has existing policies or contracts, obtain and retain copies of any sales material as required by Section 4E, the basic illustration and any supplemental illustrations used in the sale and the producer's and applicant's signed statements with respect to financing and replacement in its home or regional office for at least five (5) years after the termination or expiration of the proposed policy or contract;

G. Ascertain that the sales material and illustrations used in the replacement meet the requirements of this regulation and are complete and accurate for the proposed policy or contract; and

H. If an application does not meet the requirements of this regulation, notify the producer and applicant and fulfill the outstanding requirements.

Section 6. Duties of Replacing Insurers that Use 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 a completed application indicating replacement or when the replacement is identified if not indicated on the application, notify any other existing insurer who may be affected by the proposed replacement and within five (5) business days of a request from an existing insurer mail a copy of the available illustration or policy summary for the proposed policy or available disclosure document for the proposed contract;

C. Retain copies of the notification regarding replacement required in Section 4B, indexed by producer, in its home or regional 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 (30) 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 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; and

E. Allow credit for the period of time that has elapsed under the replaced policy 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. This provision applies to transactions where the replacing insurer and existing insurer are the same or subsidiaries or affiliates under common ownership or control.

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 in its home or regional office, 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) business days of receipt of a notice that an existing policy or contract is being replaced, send a letter to the policy or contract owner of the right to receive information regarding the existing policy or contract values including if available, 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 policy or contract owner.

C. Upon receipt of a request to borrow, surrender or withdraw any policy or contract values, send to the applicant a notice, advising the policy or contract owner of the effect release of policy or contract values will have on the non-guaranteed elements, face amount or surrender value of the policy or contract from which the 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. In the case of consecutive automatic premium loans or systematic withdrawals from a contract, the insurer is only required to send the notice at the time of the first loan or withdrawal.

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

A. In order to comply with its duties regarding replacement, an insurer shall require with or as part of each completed application for life insurance or an annuity a statement as to whether the applicant has existing policies or contracts. If the answer is "no," the duties of the insurer with respect to replacement are complete.

B. In the case of an application that is initiated as a result of a direct response solicitation, if the insurer did not propose a replacement, and the applicant answered "yes" to the question in A, the insurer shall send to the applicant with the policy or contract a notice regarding replacement as described in Appendix B or other substantially similar form approved by the commissioner.

C. In the case of an application that is initiated as a result of a direct response solicitation, the insurer shall request from the applicant a statement asking whether a replacement is intended. If the applicant indicates a replacement is intended, or if the insurer has proposed the replacement, it shall:

(1) Provide to applicants or prospective applicants with the policy or contract a notice, as described in Appendix A, or other substantially similar form approved by the commissioner. In these instances the insurer may delete the references to the producer, including the producer's signature, without having to obtain approval of the form from the commissioner. The insurer's obligation to obtain the applicant's signature shall be satisfied if it can demonstrate that it has made a diligent effort to secure a signed copy of the notice referred to in this paragraph. 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 notice referred to in this section; and

(2) Comply with the requirements of Section 6B, if the applicant furnishes the names of the existing insurers, and the requirements of Sections 6C, 6D and 6E.

Section 9. Violations and Penalties

A. Any failure to comply with this regulation shall be considered a violation of [cite twisting section of state's unfair trade practices act]. 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 intentional 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 policy or contract owner to write directly to the company in such a way as to attempt to obscure the identity of the replacing producer or company.

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

C. Where it is determined that the requirements of this regulation have not been met the replacing insurer shall provide to the policy owner an in force illustration if available or policy summary for the proposed policy or available disclosure document for the proposed contract and the notice regarding replacements in Appendix A.

D. Violations of this regulation shall subject the violators to penalties that may include the revocation or suspension of a producer's or company's license, monetary fines and the forfeiture of any commissions or compensation paid to a producer as a result of the transaction in connection with which the violations occurred. In addition, where the commissioner has determined that the violations were material to the sale, the insurer may be required to make restitution, restore policy or contract values and pay interest at [insert reference to a rate set by an applicable statute or regulation] on the amount refunded in cash.

Section 10. Severability

If any section or portion of a section of this regulation, or its applicability 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.

Section 11. Effective Date

This regulation shall be effective [insert date].

APPENDIX A

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 may involve discontinuing or changing an existing policy or contract. If so, a replacement is occurring. Financed purchases are also considered replacements.

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.

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.

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.

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 you are contemplating replacing (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 or its agent for information about the old policy or contract. [If you request one, an in force illustration, policy summary or available disclosure documents must be sent to you by the existing insurer.] Ask for and retain all sales material used by the agent in the sales presentation. 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

I do not want this notice read aloud to me. ________ (Applicants must initial only if they do not want the notice read aloud.)

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

For Life Insurance

PREMIUMS:
Are they affordable?
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 paid?
How will the premiums on your existing policy be affected?

Will a loan be deducted from death benefits?
What values from the old policy are being used to pay premiums?

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?

APPENDIX B

NOTICE REGARDING REPLACEMENT
REPLACING YOUR LIFE INSURANCE POLICY OR ANNUITY?

Are you thinking about buying a new life insurance policy or annuity and discontinuing or changing an existing one? If you are, your decision could be a good one—or a mistake. You will not know for sure unless you make a careful comparison of your existing benefits and the proposed policy or contract's benefits.

Make sure you understand the facts. You should ask the company or agent that sold you your existing policy or contract to give you information about it.

Hear both sides before you decide. This way you can be sure you are making a decision that is in your best interest.

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ATTACHMENT THREE

Viatical Settlements Working Group
Salt Lake City, Utah
March 16, 1998

The Viatical Settlements Working Group of the Life Insurance (A) Committee met at the Salt Palace Convention Center in Salt Lake City, Utah, at 1 p.m. on March 16, 1998. Lester Dunlap (La.) chaired the meeting. The following working group members were present: Michael Bownes (Ala.); Mike Hessler (Ill.); Marlyn Burch (Kan.); Louis Belo (N.C.); Tom Foley (N.D.) and Dan Keating (Okla.).

Lester Dunlap (La.) said the purpose of this meeting is to review the charge and make plans for 1998. He read the charge that requires the working group to "complete amendments to 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." Mr. Dunlap noted that the revisions to the Viatical Settlements Model Act that the working group adopted in December 1997 include the expectation that chronically ill will viaticate policies. He said this may require a separate standard for minimum payouts for the chronically ill. He said he hoped the actuarial study that Tom Foley (N.D.) and Mark Peavy (NAIC/SSO) offered to complete will give guidance. In addition, a group of technical resource advisors are developing forms to use in soliciting information from insurers that is needed by viatical settlement providers. Mr. Dunlap noted that a standardized disclosure form such as developed in New York or Texas would be helpful for educating individuals, and it is the intent of the working group to develop an appendix with that kind of disclosure guide.

1. <u>Actuarial Study</u>

Mr. Foley explained that the original payout standards in the model regulation anticipated a relatively early demise after an individual viaticates a policy. There was little information available at that time so the table developed by the working group was probably a good option. He said it would be difficult to come up with a similar table for the chronically ill, but Mr. Peavy and he are willing to work with the group to develop new tables. He emphasized the importance of information from the viatical settlement industry. Mr. Foley suggested, as an alternative to the current minimum payout pricing structure, a participation plan where an initial payout is made and if the individual dies relatively early an additional payment would be made to the beneficiary. He compared this to the experience in the life insurance industry where an individual with a participating policy receives a greater benefit if the insurer has higher earnings on the amounts invested. Mr. Peavy referred the members of the working group to a list he prepared showing the elements in a potential actuarial study (Attachment Three-A). Mr. Peavy emphasized that these would be difficult issues to address and reach consensus on. He suggested a conference call of a few individuals who would be interested in assisting in structuring the actuarial study. Mr. Dunlap responded that the working group may ultimately vote not to make any changes to the current set of discounts but emphasized that a modified set of discounts might be needed for the chronically ill. Holly Roth (Viaticus) said the viatical industry would welcome the opportunity to work on this issue. She said her company had a large database that the working group might find helpful.

Robert Shear (Accelerated Benefits Capital), representing the Viatical Association of America (VAA), agreed that when the original discount provisions were written, most who viaticated policies were AIDS patients. He said those now served are much more diverse and this will require a further study of the pricing. Ms. Roth suggested a conference call to help them understand what type of information they need to gather, and then a face-to-face meeting to discuss the information. Mr. Foley suggested a meeting in Kansas City before the Life and Health Actuarial (Technical) Task Force meetings in early June.

To create a first draft of the model regulation, Mr. Dunlap suggested a group of drafters meet in Kansas City in late April or early May. He solicited suggestions and recommendations from interested parties to assist those drafters. Doug Head (Medical Escrow Society) said he was pleased by the working group's hard work on the model act and expressed the desire of the viatical settlement industry to work with insurance regulators on drafting regulations. He also said the viatical settlement industry would work with the insurance industry to address the concerns that they share. Mr. Dunlap asked interested parties to submit suggestions and drafts to Carolyn Johnson (NAIC/SSO) by mid-April so that the drafters could consider them in early May.

Paul Schoener (N.Y.) described to the working group a *Wall Street Journal* article he had recently seen about the viatication of structured settlement annuities. He noted that a structured settlement was generally set up to avoid the problem of a person spending a lump sum and becoming destitute. He expressed concern about the procedure of trading a structured settlement for a lump sum payment. He asked if consideration of this issue would fit under the working group's charge. Mr. Head said viatical settlement providers are not in the business of purchasing structured settlements; that is another industry. Mr. Shear said there may be some ownership relationship between companies that acquire structured settlements and companies that are in the business of viatical settlements. Mr. Dunlap recalled that this issue had been brought to the attention of the Life Insurance (A) Committee by Dwight Bartlett (Bartlett Consulting), formerly the chair of the A Committee, and he agreed to discuss this issue with the A Committee to see whether it is appropriate to extend the charge.

Mr. Foley asked if the working group will discuss any further the Viatical Settlements Model Act now before the Life Insurance (A) Committee. He asked if the A Committee would have a full discussion or just vote. Mr. Dunlap responded that he did not know for sure, but he would expect at least some discussion by the parent committee. Mr. Foley said that he thought there would need to be an airing of the issues related to the secondary market and the confidentiality of information. He said he did not feel any differently about the issue than he had expressed at the last Viatical Settlements Working Group meeting. He said he plans to speak out at the A Committee meeting, but North Dakota is not a voting member of that committee. Mr. Foley said he continues to be astounded that he could invest in a policy on an individual's life and have the name and address and other information available to a person who would gain by that individual's dying sooner rather than later. Mr. Dunlap said that after the Winter National Meeting he looked at the current model and states with laws on viatical settlements and did not see any but the Maine statute that addresses the issue of disclosure of these names. He noted that Maine's prohibition is limited to individual investors; institutional investors can access the information. He suggested that if there is really a problem, it would have become obvious before now because so few states prohibit disclosure of this information. He said he had made calls to states with the model act in place and those states responded that they were not aware of any deaths that had been caused so another could profit financially from the viatical settlement. Mr. Foley opined that this is not information that would likely come to light. Mark Kramp (State Farm) said he is now working on the case of an investor who wanted information about the insured and his company had refused to turn over that information. He opined that anyone who has dealt with life insurance claims knows of instances where Slayer Statutes should have been invoked. He opined that this is a moral issue. The right thing to do is not to allow that information to be disclosed. He said it was not an adequate response to say there is another law to address the issue after the fact. Mr. Shear said it is important to note that for the most part, private investors do not have access to that information because many firms do not give out identifying information. He said there were some investors who did feel the need to have that information. He suggested a further discussion of this issue could take place during the development of the regulation. Mike McNerney (Mutual Benefits Corporation) said it was important to balance the needs of all. To the extent an entity is going to provide funds, it may want details of the policies that the money is being loaned against before it purchases an interest in the policy. He emphasized that there is no evidence that those who invest are involved in murder. Mr. Foley suggested that the model act has to be very clear that the working group is in no way condoning individual investors having information. He said he is not ready to give up on keeping the information confidential from institutional investors, but is extremely concerned about individual investors having that information. He said he had not heard any discussion that made him change his mind.

Mr. Dunlap asked Roger Strauss (Iowa), who was the chair of the working group that developed the original Viatical Settlements Model Act, if there was any discussion on this issue at that time. Mr. Strauss responded that the issue had not come up. He agreed with Mr. Dunlap that he did not see this as an important issue. He said that in theory it could happen, but it is not likely.

Mr. Keating said that in addition to Mr. Foley's comments, he also was concerned about Section 9F of the model act that allows the provider to contact a viator. He said there must be a better way than to contact the viator and ask if he is still alive.

Having no further business, the Viatical Settlements Working Group adjourned at 1:55 p.m.

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ATTACHMENT THREE-A

Discussion Document for Viatical Settlements Working Group - 3/16/98
Aspects Related to a Potential Actuarial Study

Elements of Pricing:
1) The probability of death for a particular viator.
2) The viatical company's acquisition and maintenance expenses associated with a particular viatical settlement.
3) Overall administrative expenses of the viatical company.
4) Taxes.
5 Risk and profit margin.
6) Interest.
7) The amount of premium necessary to keep the policy in force.
8) The amount of death benefit that will be paid.

Issues:
1) How is a fair estimate of mortality determined?
2) How is a fair estimate of the company's expense level determined?
3) What is a fair profit?
4) How is the appropriate interest rate determined?
5) How are future premiums necessary to keep the policy in force determined for policies such as universal life and indeterminate premium policies?
6) How does one determine the exact amount of death benefit for policies where the death benefit varies, e.g., participating policies where the dividends are used to purchase additional insurance, or universal life policies where the death benefit is the cash value plus a stipulated amount?
7) Should the amount paid the viator be no lower than an estimate of the future cash values available under the policy? If so, how is that estimate determined?

Advantages of current "Minimum Percentages" in the Regulation:
1) They are relatively easy to apply. The only two variables are the viator's life expectancy and the insurer's rating by A.M. Best or comparable rating agency. (This is not to suggest that the estimate of the viator's life expectancy is an easy or non-controversial process.)
2) The 50% floor guarantees that viators will receive a substantial amount.

Disadvantages of current "Minimum Percentages" in the Regulation:
1) None of the questions raised in "Issues" is directly addressed. It is implicitly assumed that the minimum percentages incorporate somewhat accurate estimates of those items.
2) The 50% floor becomes less appropriate as the life expectancy of the viator lengthens.

Aspects Related to a Potential Actuarial Study:
1) There will be no easy or obvious answers to any of the questions raised in "Issues."
2) Some of the questions are as much (or more) philosophical as actuarial. For example, what is a fair profit?
3) Given #2, if an actuarial study is done, it will need to include actuarial and other representatives of the viatical companies, as well as regulators and consumer representatives.

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ATTACHMENT FOUR

Viatical Settlements Model Act
Draft: 12/6/97
Adopted by the Life Insurance (A) Committee

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Section 7. Examination
Section 8. Disclosure
Section 9. General Rules
Section 10. Authority to Promulgate ~~Standards~~ Regulations
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Section 12. Effective Date

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.

~~A~~C. "Person" means a ~~natural or artificial~~ legal entity, including but not limited to, an individual~~s~~, partnerships, limited liability company, association~~s~~, trust~~s~~, 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.

~~B~~E. "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.

~~C~~F. "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.

~~D~~G. "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.

~~E~~H. "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.

~~H~~I. "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~~ 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 amounts].~~ Failure to pay the fees by the renewal date results in expiration ~~within the terms prescribed shall result in the automatic revocation~~ of the license.

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 a~~ny~~ license to a~~ny~~ 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 a~~ny~~ 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 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 or not 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 r~~Receipt of the proceeds of a viatical settlement may adversely affect 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, ~~A~~a 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 A~~a~~ct.

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.~~

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ATTACHMENT FIVE

To: Lyssa E. Hall, Office of Exemption Determinations, Pension and Welfare Benefits Administration, U.S. Department of Labor
From: Terri Vaughan, Chair, NAIC Life Insurance Committee
Date: March 17, 1998
Re: Comments on Proposed Regulation on the *Harris Trust* Issue

We would like to provide comments on the proposed regulation published in the *Federal Register* on Dec. 22, 1997, in accordance with Section 1460 of Public Law 104-188 on behalf of the NAIC. The NAIC is an organization of the insurance regulators of the 50 states, the District of Columbia and four territories. The NAIC is a non-profit association created to foster cooperation between the states in regulating the insurance industry. State insurance regulators are charged with monitoring and regulating financial solvency, corporate conduct and market conduct so policyholders are not harmed.

The Life Insurance Committee of the NAIC has closely followed the developments in this area in recent years. We are well aware of the challenge facing the Department of Labor as it attempts to craft rules in response to Public Law 104-188. While the Department of Labor is concerned primarily with protecting plan participants, the insurance regulators are concerned with protecting *all* policyholders, not just plan participants. In that context, we have concerns with several of the provisions of the proposed regulation. The state insurance regulators stand ready to work with the Department of Labor in development of regulations that will address all of our regulatory interests.

From the supplementary information submitted with the proposed regulation, it appears that the prudent management standard in proposed subsection (g) of Section 2550.401 c-1 applies to general account assets supporting transition contracts regardless of whether the contracts satisfy the requirements of subsections (b) through (f) of the proposed regulation and regardless of whether the general account assets are plan assets under the Employee Retirement Income Security Act (ERISA). It appears subsection (g) applies regardless of whether the general account assets supporting the contracts are also plan assets. As we interpret it, this subsection addresses the irreconcilable conflict between state insurance laws that require insurers to treat all policyholders in a fair and equitable manner and the ERISA fiduciary rules that require that a fiduciary manage plan assets for the exclusive benefit of plan participants and their beneficiaries.

However, it appears that a transition contract that does not satisfy one or more of the requirements under subsections (b) through (f) of the proposed regulation will cause general account assets to be plan assets subject to ERISA. This would subject the general account to prohibited transaction rules and limitations on holding employer securities and real property, as well as other fiduciary duties that are deemed to exist. The only relief from existing standards is the prudent management rules set forth in subsection (g). Therefore, insurance companies will need to qualify transition contracts under subsections (b) through (f), especially contracts holding large amounts of funds.

Our concerns with respect to provisions (b) through (f) are described below.

I. The proposed rules may preempt state rehabilitation or liquidation plans.

The NAIC is extremely concerned with the five-year book value installment payment and the two-way market value adjustments as they pertain to possible preemption of any rehabilitation or liquidation plan approved by a state court for an impaired or insolvent insurer. A moratorium on the payment of cash surrender benefits has been used in many rehabilitation efforts, such as the rehabilitation of the Mutual Benefit Life Insurance Company. The moratorium allowed the rehabilitator to conserve illiquid and severely depressed assets such as bonds, real estate holdings and mortgages and to hold these assets until market conditions improved, thus optimizing the amount of cash available for those contractholders who elected to surrender at the end of the moratorium period. It appears that an irreconcilable conflict will exist between the proposed regulation rules allowing a two-way market value adjustment and a five-year book value installment payment upon 90 days notice of the plan sponsor and a rehabilitation plan placing a moratorium on cash surrenders of greater than 90 days. Even if you agree to implement all the suggestions following, an exception in the case of insolvency is absolutely necessary to permit state regulatory and judicial oversight to continue to function.

II. The proposed regulation raises solvency and disintermediation concerns on the part of insurance regulators.

The NAIC is concerned with the Department of Labor's apparent perception that the five-year book value payment and other termination rules will have an insignificant impact on insurers. In the summary issued with the proposed regulation, it was stated that approximately 3% of the life insurance industry's assets are in contracts that would be subject to the proposed regulation. For purposes of solvency regulation, the DOL's comparison of business written under the contracts and the percentage of assets covered by the contracts is misleading.

First, the use of industry averages is inappropriate. There are many insurers that have a significant amount of assets in contracts that the Department of Labor believes are covered by the proposed regulation, far beyond the 3% the DOL suggests.

Second, even when using industry averages, the disintermediation risk is greater than the DOL recognizes. The correct measurement is not a comparison with the total assets, but rather with an insurer's surplus. Most well-managed insurers have a surplus that ranges between 4-6% of total assets. When you compare the amount covered under the contracts in question with surplus, it is clear that solvency impairment can quickly occur in the event of significant disintermediation and book value withdrawals.

III. The shortened duration of investments for asset matching will likely result in lower returns for contractholders.

While the NAIC concurs that contractholders should not be locked into economically disadvantageous relationships, it is the view of the NAIC that a mandated market value lump sum and five-year book value surrender right will require insurers to shorten the duration of supporting assets and reduce the amount of non-publicly traded assets to better match their assets with the revised contractual liabilities that will result if the proposed regulation is not modified. There is a good likelihood that many insurers will realign their investment portfolio, resulting in lower interest rates credited to these contracts. The reduced interest rate may require additional plan contributions for contracts funding defined benefit plans and may result in lower account balances for defined contribution plans. If these results occur, the best interests of plan sponsors, plan participants and their beneficiaries will not be served.

Furthermore, if the proposed regulation does not provide any direction as to the manner in which an insurer may alter its general account assets attributable to transition contracts, existing assets underlying these contracts must be exchanged for better-matched assets. It would appear that one or more classes of contractholders, including "non-transition" ERISA contracts, will suffer. This is contrary to the prudence standards required in paragraph (g) of the proposed regulation and raises concerns under state insurance laws that all contractholders are not being treated in a fair and equitable manner. Finally, one or more classes of "non-transition" ERISA contractholders may experience a mismatch of assets and liabilities, resulting in lower interest rate crediting or raising possible self-support concerns under applicable state insurance laws for such products as guaranteed investment contracts.

The NAIC strongly urges that benefit plans be given some freedom to select among several types of termination and discontinuance provisions in return for a better crediting rate. To protect the interest of all policyholders, including plans and plan participants, a phase-in of a minimum required book value surrender provision should be provided to give insurers time to reallocate assets in the least disruptive way possible. Since it appears that a 10-year installment payout may be reflective of the average payout length for all insurers writing deposit administration and immediate participating contracts, we suggest an interim period of five years during which plan sponsors could select from among alternative book value installment payouts offered by insurers. By the end of the interim period, each insurer would be required to offer a five-year installment book value payout, which is a financial equivalent to the lump sum payment, and could offer other installment periods not to exceed 10 years.

IV. An upward and downward market value adjustment will encourage disintermediation, which has an adverse impact on persisting policyholders.

The NAIC has concerns with the provision of the regulation that allows for both downward and upward market value adjustments. Upward adjustments, which appear to be contemplated under paragraph (h)(7), will encourage disintermediation and increase liquidity concerns. Again, insurers may need to revise investment strategies, possibly resulting in reallocation of assets or maintenance of higher reserves. This may result in lower interest crediting rates. The use of a proper market value adjustment methodology is intended to maintain equity between those contractholders who elect to terminate and those contractholders who do not terminate. Disintermediation has an adverse impact on persisting contractholders. Some contractholders should not benefit at the expense of other contractholders.

V. The Memorandum for the actuarial opinion should be allowed to remain confidential.

In respect to the disclosure of the actuarial opinion certifying the adequacy of an insurer's reserve, including any supporting documents, i.e., the actuarial memorandum, the NAIC believes that this requirement should be deleted. The actuarial opinion is already publicly available. Under most state laws, the actuarial memorandum is treated as confidential due to the sensitivity of the material it contains. If there is any possibility that the supporting material may become public information, regulators are concerned that insurers will not provide full, complete and candid information in the supporting documents, making regulation of solvency more difficult.

The NAIC appreciates the opportunity to bring the concerns of state insurance regulators regarding this proposed regulation to your attention. We hope you will consider modifications based on the concerns we have raised.

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ATTACHMENT SIX

Charitable Gift Annuities Model Act
Draft: 3/17/98
Adopted by the Life Insurance (A) Committee

Section 1. Scope
Section 2. Definitions
Section 3. Certificate of Authority
Section 4. Surplus and Reserves
Section 5. Investments
Section 6. Annual Reports
Section 7. Examination
Section 8. Filing of Contracts
Section 9. Disclosure

Section 10. Other Applicable Code Provisions
Section 11. Severability
Section 12. Effective Date

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 Annuities 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 ten percent (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 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) 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 account 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 or persons 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 Subsections 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.

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ATTACHMENT SEVEN

Equity Indexed Products Working Group
Salt Lake City, Utah
March 14, 1998

The Equity Indexed Products Working Group of the Life Insurance (A) Committee met in Room 150G of the Salt Palace Convention Center in Salt Lake City, Utah, at 5 p.m. on March 14, 1998. Jerry Fickes (N.M.) chaired the meeting. The following working group members were present: Roger Strauss (Iowa); Lester Dunlap (La.); Frank Cote (Mont.); Dan Keating (Okla.); and Leslie Jones (S.C.).

Jerry Fickes (N.M.) said this is an organizational meeting of a new working group formed to look at narrow issues related to equity indexed products. He said the charge to this group is to "consider issues related to sales of equity indexed products, such as marketing and agents' licensing requirements and make recommendations by the 1998 Summer National Meeting." Mr. Fickes noted that he had already discussed the time frame with Commissioner Terri Vaughan (Iowa), the chair of the Life

Insurance (A) Committee, and Commissioner Vaughan agrees that it will take longer for this group to complete its task. Mr. Fickes presented three possible areas for working group activity and asked working group members to comment on them. 1) Market Conduct Enforcement—The working group agreed that it was appropriate to prepare recommendations for consideration by the Market Conduct and Consumer Affairs (EX3) Subcommittee. 2) Licensing of Agents—Mr. Fickes noted that the agents' licensing group is also under the Market Conduct and Consumers (EX3) Subcommittee and suggested making recommendations on licensing requirements for agents selling equity indexed products. 3) Guaranty Fund Coverage—Mr. Fickes said the working group might want to make recommendations on this to the Insolvency (EX5) Subcommittee.

Roger Strauss (Iowa) said that it was not possible to work on all of these issues simultaneously and suggested the working group prioritize the topics mentioned by Mr. Fickes.

Leslie Jones (S.C.) asked if this working group would be discussing disclosure issues. She suggested it was important that this group not duplicate the efforts of the Life Disclosure Working Group. Mr. Fickes agreed that was under the purview of the Life Disclosure Working Group, and asked Tom Foley (N.D.), the chair of the Life Disclosure Working Group, if that group was working on contract approval issues also. Mr. Foley said the Life Disclosure Working Group presented a seminar to educate states on things to look for in contract approval, but other than that the group did not intend to discuss contract approval issues. He said it would be a significant stretch to put that under the charge to the Life Disclosure Working Group and opined that it would be more logical to look at contract approval issues under the Equity Indexed Products Working Group. He said he would be happy to provide the contract filing guidelines from North Dakota and Illinois, which had been reviewed by the Life Disclosure Working Group. Mr. Fickes said it would be helpful for this working group to continue that review of materials and go forward with it. He asked Carolyn Johnson (NAIC/SSO) to request from states any filing guidelines or similar information that they were using. Mr. Foley asked if all states had received the video provided by the America Council of Life Insurance (ACLI) of the seminar that the working group and the ACLI sponsored jointly. About half of the states represented at the table and in the audience indicated they had received that video. Reece Boyd (ACLI) said the video was sent to the commissioner of each state in September 1997 and suggested the regulators check with their commissioners for the copy. He offered to send an additional copy to any state that requested one from him.

Mr. Fickes asked how the working group would like to approach the issue of agents licensing. He said this was an important issue in that it would safeguard both consumers and insurers. Mr. Foley asked if licensing incorporates training. He suggested it was possible to give the same license, but to encourage companies to train agents and test for proficiency. Doug Barnhardt (Barnhardt & Associates), representing the National Association of Variable Annuities (NAVA), said his organization would be willing to share information it had on training and education of agents. Mr. Foley described a recent equity indexed annuity filing he had approved that had an extensive training program for the agents selling the equity indexed products. Dan Keating (Okla.) noted that one of the major reasons for a recent approval in his state is that the company had good agents training. He said many agents that want to sell equity indexed products are clamoring to become agents of that company. Mr. Strauss said it sounded to him like there was some overlap because part of the contract review process was to see what type of training the company offered its agents. He asked the working group to consider whether they were actually discussing license criteria for equity indexed product producers or instead part of the product approval process. He noted that, if a separate license would be required, it would be necessary to talk about testing requirements, continuing education, etc., so the discussion becomes more complex. Mr. Keating said some states are thinking of requiring a separate licensing, so that aspect cannot be ignored. Mr. Foley suggested changing licensure laws is a long range project and will not be immediately helpful so it makes more sense to look first at training by the companies. Mr. Fickes asked carriers selling equity indexed products to send information about any specific training program to Ms. Johnson prior to the Summer National Meeting. Mr. Fickes also thanked Mr. Barnhardt for his offer for a presentation from NAVA at the Summer National Meeting.

Scott Cipinko (National Alliance of Life Companies—NALC) noted that the Agent Licensing Models Working Group of the Market Conduct and Consumer Affairs (EX3) Subcommittee also is organizing at this time. He suggested the Equity Indexed Products Working Group request that Gene Reed (Del.) or Sam Myer (S.D.) who are co-chairs, join this working group. Mr. Fickes directed Ms. Johnson to ask these individuals to consider joining the working group.

Mr. Strauss moved and Ms. Jones seconded a motion to concentrate first on the issue of equity indexed contract review and the working group passed the motion. Mr. Fickes asked staff to prepare a work plan for the working group so that each area could be considered.

Charlotte Liptak (TransAmerica) said that one of the charges of the Insolvency (EX5) Subcommittee is to look at the guaranty fund issues related to equity indexed products. The working group reviewed the charge to the EX5 Subcommittee and agreed that it appears that issue will be handled there, but the working group may make some suggestions.

Mr. Keating moved and Ms. Jones seconded a motion to adjourn the meeting and the meeting adjourned at 5:45 p.m.

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ATTACHMENT EIGHT

Life Disclosure Working Group
Salt Lake City, Utah
March 16, 1998

The Life Disclosure Working Group of the Life Insurance (A) Committee met at the Salt Palace Convention Center in Salt Lake City, Utah, at 2 p.m. on March 16, 1998. Tom Foley (N.D.) chaired the meeting. The following working group members or their representatives were present: Sheldon Summers (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Cindy Martin (Mass); Paul DeAngelo (N.J.); Jerry Fickes (N.M.); Louis Belo (N.C.) and Dan Keating (Okla.).

1. Consider Adoption of Equity-Indexed Annuities Buyer's Guide

Tom Foley (N.D.) said there seems to be much agreement that the working group should attempt to finalize an Equity-Indexed Annuities Buyer's Guide so that companies can begin to use the guide. He said Brenda Cude (Illinois Cooperative Extension Service) has been very helpful in putting the guide that had been developed into plain understandable English. He said there were changes to the guide in response to Ms. Cude's comments as well as more changes being considered today. He said the working group will listen to comments on the suggested technical changes being presented today and hopefully adopt the buyer's guide and send it to the Life Insurance (A) Committee. Companies would then be encouraged to voluntarily use the buyer's guide. Mr. Foley said that everyone he spoke to thinks it is a good idea to have the guide available now. Charlotte Liptak (Transamerica) reviewed the draft section by section and asked the group to consider technical changes to the document. After consideration of the technical changes, Roger Strauss (Iowa) moved and Dan Keating (Okla.) seconded a motion to adopt the Equity-Indexed Annuity Buyer's Guide (Attachment Eight-A). The motion passed.

Lester Dunlap (La.) said he discussed the timetable for the Deferred Fixed Annuities Buyer's Guide (see *NAIC Proceedings* 1997 Third Quarter Vol. II pages 1232–1236) with the technical resource advisors. Riva Kinslick (Prudential) suggested the following timeline:

April 10, 1998	Working group comments to Carolyn Johnson (NAIC/SSO). Ms. Johnson incorporates comments of working group.
April 22, 1998	Ms. Johnson sends draft to Linda Lanam (Life of Virginia) who incorporates comments from the life insurance industry.
May 1, 1998	Draft of buyer's guide sent to interested parties.
Week of May 11	Conference call of Life Disclosure Working Group to discuss.
Week of May 25	Document to Ms. Cude for readability testing.
June 8, 1998	Document mailed to interested parties.

The working group agreed that this timetable would allow adoption of the Deferred Fixed Annuities Buyer's Guide at the Summer National Meeting. Mr. Foley explained that the fixed annuity guide would have the equity indexed guide as an appendix. The working group adopted the appendix first, but will adjust it as needed. Mr. Foley suggested that when the buyer's guide is mailed to interested parties, it also could be added to the NAIC's Web site to get additional comments.

2. Report from the American Academy of Actuaries (AAA)

Barbara Lautzenheiser (Lautzenheiser & Associates) gave an update on the information provided by the AAA to the working group at the interim meeting. She said the AAA will continue working on the "bright line" test because it believes that will be the most important test to the working group. The other test is extremely complex and so will be less workable. She said the AAA group is now testing and modeling to refine development of the bright line test.

3. Discuss Draft of Annuity Disclosure and Sales Illustrations Model Regulation

a. Illustrations

Mr. Foley said there are a number of issues to discuss in regard to the model regulation (Attachment Eight-B). He asked the working group to consider first the issue of illustrations. He said so far the working group has considered that illustrations would be optional on a sale by sale basis, but if an illustration is used it must meet the criteria in the model. The current standard in the model is that if a company wants to include any non-guaranteed element in its disclosure document, an illustration is required.

Ms. Kinslick said that at the interim meeting the working group talked about ways to deal with the renewal rate issue, because the group is interested in showing a renewal rate history. She said one method is to show the current rate and the fact that it is not guaranteed. She said she understood that this would be allowed on the disclosure document. Mr. Foley asked if she was suggesting that, for a declared rate fixed annuity, the insurer could tell the current rate even though it was not guaranteed. Ms. Kinslick responded that this will help a consumer understand how the contract works without using a full ledger illustration. Steve Frankel (Northwestern Mutual) said that a full illustration might not be necessary, but whatever numbers are used should be supportable.

Bob Brown (CIGNA) said a ledger illustration showing accumulated values is not produced often for an annuity sale because it is not very helpful.

Mr. Foley said that for a declared rate fixed annuity, the "plain vanilla" annuity, the working group explored the concept that illustrations would be optional, and that it is permissible to show non-guaranteed elements if an actuarial certification is filed with the commissioner indicating those rates are supportable. Mr. DeAngelo agreed that the illustration should be optional, but he thought that if non-guaranteed elements are shown into the future that must be in the context of an illustration. Mr. Foley countered that if the company said "currently we are paying 5%" that would be a non-guaranteed element, but it would be helpful information. Cindy Martin (Mass.) asked what the trigger is for an illustration if the disclosure document may describe the first-year rate as well as other non-guaranteed rates. Mr. Foley clarified that the working group is considering allowing the disclosure form to say something like "on this form we are currently paying 5% on renewal," as long as there is an actuarial certification provided to the regulator saying it is supportable. Mr. DeAngelo agreed that it is important to tell the renewal rate to help consumers recognize a first-year bonus. Ms. Martin agreed that another point to get across is that the rate can and likely will change.

Mr. Foley suggested that, as succinctly as possible, this information needs to be included in the buyer's guide. That way consumers will come to a correct understanding of how the rate might change.

Mr. DeAngelo said he saw, "what I pay now on a contract issued last year" as quite different from saying, "what I expect to pay next year on contracts I am issuing now." Mr. Brown said that the best measure of the intent of the company is what has happened in the past. Mr. DeAngelo clarified his understanding that the agreement of the working group is to allow the disclosure document to include one specific non-guaranteed element in the limited context of describing the rate companies currently pay on annuities issued in prior years.

Mr. Foley asked the working group if this same set of rules is appropriate for multiple fund fixed annuities, such as two-tier annuities and other types of products being developed. He asked if an illustration should be required. The rationale the working group had used in setting this requirement initially was that this is a much more complex product and an illustration is needed to demonstrate the complexities of the product. Roger Wiard-Bauer (LifeUSA) said it is possible to disclose that information within the one-page disclosure document, simply by adding a paragraph or two. Mr. DeAngelo suggested that the use of non-guaranteed elements in the very limited context discussed earlier would also work on two-tier annuities. Mr. DeAngelo said there is a great deal of difference in talking about a depiction of what will be paid on a contract issued today into the future rather than what is being paid today on a contract issued in the past. That is a fact; a company knows what is being paid today. Mr. Foley asked if one of these should be allowed and one not and Mr. DeAngelo responded that both should be allowed but one requires an illustration. Ms. Liptak expressed her understanding of the working group's discussion. She said that disclosure of a current first-year rate was permissible in the disclosure document and, if the company wants to disclose its renewal rate, the only rate the company can talk about is what older contracts are paying now as a renewal rate. If the company wants to talk about what this contract could pay in the future, it needs to provide an illustration. Mr. DeAngelo agreed that was his intent. Ms. Liptak suggested that if companies are going to talk about renewal rates, some sort of disclaimer should be required that past rates are not necessarily indicative of future performance. The working group agreed that is appropriate.

Mr. Foley said he understood Mr. DeAngelo to say that even for multiple fund policies he was comfortable applying the same requirements, but with added disclosure language. Mr. Keating opined that the success of that avenue depends on how well written the extra descriptive language is.

Mr. Foley asked how the working group wants to handle illustrations for equity indexed annuities. The kind of language being discussed for other types of annuities such as "we are paying [ ] today" does not work for an equity indexed product. Mr. Foley reminded the group that they talked at some length about requiring a hypothetical depiction so that companies could see how an equity indexed product would perform in a rising and falling market. He said the company would take its design and on a guaranteed basis show the value using the same hypothetical movement of the market. Mr. Wiard-Bauer said that the AAA came to the conclusion that any type of hypothetical is misleading and that a description of the method of interest crediting would be better.

Ms. Liptak said the technical resource advisors met to talk about disclosure for equity indexed annuities. They listed some parameters that could be applied to the requirement for a hypothetical depiction such as: not personalized; a generic premium; a single term or five years, whichever is longer; examples without withdrawals and using caps, floors and participation of that design; and a statement that the depiction is not any guarantee of future performance. She said the technical resource advisors suggested three depictions. One a "worst case" scenario and two others. Mr. Keating said the Oklahoma Insurance Department encourages hypothetical depictions.

Mr. Foley suggested that for the purposes of this model, regulators do not know enough to hone in on specifics for depictions. He suggested the model include general parameters such as Ms. Liptak just read and add balancing language. The basic criteria is not to mislead. He suggested the appropriate illustration or depiction may be clearer in the future but he was reluctant to add more specifics because it might stifle innovation.

Mr. DeAngelo said he likes the parameters that Ms. Liptak read, and to the extent that a company uses a hypothetical depiction that is other than guaranteed, it should include a midpoint depiction. Mr. Foley said the next version of the draft model regulation will replace Section 6 with a section that describes the numeric depictions and strongly encourages the use of a midpoint. Mr. Fickes said that regulators do not want to destroy the marketability of the equity indexed product, but insurers need to be honest in describing their product.

b. Section 5 Requirements for Disclosures

Mr. Foley said that after the last working group meeting in February, the draft was revised to reflect the discussion regarding Section 5. He asked the working group members to review that language and consider further changes.

Julie Spiezio (American Council of Life Insurance—ACLI) noted that Section 5A does not work for direct marketing. Mr. Strauss suggested that the section instead say that the disclosure document must be sent within 48 hours when the sale is not face to face.

Mr. Keating questioned Subsection B(3)(c) as to whether the settlement options are included in the contract. He suggested that if they are, they may need to be defined in Subparagraph B(3)(a). He suggested that if income options are going to be included, the interest rate would normally be shown.

Ron Panneton (National Association of Life Underwriters—NALU) said he understood there was general agreement at the interim meeting that the first element of a disclosure document should be a notice that there is a buyer's guide available and the consumer should ask for a copy. Mr. Foley agreed to add that requirement. Peg VanDriesse (American Express Financial) asked why notice should be included when the agent is already required to provide it. Mr. Foley responded that would give regulators additional assurance that the applicant receives the buyer's guide.

Mr. Foley said that Subsection C seems to require companies to show the first-year rate. Mr. DeAngelo pointed out that if that is required, companies will need to reprint the document often. Mr. Foley agreed that is true, but asked why anyone would purchase an annuity without knowing the rate that would be paid. Ms. Kinslick suggested that the disclosure document could give an 800 number that the prospect could use to find the current rate, or there could be a blank and the agent could write in the number. If the agent uses computer software, that could easily be changed, or the company could have a Web site that posts its current rate. Phil Poirier (Intuit) said that Subsection F is not technically correct. He suggested that the regulators focus on the intention rather than using technical language. When the Internet moves to Web TV, there will not be a hard drive. Mr. Foley asked Mr. Poirier to suggest language that would be more appropriate.

Mr. Foley asked that comments on this draft be received by April 10 and he and Ms. Johnson will make changes to reflect the discussion and the comments and distribute a revised document by early May. Mr. Strauss suggested that it would be more efficient to prepare a revised draft before encouraging companies to comment so that the comments came to the revised document. He pointed out that some of the language in this draft is already inapplicable because of the decisions being made. Mr. DeAngelo agreed and also noted that there will be new language that will address the issues agreed upon and companies should also have an opportunity to comment on that. Mr. Strauss pointed out that even the members of the working group are not sure exactly what they agreed to do.

The working group agreed to the following time line:

April 17, 1998	Mr. Foley and Ms. Johnson redraft, based on decisions of the working group and send to working group.
May 15, 1998	Working group comments to Ms. Johnson.
May 31, 1998	Revised draft released to interested parties.

Mr. Foley noted that would allow the interested parties three weeks to review the document before the Summer National Meeting. He encouraged those who offered to redraft sections of the current model in response to the comments and suggestions during the meeting to send those comments to Ms. Johnson to be included in the April 17 draft.

4. <u>Adopt Minutes of Feb. 19–20, 1998 Interim Meeting</u>

Mr. Strauss moved and Mr. Dunlap seconded a motion to adopt the minutes of the Feb. 19-20 meeting of the Life Disclosure Working Group. The motion passed (Attachment Eight-C).

5. <u>Generally Recognized Expense Table (GRET)</u>

Mark Peavy (NAIC/SSO) said the AAA will not make a formal analysis of the expense table in 1998. The only adjustment that might be made would be for inflation. The preference of the chair of the AAA committee, Tim Harris (Milliman & Robertson), is to leave the table as it is for use in 1999 and let the AAA do thorough research for a revised expense table.

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

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ATTACHMENT EIGHT-A

Buyer's Guide To Equity-Indexed Annuities
Draft: 3/16/98
Adopted by the Plenary

[The language in this Buyer's Guide is limited to that contained on the following pages, and may be used without obtaining specific copyright permission from the NAIC until the revised annuity buyer's guide is adopted. The guide is not appropriate for use in Massachusetts.]

Prepared by the National Association of Insurance Commissioners

The National Association of Insurance Commissioners is an association of state insurance regulatory officials. This association helps the various insurance departments to coordinate insurance laws for the benefit of all consumers.

This guide does not endorse any company or policy.

Reprinted by. . .

This Guide has been written to help you understand annuities in general and equity-indexed annuities in particular. There are different kinds of annuities. It is important for you to understand the differences among various annuities so you can choose the kind that best fits your needs. At the end of this Guide are questions you should ask your agent or the company. Make sure you are satisfied with the answers before you make a purchase.

WHAT IS AN ANNUITY?

An annuity is a series of income payments made at regular intervals by an insurance company in return for a premium or premiums you have paid. The most frequent use of income payments from an annuity is for retirement.

An annuity is neither a life insurance nor a health insurance policy. It is not a savings account or a savings certificate. You should not buy an annuity for short-term purposes. See pages 7 and 8 for a description of other features that apply to annuities in general as well as to equity-indexed annuities.

WHAT ARE THE DIFFERENT KINDS OF ANNUITY CONTRACTS?

Individual or Group

An individual contract covers only one or two persons. A group contract covers a specific group of people, for example, the employees of an employer.

Immediate or Deferred

An immediate annuity begins to make income payments soon after you pay the premium. The income payments from a deferred annuity start later, often many years later. Deferred annuities have an "accumulation" period, which is the time between when you start paying premiums and when income payments start. The time after income payments start is called the "payout" period.

Single Premium or Installment Premium

You pay the insurance company only one premium for a single premium annuity. You pay for an installment premium annuity through a series of payments. There are two kinds of installment premium annuities. One kind is a flexible premium contract. You can pay as much as you want, whenever you want, within set limits. The other kind is a scheduled premium contract, which specifies how much your premiums will be and how often you will pay them.

Fixed or Variable

During the accumulation period of a fixed deferred annuity, premiums (less any applicable charges) earn interest at rates set by the company or in a way spelled out in the annuity contract. The company guarantees that it will pay no less than a minimum rate of interest. During the payout phase, the amount of each income payment you receive is generally set when the payments start and does not change.

During the accumulation period of a variable annuity, premiums (less any applicable charges) are put into a separate account of the insurance company. You decide how those premiums will be invested, from stock or bond mutual fund choices. The value of the separate account, and therefore, the value of your variable annuity, varies with the investment experience of the funds you choose. There is no guarantee that you will receive all of your premiums back. There is also no guarantee that you will earn any return on your annuity. During the payout period of a variable annuity, the amount of each income payment you receive may be fixed (predetermined) or variable (changing with the value of the investments in the separate account).

WHAT ARE EQUITY-INDEXED ANNUITIES?

An equity-indexed annuity is a fixed annuity, either immediate or deferred, that earns interest or provides benefits that are linked to an external equity reference or an equity index. The value of the index might be tied to a stock or other equity index. One of the most commonly used indices is Standard & Poor's 500 Composite Stock Price Index (the S & P 500), which is an equity index. The value of any index varies from day to day and is not predictable.

When you buy an equity-indexed annuity you own an insurance contract. You are not buying shares of any stock or index.

While immediate equity-indexed annuities may be available, this Buyer's Guide will focus on deferred equity-indexed annuities.

HOW ARE THEY DIFFERENT FROM OTHER FIXED ANNUITIES?

An equity-indexed annuity is different from other fixed annuities because of the way it credits interest to your annuity's value. Some fixed annuities only credit interest calculated at a rate set in the contract. Other fixed annuities also credit interest at rates set from time to time by the insurance company. Equity-indexed annuities credit interest using a formula based on changes in the index to which the annuity is linked. The formula decides how the additional interest, if any, is calculated and credited. How much additional interest you get and when you get it depends on the features of your particular annuity.

Your equity-indexed annuity, like other fixed annuities, also promises to pay a minimum interest rate. The rate that will be applied will not be less than this minimum guaranteed rate even if the index-linked interest rate is lower. The value of your annuity also will not drop below a guaranteed minimum. For example, many single premium contracts guarantee the minimum value will never be less than 90 percent of the premium paid, plus at least 3% in annual interest (less any partial withdrawals). The guaranteed value is the minimum amount available during a term for withdrawals, as well as for some annuitizations (see "Annuity Income Payments") and death benefits. The insurance company will adjust the value of the annuity at the end of each term to reflect any index increases.

WHAT ARE SOME OF THE CONTRACT FEATURES?

Two features that have the greatest effect on the amount of additional interest that may be credited to an equity-indexed annuity are the indexing method and the participation rate. It is important to understand the features and how they work together. The following describes some other equity-indexed annuity features that affect the index-linked formula.

Indexing Method

The indexing method means the approach used to measure the amount of change, if any, in the index. Some of the most common indexing methods, which are explained more fully later on, include annual reset (ratcheting), high-water mark and point-to-point.

Term

The index term is the period over which index-linked interest is calculated; the interest is credited to your annuity at the end of a term. Terms are generally from one to ten years, with six or seven years being most common. Some annuities offer single terms while others offer multiple, consecutive terms. If your annuity has multiple terms, there will usually be a window at the end of each term, typically 30 days, during which you may withdraw your money without penalty. For installment premium annuities, the payment of each premium may begin a new term for that premium.

Participation Rate

The participation rate decides how much of the increase in the index will be used to calculate index-linked interest. For example, if the calculated change in the index is 9% and the participation rate is 70%, the index-linked interest rate for your annuity will be 6.3% (9% x 70% = 6.3%). A company may set a different participation rate for newly issued annuities as often as each day. Therefore, the initial participation rate in your annuity will depend on when it is issued by the company. The company usually guarantees the participation rate for a specific period (from one year to the entire term). When that period is over, the company sets a new participation rate for the next period. Some annuities guarantee that the participation rate will never be set lower than a specified minimum or higher than a specified maximum.

Cap Rate or Cap

Some annuities may put an upper limit, or cap, on the index-linked interest rate. This is the maximum rate of interest the annuity will earn. In the example given above, if the contract has a 6% cap rate, 6%, and not 6.3%, would be credited. Not all annuities have a cap rate.

Floor on Equity Index-Linked Interest

The floor is the minimum index-linked interest rate you will earn. The most common floor is 0%. A 0% floor assures that even if the index decreases in value, the index-linked interest that you earn will be zero and not negative. As in the case of a cap, not all annuities have a stated floor on index-linked interest rates. But in all cases, your fixed annuity will have a minimum guaranteed value.

Averaging

In some annuities, the average of an index's value is used rather than the actual value of the index on a specified date. The index averaging may occur at the beginning, the end, or throughout the entire term of the annuity.

Interest Compounding

Some annuities pay simple interest during an index term. That means index-linked interest is added to your original premium amount but does not compound during the term. Others pay compound interest during a term, which means that index-linked interest that has already been credited also earns interest in the future. In either case, however, the interest earned in one term is usually compounded in the next.

Margin/Spread/Administrative Fee

In some annuities, the index-linked interest rate is computed by subtracting a specific percentage from any calculated change in the index. This percentage, sometimes referred to as the "margin," "spread," or "administrative fee," might be instead of, or in addition to, a participation rate. For example, if the calculated change in the index is 10%, your annuity might specify that 2.25% will be subtracted from the rate to determine the interest rate credited. In this example, the rate would be 7.75% (10% -

2.25% = 7.75%). In this example, the company subtracts the percentage only if the change in the index produces a positive interest rate.

Vesting

Some annuities credit none of the index-linked interest or only part of it, if you take out all your money before the end of the term. The percentage that is vested, or credited, generally increases as the term comes closer to its end and is always 100% at the end of the term.

HOW DO THE COMMON INDEXING METHODS DIFFER?

Annual Reset

Index-linked interest, if any, is determined each year by comparing the index value at the end of the contract year with the index value at the start of the contract year. Interest is added to your annuity each year during the term.

High-Water Mark

The index-linked interest, if any, is decided by looking at the index value at various points during the term, usually the annual anniversaries of the date you bought the annuity. The interest is based on the difference between the highest index value and the index value at the start of the term. Interest is added to your annuity at the end of the term.

Point-to-Point

The index-linked interest, if any, is based on the difference between the index value at the end of the term and the index value at the start of the term. Interest is added to your annuity at the end of the term.

WHAT ARE SOME OF THE FEATURES AND TRADE-OFFS OF DIFFERENT INDEXING METHODS?

Generally, annuities offer *preset* combinations of features. You may have to make trade-offs to get features you want in an annuity. This means the annuity you chose may also have features you don't want.

Features	Trade-Offs
Annual Reset Since the interest earned is "locked in" annually and the index value is "reset" at the end of each year, future decreases in the index will not affect the interest you have already earned. Therefore, your annuity using the annual reset method may credit more interest than annuities using other methods when the index fluctuates up and down often during the term. This design is more likely than others to give you access to index-linked interest before the term ends.	Your annuity's participation rate may change each year and generally will be lower than that of other indexing methods. Also an annual reset design may use a cap or averaging to limit the total amount of interest you might earn each year.
High-Water Mark Since interest is calculated using the highest value of the index on a contract anniversary during the term, this design may credit higher interest than some other designs if the index reaches a high point early or in the middle of the term, then drops off at the end of the term.	Interest is not credited until the end of the term. In some annuities, if you surrender your annuity before the end of the term, you may not get index-linked interest for that term. In other annuities, you may receive index-linked interest, based on the highest anniversary value to date and the annuity's vesting schedule. Also, contracts with this design may have a lower participation rate than annuities using other designs or may use a cap to limit the total amount of interest you might earn.
Point-to-Point Since interest cannot be calculated before the end of the term, use of this design may permit a higher participation rate than annuities using other designs.	Since interest is not credited until the end of the term, typically six or seven years, you may not be able to get the index-linked interest until the end of the term.

WHAT IS THE IMPACT OF SOME OTHER PRODUCT FEATURES?

Cap on Interest Earned

While a cap limits the amount of interest you might earn each year, annuities with this feature may have other product features you want, such as annual interest crediting or the ability to take partial withdrawals. Also, annuities that have a cap may have a higher participation rate.

Averaging

Averaging at the beginning of a term protects you from buying your annuity at a high point, which would reduce the amount of interest you might earn. Averaging at the end of the term protects you against severe declines in the index and losing index-linked interest as a result. On the other hand, averaging may reduce the amount of index-linked interest you earn when the index rises either near the start or at the end of the term.

Participation Rate

The participation rate may vary greatly from one annuity to another and from time to time within a particular annuity. Therefore, it is important for you to know how your annuity's participation rate works with the indexing method. A high participation rate may be offset by other features, such as simple interest, averaging, or a point-to-point indexing method. On the other hand, an insurance company may offset a lower participation rate by also offering a feature such as an annual reset indexing method.

Interest Compounding

It is important for you to know whether your annuity pays compound or simple interest during a term. While you may earn less from an annuity that pays simple interest, it may have other features you want, such as a higher participation rate.

CAN I TAKE MY MONEY OUT DURING THE TERM?

In most cases, you can take all or part of the money out of a deferred annuity at any time during the term. There may be a cost if you do. Sometimes the cost is a stated dollar amount. In other cases, you give up index-linked interest on the amount withdrawn. Some annuities do not let you make a partial withdrawal until the end of a term.

WHAT WILL IT COST ME TO TAKE MY MONEY OUT EARLY?

If you withdraw all or part of the value in your annuity before the end of the term, a *withdrawal or surrender charge* may be applied. A withdrawal charge is usually a percentage of the amount being withdrawn. The percentage may be reduced or eliminated after the annuity has been in force for a certain number of years. Sometimes the charge is a reduction in the interest rate credited to the annuity.

Some annuities credit none of the index-linked interest or only part of it if you take out all your money before the end of the term. The percentage that is vested, or credited, generally increases as the term comes closer to its end and is always 100% at the end of the term.

IS THERE ALWAYS A CHARGE TO TAKE MY MONEY OUT EARLY?

Your annuity may have a limited "free withdrawal" provision. This lets you make one or more withdrawals without charge each year. The size of the free withdrawal is limited to a set percentage of your annuity's guaranteed or accumulated value. If you make a larger withdrawal, you may pay withdrawal charges. You may also lose index-linked interest on amounts you withdraw.

Most annuities waive withdrawal charges on withdrawals made within a set number of days at the end of each term. Some annuities waive withdrawal charges if you are confined to a nursing home or diagnosed with a terminal illness. You may, however, lose index-linked interest on withdrawals.

ARE DIVIDENDS INCLUDED IN THE INDEX?

Depending on the index used, stock dividends may or may not be included in the index's value. For example, the S&P 500 is a stock price index and only considers the prices of stocks. It does not recognize any dividends paid on those stocks.

WHAT ARE SOME OTHER EQUITY-INDEXED ANNUITY CONTRACT BENEFITS?

Annuity Income Payments

One of the most important benefits of deferred annuities is the right to use the value built up during the accumulation period to provide income payments during the payout period. While income payments are usually made monthly, you can often choose more or less frequent payments. The size of income payments is based on both the accumulated value in your annuity and the annuity's "benefit rate" that is in effect when income payments begin.

The insurance company uses the benefit rate to compute the amount of income payment it will pay you for each $1,000 of accumulated value in your annuity. The benefit rate usually depends on your age and sex, and the form of annuity payment you have chosen. You can usually choose from many forms of annuity payments. You might choose payments that continue as long as you live, or as long as either you or your spouse live, or payments that continue for a set number of years.

Death Benefit

Annuities provide a variety of death benefits. The most common death benefit is either the guaranteed minimum value or the value determined by the index-linked formula.

Tax Deferral

Federal income tax on interest accumulated in an annuity is deferred until you take the interest out of the annuity. You may be required to pay taxes then on the tax-deferred accumulation. You may have to pay a tax penalty if you withdraw the accumulation before you are age 59½. The advantage of tax deferral is that you will probably be in a lower tax bracket in retirement than while you are employed. Also, during the accumulation period, you will be earning interest on money that you would otherwise have used to pay taxes. Tax-qualified annuities are subject to different rules. In any case, you should consult your own tax advisor.

HOW DO I KNOW IF AN EQUITY-INDEXED ANNUITY IS RIGHT FOR ME?

The questions listed below may help you decide which type of annuity, if any, meets your retirement planning and financial needs. You should consider what your goals are for the money you may put into the annuity. You need to think about how much risk you're willing to take with the money. Ask yourself:

- How long can I leave my money in the annuity?
- What do I expect to use the money for in the future?
- Am I interested in a variable annuity with the potential for higher earnings that are not guaranteed and willing to risk losing the principal?
- Is a guaranteed interest rate more important to me, with little or no risk of losing the principal?
- Or, am I somewhere in between these two extremes and willing to take some risks?

HOW DO I KNOW WHICH EQUITY-INDEXED ANNUITY IS BEST FOR ME?

As with any other insurance product, you must carefully consider your own personal situation and how you feel about the choices available. No single annuity design may have all the features you want. It is important to understand the features and trade-offs available so you can choose the annuity that is right for you. Keep in mind that it may be misleading to compare one annuity to another unless you compare all the other features of each annuity. You must decide for yourself what combination of features makes the most sense for you. Also remember that it is not possible to predict the future behavior of an index.

QUESTIONS YOU SHOULD ASK YOUR AGENT OR THE COMPANY

- What is the guaranteed minimum interest rate?
- What charges, if any, are deducted from my premium?
- What charges, if any, are deducted from my contract value?
- How long is the term?
- What is the participation rate?
- For how long is the participation rate guaranteed?
- Is there a minimum participation rate?
- Does my contract have a cap?
- Is averaging used? How does it work?
- Is interest compounded during a term?
- Is there a margin, spread, or administrative fee? Is that in addition to or instead of a participation rate?
- Which indexing method is used in my contract?
- What are the surrender charges or penalties if I want to end my contract early and take out all of my money?
- Can I get a partial withdrawal without paying charges or losing interest? Does my contract have vesting?
- Does my annuity waive withdrawal charges if I am confined to a nursing home or diagnosed with a terminal illness?
- What annuity income payment options do I have?
- What is the death benefit?

FINAL POINTS TO CONSIDER

It is very important that you choose an annuity that you understand well. The purpose of this Buyer's Guide is to help you to understand your annuity. Your agent or insurance company can guide you. Remember that the quality of service you can expect from the company and the agent should also be important to you when you buy an annuity.

When you receive your contract, read it carefully. It may offer a "free look" period for you to decide if you want to keep the contract. Ask your agent or insurance company for an explanation of anything you don't understand. If you have a specific complaint or can't get the answers you need from your agent or company, contact your state insurance department.

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ATTACHMENT EIGHT-B

Annuity Disclosure and Sales Illustrations Model Regulation

Draft: 2/20/98

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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 non-guaranteed 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), the regulation shall apply to annuities used to fund a plan or arrangement that is funded solely by 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 a producer for the purchase of an annuity contract. As used in this subsection, direct solicitation shall not include any meeting held by a producer solely for the purpose of educating or enrolling employees in the plan or arrangement;

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.

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

D. "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.

E. "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.

F. "Equity indexed annuity" means a deferred annuity that ties all or a portion of the benefits payable to the performance of an external equity index.

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

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

I. "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.

J. "Illustration" means a personalized 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.

K. "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.

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

M. "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 percent policy persistency thereafter.

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

O. "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.

P. "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 the Disclosure Document

A. At or prior to the taking of an application for any annuity contract subject to the regulation, the insurer, its producer 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 ~~described~~ included 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, and the fact that it is an annuity;

(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 in plain language, including examples where appropriate:

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

(b) ~~All the components of the first year crediting rate;~~ An explanation of the initial crediting rate, specifying any bonus or introductory portion, the duration of the rate and the fact that rates may change from time to time and are not guaranteed;

(c) Periodic ~~I~~income options both on a guaranteed and non-guaranteed basis;

(d) 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)~~(e) How values in the contract can be accessed;

~~(g)~~(f) The death benefit, if available and how it will be calculated;

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

~~(i)~~(h) Impact of any rider, such as a long-term care rider.

(4) Specific dollar amount or percentage charges and fees shall be listed with an explanation of how they apply.

C. The disclosure shall include information about the current guaranteed rate for new policies ~~and the renewal rate for those same policies for the past five (5) years~~ and contain a clear notice that the rate is subject to change.

~~E.~~D. Marketing material that contains language describing the non-guaranteed elements shall include both the negatives and positives of product features.

~~D.~~E. When the contact with a prospective insured is face to face, ~~T~~the disclosure shall be ~~accomplished~~ accompanied by ~~use of appropriate sections of~~ the ~~b~~Buyer's ~~g~~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.~~ unless the prospective insured indicates he has already received a Buyer's Guide.

F. When the contact with the prospective insured is through the Internet, the electronic interface must be designed to show the prospective insured the Buyer's Guide and make it available for downloading before the prospective insured can access an application.

G. When the contact is through the mail or other mass marketing method where no face-to-face contact between a producer or representative of the insurer occurs, the Buyer's Guide may be delivered at the same time as the annuity contract.

H. Where the Buyer's Guide has been delivered at or prior to solicitation, the policy shall provide for no less than a ten-day free look period. Where the prospective insured did not receive a buyer's guide until delivery of the policy, the policy shall provide for no less than a thirty-day free look period.

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 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 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 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 mid way 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 sale.

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 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 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 non-guaranteed 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 non-guaranteed elements illustrated for both new and in force contracts are not consistent with the non-guaranteed 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.

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ATTACHMENT EIGHT-C

Life Disclosure Working Group
Dallas, Texas
February 19–20, 1998

The Life Disclosure Working Group of the Life Insurance (A) Committee met at the Hyatt Regency Dallas, on Feb. 19-20, 1998. Tom Foley (N.D.) chaired the meeting. The following working group members were in attendance: Hal Phillips (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Lynda Klebold (N.J.); and Cindy Martin (Mass.).

Tom Foley (N.D.) said he had been asked to begin the meeting with two break-out groups: one for the interested parties in attendance and one for the regulators. He said this request had come from insurance industry representatives and he wanted to be sure that there was no concern that this would violate the NAIC's open-meetings policy. He asked if there was anyone present who objected to this procedure and no one voiced any objection. Mr. Foley suggested several key issues that should be discussed by each group separately and when the two groups reconvene recommendations could be suggested by each group.

Mr. Foley suggested the following key issues: 1) what is going to be the form and content of the disclosure document given at the time of sale (including any buyer's guide disclosures); 2) what should the working group do with the renewal rate expectation concept; and 3) should an illustration be required for any products or should it be strictly optional. Mr. Foley noted that the issue of supportability in illustrations is another topic that needs to be discussed and said that the American Academy of Actuaries (AAA) would present information to the working group during the meeting. Bob Brown (CIGNA) said that clearly one of the issues has been that the sales process is quite different in true group sales. He said that, if the working group should change the exclusions from those in the current draft of the Annuity Disclosure and Illustrations Model Regulation, he assumed that it would go back and review the decisions being made now.

1. Disclosure Document

Mr. Foley said the technical resource advisors have encouraged the working group to reach a conclusion that each company should be able to design its own disclosure document, but some of the regulators have been thinking of a more standardized set of questions and a company response to these. Riva Kinstlick (Prudential) said that the technical resource advisors feel very strongly that, while there should be certain key elements in the disclosure, the language should be that of the insurer. Mr. Foley asked why that concept was so important. Ms. Kinstlick responded that, if the company is to describe its own product, a standardized form will not work. She suggested it would put insurers at a disadvantage in relation to other types of financial products.

Barbara Lautzenheiser (Lautzenheiser & Associates), speaking for the AAA, said the disclosure document standards prepared by technical resource advisors over a year ago were supported by the AAA. She also expressed support for general language that would embrace disclosure applicable to all types of annuities. Charlotte Liptak (Transamerica Occidental Life Ins. Co.) said she was part of a small group that worked on the equity indexed annuity buyer's guide and she discovered how difficult it is to come up with something understandable that has consensus. She said that, with the variety of products being offered, it would be difficult to come up with standardized language that described them all adequately. She suggested instead of standardized language an alternative would be specific warning statements like those used in the Life Insurance Illustrations Model Regulation.

Roger Wiard-Bauer (Life USA) said that his company used a single-page disclosure statement and asked the applicant to sign it. He said it was helpful to get them to sign because then they would ask questions.

Ms. Kinstlick described the conclusions of the interested parties caucus. She said that the group spent a great deal of time discussing why the language of the disclosure document should not be standardized. Mr. Foley said the working group agreed that standardized language should not be required.

Ms. Kinstlick said the interested parties believed that delivery of the disclosure document at the time of solicitation is appropriate in a face-to-face contact but that the minimum standard should be at the time of sale confirmation or contract delivery. She said the request for a purchase might come from a telephone conversation or it might just be a confirmation slip rather than an application.

The interested parties also suggested that the disclosure document say in big bold letters that a buyer's guide is available and can be requested from the insurer or the insurance department.

Mr. Foley said the regulators agree that a one-page disclosure document is appropriate and that it should be distributed at the point of solicitation. He said the content of the document is outlined in the model draft of Dec. 8, 1997, and suggested that the working group review that draft to see if there was anything to add or delete from Section 5. He suggested that the way to make sure a consumer had an appropriate expectation about the interest rate is to include in the disclosure statement in big bold letters language that the expectation should be the guaranteed rate or to develop language as in a disclosure document provided to Mr. Foley that described fully how the insurer would set its renewal rates. Hal Phillips (Calif.) said there was a third alternative and that was to provide an interest rate history.

Mr. Foley asked the working group members to turn to Section 5 of the draft regulation including the standards for disclosure. He particularly asked them to look at Subsection B(3) that itemized the disclosures required. He asked if this paragraph should require information about premium taxes. He said few states tax annuities, but insurers in states where there is a premium tax might pay the proceeds net of premium taxes. Ron Panneton (National Association of Life Underwriters—NALU) said that, as a consumer, he would want to know about premium taxes. He suggested the disclosure document could say that the prospect should ask the agent about premium taxes. Lynda Klebold (N.J.) said she thought this document was going to be state-specific for the particular form and product, and in that case the language on premium taxes would not be needed in very many of the states. Ms. Liptak said that to the extent the form is the same throughout the country they would use the same disclosure form for all states. Galen Ullstrom (Mutual of Omaha) said the buyer's guide does not describe the premium tax situation, and Mr. Foley said that the modular guide he wrote describes the fact that premium taxes could reduce the benefit. Mr. Foley asked if other expense charges would be more specifically described and the interested parties responded that they would be described. Peg VanDrisse (American Express Financial Advisors) noted that the working group is describing two slightly different concepts: A description of the fees in some cases and a specific charge, such as a policy charge of $25, in the same paragraph of the regulation. Mr. Foley asked Carolyn Johnson (NAIC/SSO) to modify the provisions of the regulation to address that issue.

Dennis Herchel (MassMutual) suggested that the disclosure statement needs readability standards. Mr. Foley thanked Mr. Herchel for bringing up this issue and said the disclosure documents provided so far to the working group did not use very clear language. He said the model should encourage the use of plain English. S. Reed Ashwill (National Association of Independent Life Brokerage Agencies—NAILBA) agreed this was important and pointed out that if there are less words, larger type can be used for the benefit of senior citizens. Mr. Foley asked if there was anyone who thought the first disclosure examples were close to what should be required. Mr. Ullstrom responded that he thought they were very close. Mr. Foley said they were full of jargon. Mr. Ullstrom responded that this is what is in the contract. The disclosure document has to use the same terms as are in the contract. Mr. Foley asked if that meant definitions should be added and Mr. Ullstrom responded that he hoped not because this was supposed to be a short document. He said part of the problem with the length of the life insurance illustrations is the narrative summary that defines the terms used. Ms. Van Drisse opined that it is important to include some insurance terminology and give the prospect an opportunity to ask questions.

Mr. Phillips asked how the working group would handle the disclosure of the interest rate. He said this might change from week to week. The interested parties responded that it would not be included in the disclosure document. Linda Lanam (Life of Virginia) explained that the interested parties had first envisioned a blank space that could be filled in with the current rate. She said two states did not allow her company to do that. Mr. Ashwill pointed out that the agent might not even know the appropriate rate, for example, in a Section 1035 exchange.

Mr. Foley asked if the form should disclose that the interest rate will change. The audience agreed that it was appropriate to say that the rate being paid now may change. They compared this to the bank disclosure of the current rate for certificates of deposit. Mr. Foley asked what the response is if prospects ask what the renewal rate will be, and Mr. Ashwill said that he responds, "If interest rates stay the same, you can probably expect to receive the same rate." Mr. Foley said that there are companies that will not keep the same rate even if the overall market stays the same. He asked how to help consumers know which companies will not. Mr. Wiard-Bauer pointed out a tool in the Life Insurance Illustrations Regulation that requires the illustration actuary to report to the commissioner if rates have dropped over the past five years other than experience changes.

Ms. Liptak said that it is risky from a litigation standpoint for a company to say what it intends to do. An unethical company will say it intends to keep the same rate, but it will not. Mr. Foley said that is the reason regulators suggest that a warning be placed on the disclosure document that the consumer should plan on receiving the minimum rate. Members of the audience said that would be misleading because in most cases more than the minimum guarantee would be paid. Anita Larson (Equitable) said instead the disclosure document should say that the company has the right to change the interest rate. Ms. Lautzenheiser cautioned that the disclosure document should not create an unreasonable expectation in either direction. Ms. Larson suggested the document should disclose whether the first-year rate includes a bonus and that future rates may vary at the company's discretion, but will not be lower than [3] %. Mr. Ashwill said he often is asked by a prospect whether his annuity rate will go up if the rates in the general market go up, and he tells them that is unlikely because the company already has made the sale.

Ms. Klebold said she envisioned the disclosure document being more bullet points in the same order as described in Section 5 of the draft regulation. She said an outline form with a prominent statement on the buyer's guide and key aspects of the contract would be easier to read.

Mr. Panneton said he heard a meeting of the minds that they regulators and the interested parties agreed that companies could preprint in their document something like "as of [this date] the rate we are paying is [__%].

Mr. Foley asked if there was merit in including in the basic disclosure document the interest rate history for the past five years if the company has a history. He said the regulators will spend time at the next meeting talking about what goes in the disclosure statement. Cindy Martin (Mass.) suggested that, in addition to the points listed in Section 5 of the model regulation, it might be helpful to design a skeleton of a disclosure statement and perhaps set some standardized order of those items. Ms. Klebold noted that the Securities and Exchange Commission is working on a profile prospectus that summarizes from the prospectus in readable fashion major points of the document. Mr. Foley said that an example of a conforming disclosure document as an appendix would be helpful to the regulation.

2. <u>Delivery of the Buyer's Guide</u>

Ms. Martin said another part of the question about disclosure was when the disclosure document and the buyer's guide would be required. She asked if it was going to be at the point of solicitation. Mr. Foley agreed this was a point for discussion, because part of the disclosure process has to be how the buyer's guide will be used. Ms. Martin said that all types of information that may be given to the prospective buyer are part of the disclosure. She pointed out that the Life Disclosure Model Regulation and the Model Annuity and Deposit Fund Disclosure Regulation have always required delivery of the buyer's guide at the time of policy delivery. She said giving the buyer's guide at the point of sale is too late.

Mr. Foley said that the regulators are trying to get information to consumers in a timely manner. The consumer needs to know something about annuities before getting to the sales process. John Mathews (Allstate) suggested the working group look at the provisions of the NAIC's Rules Governing the Advertising of Life Insurance and, if there is not enough language to protect against abuse, changes should be made to that document. Mr. Foley asked if the advertising regulation applies to advertising directed to agents. Mr. Ullstrom said materials that are not intended to go beyond the agent do not fall under the advertising regulation. Mr. Mathews spoke in favor of allowing the buyer's guide to be given at the point of delivery of the policy if the policy allows for a 10-day free look period. Ms. Martin said that 99.99% of people never look at any materials delivered to them after the solicitation process. She suggested that the person needs something to look at early in the process to see if an annuity is suitable.

Mr. Foley said that consumers should come to the sales process with a significant amount of information and he asked the working group members how they could get information to consumers even before the sales process. Lester Dunlap (La.) suggested a requirement to give information at the first point of contact. Mr. Foley described a publication of the Alaska Department of Insurance, which was a newspaper insert that provided valuable information about all types of insurance in a simple easy-to-read format. He said citizens were encouraged to put that inset with their important papers. Mr. Foley suggested that regulators need to get information to consumers before the sales process, but one of the questions to grapple with is whether a consumer will read the information given to him.

Mr. Ullstrom said that a consumer would not likely read the materials at the time of solicitation if he is involved with an agent. He said an agent might be asked questions about products his company did not sell or the agent was not authorized to sell and that could lead to incorrect disclosures. He also said this discussion does not address the situation where no agent is involved. Mr. Foley said that was the exact point that led him to put together a modular guide so that the agent would only give out information on products he could sell. George Tang (Hartford) said his company had recent experience indicating that a long document was too overwhelming for senior citizens to read. He also noted that insurers are becoming less agent driven by using the Internet, direct marketing, etc., and he asked the regulators to be cognizant of that development.

Mr. Foley said the consumers attitude is that the insurance regulator will protect them by not letting insurers go beyond a certain line. He said if insurers want the flexibility to sell more, then they need to disclose more information. He challenged them to find more innovative ways to get information to the public. Mr. Wiard-Bauer said the challenge is to get information out more quickly. He gave an example of some states that still require delivery of the 1976 life insurance buyer's guide. Ms. Kinstlick said this was one more reason why standardized language for a disclosure statement is not a good choice. She said some states would have their own specific requirements and that would make it more difficult for companies to comply.

Mr. Foley said he had not heard from any of the companies present with an opinion of what regulators should do with companies that did not play fair. Mr. Wiard-Bauer said it was best to develop tools that allow legal action to be taken against those companies. He suggested that regulators should not punish all companies by over-regulating. Julie Spiezio (American Council of Life Insurance—ACLI) said there are companies out there that will violate the rules, no matter what they are. She asked the working group not to make it more difficult for good companies with activities that would not really stop the rogue players.

Ms. Klebold said the consumer should be given general tools so that he can educate himself to ask appropriate questions. She gave as an example general information about equity indexed products so that the potential applicant would know about other methods of crediting that might not be available from the company he was looking at.

Mr. Foley said the regulators' break-out group talked at length about buyer's guides. He said the group suggests that there be one general annuity buyer's guide with various appendices. So far the only one written is the appendix that described equity indexed annuities. If a company sold only fixed deferred annuities they would likely distribute the basic buyer's guide, but, if they sold equity indexed products, they would attach the appendix that described those products. He said in the future an appendix would be written for variable annuities and perhaps other products also. If it was a declared rate annuity sale the equity indexed annuity part would not be included. He cautioned that the buyer's guides will need to be updated and revised periodically to carry through this concept.

Mr. Foley said the members of the working group feel strongly that the buyer's guide should be provided at the point of solicitation, but no later than the point of application. He agreed that regulators have a significant responsibility to educate consumers and pointed to the Alaska insurance guide process as a good example.

Ms. Kinstlick said the interested parties caucus did not talk about whether to have a separate buyer's guide for equity indexed products. She said the interested parties believe it is an important responsibility of regulators to give information to consumers before purchase of an annuity. She suggested that a buyer's guide could be put on the NAIC's Web site.

The working group and interested parties discussed whether the equity indexed portion of the buyer's guide should be completed so that it could be used by companies selling equity indexed products as soon as possible. Mr. Foley said he had received numerous requests from insurers asking whether they could use this guide to provide this information to consumers. Ms. Kinstlick said the interested parties had discussed the draft and thought it could be final by June. Roger Strauss (Iowa) asked if there was really that much to do and suggested the working group could go over the draft during this meeting and complete it by the Spring National Meeting. Mr. Foley said that it behooves companies to start using the documents as soon as possible and suggested that if they wait until the NAIC adopts the model and then states require companies to use the guide, it could be the next millennium before the buyer's guides are in common usage. He said if the ACLI and the states encouraged use of the equity indexed buyer's guide now, without it being required, it could be in general use by mid-1998. Ms. Spiezio said the ACLI could distribute the document and she hoped that it would be used by the companies. Mr. Brown said it was important to have it available on the NAIC's Web site and suggested state links to that document. Ms. Kinstlick said the equity indexed annuities buyer's guide had been widely distributed to the industry and the AAA and agreed that it was nearly complete. Mr. Ashwill said that agents often use graphics and pictures to help explain a concept, and thought that was necessary in this product. Mr. Foley responded that he was sure companies do that and saw no problem as long as those pictures did not rise to the level of an illustration. Ms. Lanam asked Mr. Ashwill if he was describing a flow chart.

Mr. Foley noted that the working group and the interested parties are not in agreement on the timing of delivery of the buyer's guide. He said the regulators believe that it is important to give the guide at the point of solicitation, but no later than at the point of application. He said he did not see a problem with asking whether the individual already has a copy of the guide, and agreed it is not necessary to give one in that instance.

Beth Sutherland (TIAA-CREF) said one of the reasons for keeping the disclosure document to one page was because it was easy to mail with a direct response mailing. She said the buyer's guide was much thicker and would therefore be much more expensive to mail. Mr. Foley responded that a one-page disclosure would work well if the individual was already familiar with concepts and terminology but he did not think it worked very well by itself. Ms. Kinstlick said that in a direct market solicitation, the insurer cannot identify potential purchasers and it would be very expensive to send the buyer's guide to a large number of people. Mr. Phillips asked for a comparison of this requirement to those of the SEC. Mr. Mathews responded that there is no legal requirement to provide a prospectus before an individual purchases a stock or mutual fund. He said the reality is that insurers are competing more and more with other financial products and do not want to be at a disadvantage. Mr. Ullstrom opined that if a buyer's guide is required at the point of solicitation, there will be no more sales by direct marketing methods. Ms. Lanam said that a generic buyer's guide that describes all types of products will not help an individual understand the product he is buying. Mr. Foley responded that was the precise reason he had suggested development of a modular buyer's guide that would just cover the products the company sells. Ms. Lanam said that it is desirable for consumers to educate themselves, but it was not appropriate to add to the cost of a product that has a very narrow profit margin.

Mr. Foley said the interested parties talk about direct marketing, and asked if that means they agree that it is suitable to give a buyer's guide at the point of solicitation where there is an agent involved in the sale. Ms. Liptak said this should not be in a minimum requirements document. Mr. Tang pointed out that there are lots of retirement instruments available in the marketplace and asked if the regulators are suggesting it is appropriate to include descriptions of them. He asked that regulators be cognizant not to disadvantage insurance over mutual funds or other investments.

Mr. Foley suggested several scenarios:

(1) A call from an agent setting up an appointment to come and see a prospect; send the buyer's guide before the appointment.

(2) If the buyer's guide is not sent ahead of time, take it to the initial meeting. Sometimes the sale will be closed at that time, sometimes it will not.

(3) If no agent visits, mail the buyer's guide with the delivery of the policy.

(4) Internet sales may invite the prospect to complete an application over the Internet or invite the prospect to send in his name and request an application. He said in either instance the Internet site could be designed to make a copy of the buyer's guide available before the application is filled out.

Mr. Panneton said the disclosure may not give information about what is the best product for the prospect, but he should at least be aware that there are other vehicles that might suit his needs better. He suggested having information about the buyer's guide available and then if the consumer feels he wants it, he can ask for a guide. The consumer should have the option to say, "I trust my agent," or he can choose to stop the process and review the buyer's guide first. Ms. Martin said she did not think it was appropriate to give out the disclosure document before the buyer's guide. She asked how the consumer would know what the terms meant without the buyer's guide and she gave examples such as "front-end load," "income options," "contract withdrawal charges," and "initial rate guarantee." Ms. Lanam agreed that it would be desirable to include the buyer's guide, but it should not be a requirement. She reminded the regulators that they are developing a minimum standard. Mr. Dunlap said that Ms. Lanam's letter of Feb. 2 to the working group sounded as if Ms. Lanam agreed with the working group position. Ms. Lanam emphasized that for drafting minimum standards, it should be necessary to look at the needs of direct writers. Mr. Foley said it appeared there was agreement that the disclosure document should begin with big bold print that said a buyer's guide was available to help understand this document, and the prospect should ask for one.

Mr. Strauss summarized the discussion on the timing of the delivery of the buyer's guide. He suggested making a distinction between whether an agent is involved or not. He said, if an agent is involved, the buyer's guide should be given at the time of solicitation; if it is a direct response sale, the buyer's guide can be given upon delivery of the policy. On Internet sales, the Web site can be fixed so that the application cannot be accessed without having first viewed the buyer's guide. Mr. Ashwill said that if he as an agent did the mailing he would want to fit under the direct response rather than the agent involved sale. The working group members agreed that would be appropriate and talked instead about a face-to-face meeting triggering the delivery of the buyer's guide. Ms. Martin said she would want some minimum standardized language if a buyer's guide was not delivered at that time.

Mr. Mathews asked why regulators would make a different requirement when an agent was involved because then the individual had more opportunity to ask questions. Mr. Foley said it was strictly a matter of logistics. He said it seemed that the disclosure only made sense if there was a buyer's guide, but the regulators have heard that it is too difficult if there is not a face-to-face contact. He said what the regulators would like to do is to get the guide out to each prospect before he or she sees a disclosure statement. Ms. Spiezio opined that whenever the industry is involved in mailing a buyer's guide, that would, by definition, be solicitation. Mr. Foley agreed that was correct and said the challenge is to get the guide to individuals long before the solicitation process begins. He said he would not be surprised if half of the states were not doing an Alaska-style buyer's guide program in 1998.

Mr. Strauss also suggested that a free-look period of 30 days be required in a direct solicitation, but that it could be shortened to 10 days if the buyer's guide had been provided at the time of solicitation. Mr. Foley asked how the company would keep track of whether they were required to use a 30 or 10 day free look. Mr. Mathews responded that if a company only did one type of sale, it would be easy; otherwise they might use 30 days in all cases or develop their own tracking mechanism.

Mr. Foley said he wanted to make sure that everyone understands that the amount that a person gets back during the free-look period is exactly the same amount as that put into the contract. The interested parties agreed that no market value adjustment was contemplated.

Ms. Martin said one of the things regulators assume is that life insurance companies are creating procedures as they try to become compliant with the Insurance Marketplace Standards Association (IMSA) program. She said regulators might be adding new requirements, but most companies would be doing them anyway. Ms. Lanam clarified that to be IMSA compliant, a company must be able to show that it has procedures in place; whereas state regulators want to see that those procedures were followed in every case if the state is conducting a market conduct examination. She said it would be different if the regulation was written to say the company must have a procedure in place to deliver a buyer's guide, rather than a requirement to deliver a buyer's guide.

The working group next went through the equity indexed buyer's guide point by point to finalize the language. They asked Ms. Johnson to send a copy of the guide to Brenda Cude (University of Illinois Cooperative Extension Service), who has excellent skills at reviewing documents for readability. Mr. Strauss noted that when the document becomes an appendix to the main buyer's guide some of the introductory material would be deleted, but if the buyer's guide is going to be self-contained at this point it will need the introductory material. Ms. Johnson agreed to send the buyer's guide to Ms. Cude and to place it on the NAIC's Web site when it is completed so that interested parties can review the document before the Spring National Meeting.

3. Self-Support and Lapse-Support Testing

Steve Preston (Golden American Life Insurance Company), Ms. Lautzenheiser, Mr. Wiard-Bauer and Ms. Sutherland gave a presentation on the research done by the AAA on the issue of self-support and lapse-support testing for annuity illustrations. Mr. Preston began by saying the AAA group decided that rather than focusing on whether testing should be required, they should decide first how that testing might look. He said the group identified three possible methods that might be used: the dynamic testing method, the static test, and supportability disclosure. He said the dynamic testing method was more theoretical, the static test was a much simpler "bright line" test, and the supportability disclosure would be a narrative that was less precise. He said the overall conclusion was that the testing might be a combination of these three approaches. The four members of the AAA group described the testing methods and results in greater detail (Attachment Eight-C1).

Mr. Preston said the AAA group recognizes the need to move forward with this project aggressively and said the group has been meeting by conference call six times a week, working toward extensive modeling to see how the tests work on different types of products. He said he would like to present an oral report at the Spring National Meeting, and give a more complete report to the working group at the Summer National Meeting. He said the AAA Committee had not yet reached a conclusion as to whether an actuarial standard of practice would be required.

4. Required Illustrations

Mr. Foley said the working group had in the past discussed two types of annuities where there might be a requirement for an illustration for each sale. He said there seems to be agreement by the regulators that an equity indexed annuity and a multiple fund deferred annuity, such as a two-tier annuity, require an illustration because of the complexity of the products. He said for an equity indexed annuity there was no question that the guarantees need to be shown, and the regulators had talked about a hypothetical that demonstrates the affect of the crediting method. Mr. Foley reminded the audience that regulators have come to the conclusion that illustrations will not be required for fixed-rate deferred annuities because they had been told that most contracts are relatively simple and that companies do not use illustrations currently.

Mr. Dunlap asked the audience if they could provide some equity indexed product illustrations to the working group so that regulators could get an understanding of the types of illustrations now being used. Mr. Ashwill and Ms. Liptak agreed to provide sample illustrations to the working group. They agreed that would be helpful to the working group in its discussion.

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

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ATTACHMENT EIGHT-C1

Preliminary Report of the Disclosure Working Group
of the Committee on State Life Issues
American Academy of Actuaries
February 1998

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Richard P. Smolinski, FSA, MAAA
Elizabeth A. Sutherland, FSA, MAAA
Roger K. Wiard-Bauer, FSA, MAAA
With appreciation to the many interested parties for their participation in this process.

Annuity Supportability for Illustrating Non-Guaranteed Elements

At the request of the NAIC Life Disclosure Working Group, the American Academy of Actuaries Disclosure Working Group (Academy Working Group) has continued research on annuity supportability tests for illustrating non-guaranteed elements based on its Dec. 5, 1997, report to the NAIC. The Academy Working Group has prepared this status report for the interim NAIC Working Group meeting (Feb. 19-20, 1998). It summarizes for consideration annuity supportability method objectives, attributes, and high level descriptive examples of the possible supportability methods.

The purpose of this preliminary report of the Academy Working Group is to objectively present and analyze various methods. At present, the methods and examples are for discussion purposes and are not recommendations. In addition, at this time, no one methodology is suggested to be better than another.

The Academy welcomes the opportunity to provide technical support to the NAIC Working Group as it seeks to decide if an annuity supportability method is necessary and, if needed, what form the method could take. Although as a professional organization the Academy cannot determine the necessity of such methods, it can provide expertise in exploring various methods.

Objectives

In its Dec. 5, 1997, report to the NAIC Working Group, the Academy Working Group identified a preliminary list of supportability objectives, together with a list of risks that should be addressed in the development of supportability requirements. The Academy Working Group recognizes that there may be conflicts among these objectives, creating the necessity for compromise solutions in some supportability methods. As experienced with the Life Regulation, the result is that some of these objectives may not be entirely realized. Based on feedback and further Academy Working Group discussions, a revised summary of annuity supportability objectives is shown in Appendix A.

Considerations

Variety of Product Designs

The variety of product designs available in the marketplace makes it more challenging to develop a "one size fits all" supportability test methodology. The variety is partially because of the use of different product design features to manage risk factors.

For example, product designs with higher surrender charges or longer surrender periods will have an increased ability to pass supportability tests. Such features help recover issue expenses and avoid market value losses.

Product designs with longer annuity payout periods will also have an increased ability to pass supportability tests. This results from the ability to recover issue expenses over longer time periods, lower capital costs due to lower risk-based capital factors for payouts, and a lower risk of market value losses due to the multi-year liquidation of assets during the payout period.

Persistency

Many risk factors are related to changes in persistency having secondary financial impacts. These risk factors include issue expense recovery, market value losses, supportability of long-term future values and other items.

The Academy Working Group has reviewed the Annuity Persistency Study - 1997 Report by Life Insurance Marketing and Research Association (LIMRA) and the Society of Actuaries. This Study identifies a number of factors that relate to persistency levels. Important factors include the surrender charge level and its duration. Distribution channels also have a noticeable impact.

Research and Review Needed

Before any of the supportability methodologies can be seriously considered, additional research must be completed. Any methodology should work for the variety of annuity products currently offered to consumers. It should also allow for future product innovations and future interest rate environments. Regulators and industry will need time to review the research results and determine the appropriateness of any proposed methodology. Companies need time to apply any proposed methods to their specific products and situations.

Intent to Pay vs. Ability to Pay

The Academy Working Group also has discussed the limitations of any supportability methodology to address the company's "intent to pay" illustrated benefits. The "intent to pay" concept has been the subject of "plan approach" nonforfeiture research by the NAIC. By having a company develop a plan for non-guaranteed elements, a foundation could be created for monitoring actual paid values compared to illustrated values.

The Life Insurance Illustration Regulation self-support and lapse-support tests focused on the "ability to pay." The Life Regulation also took a limited step to monitor actual paid values by requiring the actuary to report any decreases in non-guaranteed elements due to factors other than experience changes. It also required such reporting if there are inconsistencies between paid and illustrated values for the same or similar forms.

Approaches identified by the Academy Working Group provide only a limited ability to address the "intent to pay" issue. This concept will continue to be discussed by the Academy Working Group.

Attributes of Various Methodologies

Discussions have resulted in the development of a spectrum of methodologies ranging from broad supportability testing to supportability disclosure. This spectrum, along with the specific attributes of each methodology are summarized in Appendix B "Attributes of Possible Supportability Methods For Annuity Contracts Illustrating Non-guaranteed Elements." The two left most columns, Dynamic Aggregate Testing Methods and Dynamic Product-Level Testing Methods, are examples of "Rigorous Tests" identified in the Dec. 5 report. The two right columns explore the two other methods contained in the Dec. 5 report, the Static Simplified (Bright Line) Testing Methods and Supportability Disclosure Methods.

High Level Descriptive Examples

High level descriptive examples are provided in Appendices C through F.

Rigorous Testing

Work done on Rigorous Testing has provided a strong theoretical foundation for discussion simplifications. This work draws from experience with cash flow testing to develop examples. The Rigorous Testing reports are in Appendices C & D.

Simplified Bright Line Testing

The Simplified Bright Line Test work undertook the more difficult challenge of trying to capture the essence of supportability by only considering key elements and fewer "moving parts." Much basic research remains, as few "off the shelf" examples are available to guide this work. Appendix E contains the Simplified Bright Line Test report.

Supportability Disclosure

The Supportability Disclosure work has drawn from the Academy's work in equity indexed products (including the "balancing language" concept). It has also considered the five year interest rate history proposal in the current NAIC Working Group draft. The Supportability Disclosure work is shown in Appendix F.

Closing Comments

Oral Report for March, Comprehensive Written Report for June

The Academy Working Group recognizes the competing needs to keep advancing this project as well as to keep the NAIC Working Group informed.

Because written report development uses a substantial amount of our volunteer resources, the Academy Working Group plans on providing an oral update at the March NAIC meeting. Resources will focus on the necessary research and development to provide a more comprehensive written report at the June NAIC meeting.

Actuarial Standard of Practice

The Academy Working Group understands an Actuarial Standard of Practice may be needed to complement the annuity supportability tests, if the NAIC Life Disclosure Working Group determines such tests are needed. We will continue to keep the Actuarial Standards Board and its Life Operating Committee informed of our progress.

Comments Welcome

The Academy Working Group appreciates the opportunity to assist the NAIC Working Group on exploring annuity supportability testing methodologies. Please do not hesitate to contact either of the co-chairs, Steve Preston or Barbara Lautzenheiser, with any questions or comments about the project to date or its future direction.

Appendix A: Proposed Annuity Supportability Objectives

1. Should ensure that information provided by the company creates consumer expectations for non-guaranteed elements that are not unreasonable.

2. Should address the following (via testing, disclosure or a combination of both):
   - Lapse risks
   - Disintermediation risks
   - Credit risks
   - Hedging risks
   - Expense risks
   - Mortality risks
   - Antiselection risks
   - Capital/risk-based capital requirements

3. Should address the following types of lapse risk:
   - High lapse risks: the risk that high early lapses may result in supportability problems in later years. High lapse risk is typically greater for products paying high early year benefits (e.g., products with substantial early year interest rate bonuses). High early lapses may occur due to such items as:
     a) a spike in interest rates or a bonus rate expiring
     b) expiring of the surrender charge
   - Low lapse risks: the risk that low lapses may result in supportability problems at later durations. Low lapse risk may be greater for products paying higher benefit levels in later years (e.g., products with high long-term annuitization benefits).

4. Should use, when appropriate, informed actuarial judgement; widespread actuarial practices should not be overturned.

5. Should be consistent with historic regulatory practice of not regulating profit margins.

6. Should be general enough to address both current and future designs, while being specific enough to address the major supportability concerns.

7. Should balance the cost of implementing the requirements with the benefits derived from such requirements.

8. To the extent possible, should support consistency with actuarial concepts and principles underlying proposals by other Academy work groups.

Appendix B: Attributes of Possible Supportability Methods
For Annuity contracts Illustrating Nonguaranteed Elements

Attribute	Dynamic Aggregate Testing Methods	Dynamic Product-Level Testing Methods	Static Simplified (Bright-Line) Testing Methods	Supportability Disclosure Methods
Summary	Rigorous testing similar to valuation actuary testing, to determine ability of company to pay benefits illustrated.	Rigorous testing at a product level, perhaps similar to dynamic product pricing, to determine ability of company to pay benefits illustrated for this product.	Simplified testing at a product level using static assumptions in a prescribed methodology. Designed to be more practical and easier to administer and verify. The Life Insurance Illustration Regulation testing method is in this category.	Focus on attempting to assure that expectations for consumers are not unreasonable using additional supportability disclosure. No specific testing.
Measurement of ability to pay vs. need for supportability disclosure. Ability to pay means testing if the company will have the assets to support the benefits.	Higher measurement of ability to pay; lesser need for supportability disclosure.	Fairly high measurement of ability to pay; moderate need for supportability disclosure.	Some measurement of ability to pay; increased need for supportability disclosure.	No measurement of ability to pay; very high degree of supportability disclosure provided.
What is Tested	Tests the company's ability to pay the benefits illustrated. Doesn't require a test of product supportability.	Tests product supportability. Doesn't test overall company ability to pay.	More standardized test of product supportability. Doesn't test overall company ability to pay.	May explain or illustrate the risks of the product. Doesn't require specific tests.
Level of Aggregation	Most likely to be performed at a company level, or across broad categories of products. Testing at a company-level is already being done, in most cases, by the valuation actuary.	By product, product line or policy form.	By product, product line or policy form.	By product, product line or policy form.
Dynamic vs. Static Testing	Dynamic testing under multiple scenarios.	Dynamic testing under multiple scenarios. (possibly fewer scenarios than under dynamic aggregate methods)	Static, single or multiple scenario, test.	Doesn't require specific tests.
Assumptions	Actuarial judgement used to set assumptions.	Actuarial judgement used to set assumptions.	Actuarial judgement might be restricted in setting assumptions.	n/a

Attribute	Dynamic Aggregate Testing Methods	Dynamic Product-Level Testing Methods	Static Simplified (Bright-Line) Testing Methods	Supportability Disclosure Methods
Pass/Fail Criteria	Actuarial judgement used to set pass/fail criteria. Because simplifying assumptions are not used, no error margin need be built into the test.	Actuarial judgement possibly used to set pass/fail criteria for product. Some error margin may be required in the test to cover errors introduced by not recognizing aggregation across products.	Little or no actuarial judgement allowed in setting pass/fail criteria. Significant error margins required in test to cover errors introduced by simplification of assumptions and test.	n/a
How Time Consuming, Costly and Complex	Most time consuming. Complexity means most companies could not do this more frequently than once a year. Costly because an actuary must set the assumptions and perform the testing.	Fairly time consuming and complex. Also costly as this method is also heavily dependent on an actuary.	Easier, quicker to perform. Less time-consuming. Likely that assumptions will be set by actuary, but test could possibly be performed by non-actuary.	Less time consuming, complex and costly since no testing required.
Ability to independently verify compliance.	Fairly complex to verify compliance.	Complex to verify compliance.	Easier to verify compliance.	May be easier to verify compliance for numerical disclosures; narrative disclosure language subjective to verify.
Recognition of risks for annuities identified in Academy Working Group 12/5/97 report.	Recognizes all the risks identified for annuities explicitly in testing.	Recognizes all the product-level risks, but may simplify some (those that are less important for annuities) and add error margin to test to cover simplification.	Focus primarily on product investment risks, lapse risks, and other major risks.	May describe some or all of the underlying risks.
Certification What:	That testing was performed in accordance with guidelines, and that the block of business tested passed the relevant criteria for illustration supportability.	That testing was performed in accordance with guidelines, and that the product passed the relevant criteria for illustration supportability.	That testing was performed in accordance with guidelines, and that the product passed the relevant criteria for illustration supportability.	Certification that supportability disclosure requirements were met.
By:	Actuary	Actuary	Actuary or Responsible Company Officer	Responsible Company Officer

Appendix C: Report on Dynamic Aggregate Testing Methods

The Academy Working Group has reviewed rigorous testing methods for annuity supportability. The purpose of this work was to provide a theoretical basis for looking at annuity supportability. This can be used to provide a target, or benchmark, for the Simplified Bright-Line Test methods and Supportability Disclosure methods. The following example describes one possible way to approach a test under this method.

Example of a Dynamic Aggregate Test

This example can be viewed as applying the concepts of asset adequacy analysis to anticipated new sales in the upcoming year, possibly with different pass/fail criteria and different assumptions. Under this example, testing could be aggregated across all products, or across selected blocks of business. The process begins with the definition of all the assumptions relevant to the business, such as the product design features, investment strategy, mortality, lapse and expense rates, tax requirements, etc. Dynamic testing of the assumptions would be required, particularly of the investment and lapse assumptions. The pass/fail criteria for illustration supportability could be set by the illustration actuary in accordance with actuarial standards. Cash flows would typically be projected along multiple scenarios to ensure that the illustration pass/fail requirements are met. The actuary would certify that the testing was performed, and that the block of business tested passed the criteria set for illustration supportability.

This methodology is not unique to annuities; in fact, it could be used for any product marketed. The testing process would remain the confidential work of the company. This example is similar to the valuation actuary testing, but would require modifications to that process.

Strengths: The test in this example measures the company's viability and its ability to pay the benefits illustrated. An illustration actuary would be required to explicitly identify and test all the material risks for the block of business being tested, including the risks identified for annuities in Appendix A of this report. The test in this example would allow a company to illustrate gains from synergies created by managing blocks of business whose risks complement each other.

Weaknesses: The test in this example is the most complex, time-consuming, and costly of the examples described in this report. It would require significant development time before it could be included in a regulation. It would also take significant time for companies to implement and maintain. It could have a very high level of reliance on an illustration actuary to set both the assumptions and the pass/fail criteria. Aggregation of products allows for cross-subsidy between products or issues years, i.e., a given product may not be self-supporting on a stand-alone basis. The time requirements for this process mean that this testing method would likely be completed no more frequently than once a year. Also, it may be difficult to anticipate the level of new sales for the upcoming year, which may introduce error into the testing.

Appendix D: Report on Dynamic Product-Level Testing Methods

The Academy Working Group also reviewed rigorous testing methods for annuity illustration supportability at the product, product line, or policy form level. These methods are viewed as between the dynamic aggregate methods and the static simplified methods on our spectrum of methods. They require that each product, product line or policy form be self-supporting.

Example of a Dynamic Product-Level Test

This example is essentially the same as the example given for the Dynamic Aggregate methods, except that the test is applied only to a particular annuity product being illustrated. All assumptions will relate directly to the product being tested. Thus this example requires that assets be allocated to the product being tested. Dynamic testing would be performed, and illustration supportability pass/fail criteria could be set by the illustration actuary in accordance with actuarial standards. Some simplification of assumptions or methodology could be made; for example, the number of scenarios might be reduced.

Strengths: The test in this example forces each product to be self-supporting, as it measures a product's viability to pay the benefits illustrated. It explicitly tests all the material product-level risks for annuities identified in Appendix A of this report.

Weaknesses: The test in this example is complex, time consuming, and costly. Other financial measurements (such as statutory reserving and valuation actuary testing) are assumed to test the ongoing viability of the company and the strain from other products, neither of which are explicitly tested under this example. Test results may be sensitive to the allocation methods used for assets, expenses and other items, possibly resulting in a need to introduce margins in the pass/fail criteria. Because the test design excludes the synergies developed under combinations of products, it may unnecessarily limit the company's ability to illustrate benefits that are supportable. The test in this example would require significant development time before it could be included in a regulation, and would take significant time for companies to implement and maintain.

Appendix E: Report on Static Simplified (Bright Line) Testing Methods

Challenge of Static Simplified (Bright Line Test) Development

The primary challenge for developing a static simplified test involves distilling many complex and interacting pieces down into just a few key components. Such simplified tests usually also have very specific pass or fail criteria, which is why they are frequently referred to as "bright line" tests.

Such simplification also creates a second challenge: To identify an appropriate level of error margins to ensure reasonable results for a variety of product designs and for company specific situations. Simplification often makes a test more mechanical, which means there is less opportunity for actuarial judgment to guide the determination of supportability.

Key Points and Risks

Academy Working Group discussions identified three key points in an annuity's life that should be considered in static simplified supportability testing of illustrated benefits. Also, for each key point, different risks need to be considered. The key points and risks are:

1. Early Terminations
   Risks:
   - Recovery of issue expenses
   - Market value losses because of asset/liability mismatch

2. Terminations Near the End of Surrender Charge Period
   Risks: All the risks for early termination plus:
   - Increased capital costs because of risk-based capital requirements
   - Lower earned interest rates because of the impact of asset/liability matching requirements on reinvestments

3. Longer Term Future Values (cash value and annuity payouts)
   Risks: All the risks for early terminations and terminations near the end of the surrender charge period, plus
   - Recovery of issue expenses for annuity payouts
   - Supportability of benefits because of higher persistency

Bright Line Test Methodology Examples

Three methodologies were discussed that start to test for some or all of the key points and related risks. All three approaches need more research.

1. Annuity Version of Life Self-support and Lapse-Support Tests

Description: This is essentially the life tests applied to annuities. It incorporates the same factors, such as persistency, mortality, expenses (issue and maintenance), taxes, etc. Some possible modifications to be considered include: i) development of an annuity version of the generally recognized expense table; ii) changing the life test's break even year from 15 to an earlier year for annuities (which may be partially driven by the level of surrender charges remaining); or iii) including a brief description of the interest rate allocation methodology in the annual certification to the Board of Directors and the Insurance Commissioner.

Strengths: It is consistent with the life self-support and lapse-support tests. It tests for the expense recovery and persistency risks under longer term future values (key point #3 above). This is accomplished through the 100% persistency assumption in years five and later. This stress test demonstrates the supportability of both future cash values and annuity payout benefits. Also, it is much simpler compared to the dynamic methods discussed by the Rigorous Testing Subgroup (discussed in their report, contained in Appendix B).

Weaknesses: It assumes the initial earned interest rate continues indefinitely and that capital costs should be excluded, which means no testing is done for many of the risks under the key points #1, #2 and #3. Specifically, risks that may not be tested include: i) the supportability of early cash values because of risks from issue expense recovery and market value losses because of asset/liability mismatch; and ii) the impact of the surrender charge wearing off (with increased capital costs because of risk-based capital requirements and lower earned interest rates because of the impact of asset/liability matching requirements on reinvestments). Also, Generally Recognized Expense Tables (GRET) may be challenging to develop and appropriate time would be needed.

2. Simplified Annuity Supportability and High Lapse Stress Test

Description: This approach also uses accumulated cash flow tests. First, it could use a pricing-like supportability accumulation, similar to the life self-support test. Factors that may be reflected include persistency, mortality, expenses (issue and maintenance), taxes, etc. Second, a stress test could examine the ability of the supportability accumulation to withstand adverse changes, such as higher lapses combined with a sudden increase in interest rates.

For example, in one particular test proposal, lapses are assumed to double and, immediately after the investment of the initial proceeds, interest rates are assumed to jump 2%. All other assumptions could be held static. This proposal is sensitive to the investment duration used by the company, as well as to the anticipated lapse pattern.

Strengths: It can be designed to test for early terminations, key point #1, and the related risks of the recovery of issue expenses and market value losses because of asset/liability mismatch. Also, such a test appears to be simple and familiar for those familiar with pricing, cash flow testing, or the life self-support tests. It may be able to achieve a simplistic stress test for the most significant type of interest rate risk in single premium annuity products.

Weaknesses: Current proposals only consider increased lapses for stress testing. It would not explicitly stress test two of the key points identified for annuities: i) terminations near the end of surrender charge period, with risks related to increased capital costs because of risk based capital requirements and lower earned interest rates because of the impact of asset/liability matching requirements on reinvestments; and ii) longer term future values (cash value and annuity payouts), with risks related to the recovery of issue expenses for annuity payouts and the supportability of benefits because of higher persistency. Some of these points can be overcome by developing additional stress tests for other scenarios. However, this increases the complexity involved in completing the tests.

3. Annuity Margin Approach

Description: This proposed approach is very different from the usual actuarial analysis. Its focus is the margin between the earned rate and the credited rate. As currently defined, this margin is the only "source of income." The proposal essentially requires a stress test of 100% of the business behaving exactly the same (i.e., all electing the same benefit at the same time). Because this test criteria prevents inclusion of any subsidies or losses from any other year or benefit, passing the test would means that all tested years and all tested benefits are self-supporting.

The current proposal uses a simplified list of "expenditures." It includes certain issue expenses and illustrated bonuses. For simplification purposes, it excludes items like maintenance expenses and federal income tax. Also, the proposed test criteria based on 100% of the policyholders electing the same benefit at the same times means that persistency assumptions are not necessary.

To estimate the impact of asset/liability matching requirements, the current proposal uses a standardized reduction in the earned interest rate based on the remaining level of surrender charges.

The cost of capital would also be included in the current proposal and would be calculated specifically for the product being tested. As proposed, it would be based on risk-based capital requirements for the assets supporting the product and the factors related to the product itself. Some of the factors that would be considered include the surrender charge level, the surrender charge duration, and the payout period illustrated.

Strengths: The idea underlying the Annuity Margin Approach is to use what most companies measure for managing their annuity products - the interest rate margin (or spread). With further research, it may be able to address key points #2 and #3 and almost all of the related risks, including: i) terminations near the end of the surrender charge period, including risks associated with the recovery of issue expenses, market value losses because of asset/liability mismatch, increased capital costs because of risk-based capital requirements, and lower earned interest rates because of the impact of asset/liability matching requirements on reinvestments; and ii) longer term future values (cash value and annuity payouts), including the risks related to recovery of issue expenses for annuity payouts and supportability of benefits because of higher persistency. Also, because it uses one calculation that incorporates into the pass or fail criteria a "stress test" of 100% identical policyholder behavior, separate stress test scenarios may not be needed. This may result in a relatively easy and quick test, which might allow for a more frequent review of new sales interest rates. Thus far, the proposed test appears to provide a reasonable approximation to more complex annuity supportability testing.

Weaknesses: As proposed, it blends standardized assumptions and product specific requirements, which may not work well for all products or companies. Also, it uses only the margin generated by the supporting assets and as proposed is not based on a projected levels of assets. This means the test is less stringent on products in the early years and much more conservative in the later years. Since the pass or fail criteria may apply only after a certain year and not to earlier years, the proposal of assuming 100% of the business behaving the same way means losses from early lapses are not in the accumulations used to test later payments. Standardized earned interest rate reduction assumptions may not reflect actual experience related to asset/liability duration changes because of reinvestment. The test is much more mechanical than other tests considered and has fewer opportunities for actuarial judgment to determine product supportability.

Because it is such a different approach, more research and discussion is necessary before it can be determined whether the proposed test methodology is viable for a variety of product designs and interest rate environments.

Appendix F: Report on Supportability Disclosure

The American Academy of Actuaries Disclosures Working Group was charged with the task of evaluating the concept of "supportability disclosures" as an alternative to quantitative supportability tests. The following list of examples of different types of "supportability disclosures" is intended to provide a feeling for the breadth of ideas that fall within this approach. It is not intended to imply any preference for any method.

Supportability Disclosure - "Narrative" Examples

Example 1: Disclaimer in Narrative Summary and Customer and Agent Certifications

The NAIC Life Insurance Illustration Model Regulation requires illustrations under certain circumstances. The assumption underlying the required illustration is that currently illustrated non-guaranteed elements will continue unchanged for all years shown. This assumption is required to be disclosed in the Narrative Summary to the policyholder along with the statement that "This is not likely to occur, and actual results may be more or less favorable than those shown." The soon to be adopted Illinois version of the Illustration Regulation goes a step further and requires that the prospective policyholder sign a certification acknowledging an understanding of the assumption, as described above, underlying the illustration. In addition, the agent must sign a comparable certification that the policyholder was made aware of the assumption underlying the illustration. The certifications are examples of supportability disclosures.

Example 2: Marketing Material with "Balancing Language"

The recently released Report of the American Academy of Actuaries Equity Indexed Products Task Force contained several recommendations concerning marketing material and illustrations. One of the major recommendations dealt with the idea of "balancing language." Balancing language is the term used to refer to the recommendation that both the negatives and positives of product features are described for consumers. Several examples of situations in which balancing language might be appropriate, along with examples of balancing language, were provided in the report.

The idea of "Balancing Language" can be applied in any advertising or illustration situation. For example, it can be used with deferred annuity illustrations that show possible future periodic payments based on non-guaranteed elements.

Balancing language can be considered another form of supportability disclosure.

Example 3: "Risks" Disclosure

This example comes from the field of securities. The use of ideas from the securities area should not be construed to mean that annuities are securities. To the extent that both types of financial products share common elements, similarity in disclosure requirements should be explored. The primary disclosure vehicle in a securities transaction is the prospectus. The prospectus is required to discuss various risks associated with the product. Such a disclosure acts as an additional disclosure by discussing the factors that have an impact on future values. In the context of annuity illustrations, factors such as changes in prevailing interest rates, changes in investment strategy, better than expected persistency, changes in profit margins, changes in the rate of inflation or some other index, and higher than expected expenses could be discussed from the standpoint of potential risk to the customer.

The following list of "Advantages and Disadvantages" applies to the Narrative Class of Supportability Disclosures.

Advantages:

- Flexible enough to be applicable to both current and new policy designs and all policy features including some of the more subtle ones. Hence, the approach is less apt to be gamed by new designs (all narrative examples).

- The narrative component of a disclosure-based approach may be an attractive supplement to numerical displays since it may be less intimidating to customers who may be "mathematically challenged" (all narrative examples).

- Certification disclosure somewhat ensures that the customer has recognized that future policy values will probably not be as shown in the illustration (Example 1 only).

- Balancing language allows the customer to see both the positives and negatives of the product, aiding them to make a decision (Example 2 only).

- Risks disclosure provides information on a complete set of factors that can affect the future policy values (Example 3 only).

- Risks disclosure explains the risks of annuity plans that are not necessarily specific to a product; allows the customer to be made aware of the various types of risks that cause the policy values to be different than even what is considered "reasonably" expected (Example 3 only).

Disadvantages:

- For some consumers, narrative disclosures may be less explanatory than numerical displays (all narrative examples).

- Company implementation of supportability disclosure requirements may be less uniform than traditional numerical disciplined illustrations (all narrative examples).

- Certification disclosures may introduce administrative "issues"; when do the applicants sign, return, etc., the certification. Does non-receipt of the certification delay issue (Example 1 only)?

- Balancing language can result in undue weight being given to immaterial issues (Example 2 only).

- Balancing language and risks disclosure are subjective methods that may generate more regulatory involvement. With increased regulatory involvement, there is greater opportunity for state variations, which can complicate administration (Examples 2 and 3 only).

- With risk disclosure, the consumer cannot quantify the risks presented, making it difficult to assess each risk's level of pertinence, which may vary by consumer (Example 3 only).

Supportability Disclosure - "Numerical" Examples

Example 4: Disclosure of First Year and Renewal Year Crediting Rates

The next example of a supportability disclosure has been suggested by some regulators but, as far as we know, never implemented. The basic idea is for insurers to disclose historical first year and renewal crediting rates on products similar to the product under consideration by the consumer. The motivation behind this type of supportability disclosure is to provide assurance to the policyholder that the illustration being provided is not merely part of a "bait and switch" scheme.

Displaying first year and renewal crediting rates for successive generations of issue periods may help the customer evaluate whether the initial crediting rate is simply part of a "bait and switch" strategy or whether it is supportable over future policy periods. However, supportability is dependent on investment returns which are not captured in the display suggested. One way of dealing with this shortcoming is to add to the matrix of first year and renewal crediting rates, data on five year on-the-run Treasury rates.

While this type of supportability disclosure has, to our knowledge, never been required or mandated by any state, this type of information has been published in the trade press. The November 1997 edition of Best's Review - Life/Health Edition provided historical initial and renewal crediting rates for 88 insurers on their leading plan available five years ago.

Advantages:

- Supportability disclosures based on historical crediting rates may be a useful tool to identify insurers who employ "bait and switch" tactics.

Disadvantages:

- Supportability disclosures based on displays of actual historical crediting rates may generate customer questions that are difficult to answer by the sales force.

- Supportability disclosures based on displays of historical crediting rates may make it difficult for new companies to enter certain markets because of a lack of historical data.

- Who decides/regulates whether the product being used to show rates is similar enough to the proposed product? This could be open to interpretation and result in different state interpretations or gamesmanship by companies. What are the ground rules for determining what is "similar" and for those products that have no "similar" predecessor, what information will be (if any) required to be shown? This method will generate more regulatory involvement.

- This type of disclosure focuses on the intent of supportability and not the ability to support the numbers displayed in the illustrations.

- This method may be inappropriately used for interpretations of the illustrations that are inaccurate regarding intent, and may result in an over-interpretation of results.

- Practical issues: how to apply to equity-indexed, two-tiered, interest-indexed, and flexible premium products; for declared rate products, which renewal rate at point in time can be used (i.e., the highest renewal rate over the last year, six-month period, or month), or an average of all the renewal rates declared for the product over the last year, six-month period, or month. If an average is used, then disclosure of such rate could be misleading since it may not be the actual renewal rate applied to any policy during the time period. Even more complication is added when different first-year rates apply to the same renewal rate, or where renewal rates vary by month and year of issue.

- 5-year Treasury rates may be somewhat appropriate for first-year credited rates, but really have no relationship to renewal rates. In fact, there could be the case where 5-year Treasuries at high rates are rolling off out of the portfolio lowering the overall portfolio rate even if current rates are rising (i.e., there is a substantial lag between current rates and what the portfolio may being earning resulting in no real correlation between the current 50-year Treasury rates and the portfolio rate).

- This method could lead to lengthy disclosure (especially for products with renewal rates that can potentially change on a monthly basis) that could lead to more confusion for the customer.

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ATTACHMENT NINE

Synthetic GIC Working
Salt Lake City, Utah
March 15, 1998

The Synthetic GIC Working Group of the Life Insurance (A) Committee met in Room 250 CF of the Salt Palace Convention Center in Salt Lake City, Utah, at 7:30 a.m. on March 15, 1998. Larry Gorski (Ill.) chaired the meeting. The following working group members or their representatives were present: Sheldon Summers representing Woody Girion (Calif.); Jack Gies (Conn.); and Donald Bryan representing Lynda Klebold (N.J.).

Larry Gorski (Ill.) began a discussion relative to the March 14, 1998, memo to him from Arnold Dicke (New York Life) representing the American Academy of Actuaries (Attachment Nine-A) relating to the Synthetic Guaranteed Investment Contracts Model Regulation (Attachment Nine-B). After a brief discussion, the working group agreed to the change in Item #1.

The discussion then moved to the first bullet point under Item #2. Blaine Shepherd (Minn.) asked if the reference to "the level of reserves" in Section 10B(2)(b) should instead be "the level of risk charges." Mr. Gorski said that he believes the reference to "the level of reserves" is correct. Jack Gies (Conn.) asked if it is clear what is encompassed within "reserves." Mr. Gorski noted that Sections 10A(1) and 10D(1), taken together, provide an operational definition of "reserves." Mr. Gies said those descriptions are satisfactory, and no further definition is needed.

Next, the second bullet point under Item #2 was discussed. Mr. Gorski said that Paragraphs (2)(b), (2)(d), and (2)(e) under Section 10B are candidates for moving to Section 10B(4). He said that the determination of the fair market value of the segregated portfolio could involve discounting relative to non-publicly traded financial instruments, thereby bringing this determination within actuarial responsibilities. Bob Brown (CIGNA) said the degree of actuarial expertise required varies with the nature of the portfolio. He said that the valuation of "simple" portfolios is basically a "mechanical" process, whereas the valuation of "complex" portfolios may involve significant actuarial involvement. Relative to Paragraph (2)(e), Mr. Gorski said that the actuarial nature of this exercise is "even more clear-cut" than the requirement of Paragraph (2)(d).

Next, the third bullet point in #2 was discussed. Mr. Gorski stated that he personally has no problem with the actuarial memorandum being submitted to the commissioner only upon request. He said language to that effect will be included in the next draft.

The discussion then moved to the second half of the Dicke memo, which deals with the various suggested requirements relative to the actuarial opinion for synthetic GICs. Essentially, the suggestions are intended to provide more consistency with the Section 8 opinion required for the statutory annual statement. A general discussion ensued on this topic, during which it was agreed that the working group will draft language over the next three months to incorporate the suggestions.

Mr. Gorski emphasized that discussions over the next three months will be limited to changes from the March 3, 1998, draft. He said that "I don't want to go back to step one on the other issues." Sheldon Summers (Calif.) stated that another issue is whether the actuarial opinion for synthetic GICs will be incorporated into the overall Section 8 opinion, or will remain distinct.

The next item of discussion was the Feb. 26, 1998, letter (Attachment Nine-C) from Allen Elstein (Conn.). In that letter, Mr. Elstein suggests that, relative to Sections 5B and 5C, "the point at which such 60-day period commences should be more clearly described." Mr. Elstein suggested that the 60-day period begin at the point of "receipt by the Department of such filing." Donald Bryan (N.J.) noted that New Jersey uses "the date of mailing." He said the current language in the draft appears to give the states some latitude in determining the beginning of the 60-day period. Mr. Gorski said that a drafting note will be inserted which says "states should insert a starting point that is consistent with other regulatory practices within that state."

The next point in Mr. Elstein's letter dealt with the review and approval of the plan of operations by the non-domiciliary state (Section 5C). Mr. Gies said that the purpose of Mr. Elstein's suggested language changes is "to allow a two-week period for that state to nevertheless solicit the materials and look at them." Mr. Gorski said that he believes there is some confusion relative to the language in Section 5C of the March 3, 1998, draft, and he stated that the phrase "shall be waived" should be replaced by "may be waived" in the introductory paragraph. Mr. Gorski said that this change is needed because the waiver described in Section 5C is dependent upon the "affirmative" approval by the domiciliary state. He also said inserting Mr. Elstein's suggested 15-day period would clearly indicate how long a state has to determine if the domiciliary state has acted "affirmatively." Mr. Brown objected to "this fairly dramatic change." He said if the potential exists "for dual review of the plan of operations every time we go to write such a contract, that is a major problem." A discussion then ensued as to the meaning of "affirmatively approved." Mr. Gorski said that the term encompasses more than merely deemer provisions. He said that it includes situations where a company files its plan of operations with the domestic state but does not intend to market the product there. He said it also includes situations where there is a "concern about the level of review" performed by the domestic state. Mr. Gorski said to tell a state 'we are going to file a contract with you with all of the substantive provisions being in variable contract language form' and not give that state the opportunity, if it so chooses, to review the plan of operations is incomprehensible. Mr. Gorski then repeated that he favors 1) changing the word "shall" to "may" and 2) inserting the "15-day" language.

Mr. Gorski asked why the creation of subsidiaries devoted exclusively to the sale of synthetic GICs would not be a means of addressing industry concerns regarding regulatory delays. He said that regulators would have fewer concerns about approving products in such circumstances, given that subsequent problems with the products would not affect "the fortunes of the general account."

The discussion then moved to the portion of Mr. Elstein's letter which suggests that a portion of the risk charge be accumulated as a contingency reserve or liability. Mr. Gies stated that, although the probability of losses is small, the hit to surplus can be fairly dramatic when it happens. He stated that he would like to revisit the issue of whether a portion of the risk charge should be set aside to have the effect of smoothing the impact on the company's surplus. Mr. Summers and Mr. Shepherd said that they have this requirement in their states' laws. Mr. Brown objected to the proposal, saying that the reserving methodology required by the model is already more rigorous than required for virtually any other product line. He also said that the testing done in order to render the actuarial opinion should eliminate the concern that additional reserves are needed. Mr. Gorski noted that the model requires reporting by a company officer as to whether actual benefit payments conform to the benefit payment estimated to be made as described in the plan of operation, and that this reporting would help regulators determine if the risk charges are appropriate.

A brief discussion ensued regarding the risk-based capital treatment of these products. Mr. Brown stated that C-1 and C-3 amounts are computed, but then credit is given for the difference between the value of the minimum promises and the value of the assets supporting them, either in the outside trust account or in the supplemental account. He further stated that normally the capital charge in RBC will be zero. Mr. Gorski said it really boils down to both the reserves and RBC are dependent upon asset adequacy analysis type thinking for any positive component to either one of those. Mr. Brown rephrased Mr. Gorski's comment by saying that, while in certain circumstances there will be a positive reserve, typically there would not be an additional RBC piece above the reserve. Mr. Gies asked Mr. Brown if the Actuarial Opinion and Memorandum Regulation (AOMR) analysis sufficiently shock the situations so that these kinds of remote contingencies are captured in that. Mr. Brown responded that the relevant actuarial standards of practice require the testing of relatively severe scenarios. Mr. Gorski asked how rigorous is the company's determination of risk charge. Mr. Brown responded that it is his impression that the calculation of the risk charge is not particularly rigorous, and he agreed with a concept stated by Mr. Gorski that the risk charge is typically a mechanism to recover the cost of capital. After a brief discussion, Mr. Gorski said that taking Mr. Brown's comments at face value, it follows logically that the accumulation of risk charge would probably not bear much relationship to emerging losses under the product. Mr. Gies said that he agreed with Mr. Gorski's statement, but that the point is well made that a remote but substantial risk is being embraced, and our thinking ought to progress as to whether there is a regulatory interest in hedging away that remote contingency. In conclusion, Mr. Gies said that this matter could be left to the individual states in terms of how strong any state feels about that issue.

A brief discussion then occurred regarding exactly which of Mr. Elstein's suggested changes to Section 5C had been agreed to. At the conclusion of that discussion, Mr. Gorski said except for adding the same language relative to receipt by the Department included in the section on the domestic review, we buy into this, and we are also going to change "shall" to "may". Mr. Summers asked if it is necessary to replace "shall" with "may." After a brief discussion, Mr. Gorski said the word "may" is not needed if everyone understands the full ramifications of "affirmatively approved." Mr. Gorski concluded by saying a drafting note to fully explain "affirmatively" and the full impact of that would be inserted. Mr. Gorski said that a domestic state may consider its approval to be affirmative, but "the state of filing after questioning that state, may say that it doesn't accept it.

The next item considered was the Feb. 23, 1998, memo from Alfred A. Turco (Chair, Government Relations Committee, Stable Value Investment Association) (Attachment Nine-D). An opportunity was provided to regulators and the audience to comment on the letter; no comments were made.

The next item considered was the March 6, 1998, memo from Stanton L. Cole (American Council of life Insurance—ACLI) (Attachment Nine-E). Michael Bartholomew (ACLI) said that the comments made in the March 6 memo may be moot, given the working group's previous discussion. He said he is unclear as to what changes in the model were agreed to, but clearly we are not on the same wavelength as the regulators. He said that to subject it (i.e., the plan of operations) to a lot of change effectively puts the company out of the market. Mr. Gorski responded by saying that, given the degree of variable language in the contracts, it is unreasonable to ask regulators to forgo their review of the plan of operations. Mr. Bartholomew said that more recognition should be given to the domiciliary state's role as the primary overseer of a company's financial condition. Mr. Bartholomew asked Mr. Gorski when the 15-day period for the non-domiciliary state's review will begin, i.e., the date of mailing or the date of receipt. Mr. Gorski said that will be determined by each state, consistent with that state's other regulatory requirements. Mr. Bartholomew said he is not aware of any state that measures from the date of receipt. He asked how companies will know when the filing is received by a department. Mr. Gies said that companies are able to call the department to determine the date of receipt.

Mr. Shepherd's memo of Feb. 27, 1998, was then reviewed (Attachment Nine-F). Mr. Shepherd said that his points #1 and #2 had been incorporated into the March 3, 1998, draft, and he said his point #3 does not need to be pursued at this point.

Mr. Gorski suggested that the language in Section 6F will be changed as follows: "The contract shall provide the insurer with the right to prior notice of and the right to approve any change of investment managers." He also suggested that the comma on the fifth line of Section 10A(1) of the March 3, 1998, draft be removed. Finally, Mr. Shepherd questioned whether the "$9 billion" in Section 5A should be "$1 billion." Mr. Gorski said that he thinks this figure comes from the New York requirements; he asked staff to research this matter.

Mr. Summers moved and Mr. Gies seconded a motion to adopt the minutes of the Feb. 25, 1998, conference call (Attachment Nine-G). The motion passed unanimously.

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

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ATTACHMENT NINE-A

To: Larry Gorski, Chair, Synthetic GIC Working Group of the Life Insurance (A) Committee
From: Arnold Dicke, American Academy of Actuaries
Date: March 14, 1998
Re: Comments on Certain Provisions of the 11/26/97 draft of the Proposed Synthetic Guaranteed Investment Contracts Model Regulation

On the Feb. 25, 1998, conference call of the Working Group, I was asked to forward certain questions relative to the language used in describing the responsibilities of the qualified actuary under the Proposed Model Regulation to Alastair Longley-Cook, Chair of the Academy Working Group on the Proposed Separate Accounts Funding Minimum Benefits Regulation. I did so, and received from Mr. Longley-Cook a draft of the response his group is intending to submit at the Salt Lake City meeting. This response makes recommendations that, when applied to the provisions of the Nov. 27, 1997, draft of the Synthetic GIC Model Regulation, would be as follows:

1. Section 5(E)(1)(l): The words "An unqualified opinion" should be substituted for "A statement certified." The actuary cannot *certify* as to the adequacy of the consideration for risks in the usual sense of the word, which implies a guarantee. The actuary can *opine* as to the adequacy, with an unqualified opinion implying the same degree of positive assurance provided by the Actuarial Opinion and Memorandum Model Regulation (AO&MR).

To provide the opining actuary with the appropriate guidance as to what constitutes adequacy in this case, an Actuarial Standard of Practice, perhaps supplemented by Practice Notes, should be developed. There is no existing guidance available to the actuary. However, the adoption of the Model Regulation need not be delayed until such Standard is developed.

2. Section 10: The only changes recommended by the Academy Working Group with respect to the actuarial opinion and memorandum required by the draft are as follows:

- The words "good and sufficient" should be replaced by "adequate" throughout the section. This change would ensure consistency with the AO&MR which uses only *adequacy* as the reserve criterion. The previously-used good *and sufficient* currently has no commonly agreed upon meaning. Specific references in the draft are paragraphs B(2), B(4), and D(4)(b).

- The list of officer-certified items in B(2) should not include any that require actuarial expertise. These should be transferred to the list of items required in the actuarial memorandum, paragraph B(4). Specifically, item (b) appears to require such expertise.

- The filing requirements for the actuarial opinion and memorandum should be made consistent with those for the company-wide actuarial opinion and memorandum. For example, the opinion would be filed annually, but the memorandum would be submitted to the commissioner only upon request.

In addition to "translating" the points made by Mr. Longley-Cook's Working Group, I would make the following additional observations with respect to the Synthetic GIC Model Regulation. The draft sets forth a requirement for an actuarial opinion and memorandum that presumably is intended to replicate the company-wide opinion and memorandum, but to focus on the assets backing synthetic GICs only. Ideally, the Academy would like to see this requirement coordinated with and incorporated into the company-wide memorandum, even if a separate statement of opinion with respect to synthetic GIC business is required. Unfortunately, the draft does not go into the same detail as does the AO&MR. A number of items need to be treated definitively, by incorporation into or coordination with the AO&MR or by referring to or copying its language:

a. Confidentiality of the memorandum. This was already mentioned above. The memorandum will necessarily contain proprietary information.

b. Protection of the actuary from liability. The AO&MR and Standard Valuation Law specifically release the appointed actuary from liability to anyone except the commissioner and his or her company. The actuary opining under the synthetic GIC draft does not appear to have the same protection.

c. Appointment of the actuary. There is no provision for appointment of the actuary. Without such appointment, the actuary may be disadvantaged in dealing with management if controversies arise.

d. Review of actuarial work. The AO&MR and the Standard Valuation Law permit the commissioner to obtain an outside review of the appointed actuary's work under certain circumstances.

e. Form of actuarial opinions. The exact form of the actuarial opinion was developed through long discussion. It should be used here. Even placing the word "adequacy" in the text does not make clear that what the actuary should be opining on is that "the reserves and related actuarial items, when considered in light of the assets hold by the company with respect to such reserves and related actuarial items *and the assets held in the segregated portfolio and anticipated cash flows,* including, but not limited to, the investment earnings on such assets *after taking account of any risk charge payable,* and the considerations anticipated to be received and retained under such contracts, make adequate provision, according to presently accepted actuarial standards of practice, for the anticipated cash flows required by the contractual obligations and related expenses of the company." I suggest this language be used in place of the words "after taking account of any risk charge payable, the segregated portfolio of 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" in paragraph 10(B)(2), even if the opinion is defined by reference to the AO&MR.

f. Supporting opinions. The AO&MR also gives specific language for supporting opinions. In at least one case, this language was carefully worked out in discussions with a group representing the affected parties (auditors). This language should be incorporated by reference as well, particularly as regards to reliances.

I realize there is a drafting note about possibly including the information in the actuarial opinion and memorandum as part of a state's overall filing requirements, but considering the importance of the above issues, I personally feel that is too weak a linkage. I would prefer to see the points just listed specifically included in the language of the Model Regulation.

Because of the short time frame, I have not been able to go over these issues with the Academy's General Counsel. From past experience, I know she is concerned about protections for actuaries and generally prefers actuarial opinion language to be specified by law or regulation. I will obtain her input as soon as possible and forward it to you.

Thank you for the opportunity to comment on behalf of the Academy.

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ATTACHMENT NINE-B

Synthetic Guaranteed Investment Contracts Model Regulation
Draft: 3/3/98

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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~~ reference 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. "Account assets" means the assets in the segregated portfolio plus any assets held in the general account or a separate account to meet the asset maintenance requirements.

~~A~~B. "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~~C. "Asset maintenance requirement" means the requirement to maintain assets to fund contract benefits in accordance with Section 10 of this regulation.

~~C~~D. "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~~E. "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~~F. "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~~ reference future changes in market conditions.

~~F~~G. "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~~H. "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~~I. "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~~J. (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~~K. "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~~L. "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~~M. "Market value record" means an accounting record provided by the contract to reflect the fair market value of the segregated portfolio.

~~M~~N. "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~~O. "Plan of operation" means the plan of operation filed with the commissioner of the domiciliary state pursuant to Section 5 of this regulation.

~~O~~P. "Qualified actuary" means an individual who meets the qualification standards set forth in [insert statutory reference].

~~P~~Q. "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~~R. "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~~S. "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~~T. "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~~U. "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 admitt3d 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.~~

A. An insurer will be financially qualified under this section if 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. In lieu of the requirements in the preceding sentence, the insurer may be required to satisfy such other financial qualification requirements as set forth by the commissioner deemed necessary or appropriate in a particular case to protect the insurer's policyholders and the public.

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 if, in his opinion, the filing and approval is not necessary for the protection of the public.

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;

<u>(g) A description of the crediting rate formula, if any, and how it will operate to take into account differences between the market value record and the contract value record over time;</u>

(~~g~~<u>h</u>) ~~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.~~ <u>A demonstration of financial results showing at a minimum the projected contract value records, the applicable fixed rate or rates of return, the projected market value records, and how these values and rates of return may be affected by changes in the investment returns of the segregated portfolio and reasonably anticipated</u> 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~~<u>i</u>) 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~~<u>j</u>) A description of the procedures to be followed when a unilateral contract termination event occurs;

(~~j~~<u>k</u>) 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 Subsections B and C of this section as appropriate;

(~~k~~<u>l</u>) 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~~<u>m</u>) 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~~<u>n</u>) 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 percent of the spot rate as described in the plan of operation (pursuant to Section 5E) or the actuary's opinion and memorandum, ~~prepared~~ (pursuant to Section ~~5E~~10B), 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~~ from year thirty to the date of valuation at a rate not greater than 105 percent 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 December 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) Substantially conform ~~to~~ with those portions of Section [insert regulatory reference to ~~state's~~ Actuarial Opinion and Memorandum Regulation] of these regulations that are applicable to asset adequacy testing and either:

(i) Demonstrate the sufficiency of account assets based upon cash flow analysis, or

(ii) ~~Demonstrate~~ Explain why cash flow analysis is not appropriate, describe the alternative methodology of asset adequacy testing used, and ~~set forth~~ demonstrate the ~~procedures used to determine the~~ sufficiency of account assets under that methodology;

(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 account 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 because of 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].

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ATTACHMENT NINE-C

To: Mark D. Peavy, Life Health Actuary, NAIC
From: Allen R. Elstein, FSA, MAAA, Examination Division (Conn.)
Date: Feb. 26, 1998
Re: Comments relating to Synthetic Guaranteed Investment Contracts Model Regulation

The following comments regarding the proposed model regulations dealing with Synthetic GIC and Guarantees Funded Through Insurer Separate Accounts are directed to Messrs. Larry Gorski (Ill.) and Blaine Shepherd (Minn.) respectively, chairs of NAIC working groups with respect to these models. The comments generically apply to both regulations, but will be cast in terms of the synthetic GIC model in the interest of brevity.

Specifically, Section 5 of the synthetic GIC model describes in subsections B and C the basis on which the filing and approval of such contracts is to be determined. Subsection B references domestic insurers. A sixty (60) day deemer provision is described. The point at which such 60-day period commences should be more clearly described. The following is suggested language for Section 5B:

> A domestic insurer will .... and such filing has been affirmatively approved or has not been disapproved within the sixty (60) day period following <u>receipt by the Department of </u>such filing, in which event such plan of operation and such form of contract shall be deemed approved. (addition to text = <u>underline)</u>

With respect to Sections 5C for non domestic insurers, similar comment applies as follows.

> A non-domestic insurer will....,and such form and such plan of operation have been affirmatively approved or have not been disapproved within the sixty (60) day period following <u>receipt by the Department of </u>such filing, in which event such form of contract and such plan of operation shall be deemed approved. <u>Not withstanding the forgoing,</u> the <u>requirement for</u> filing and approval of the plan of operation shall be waived:
>
> (1) <u>upon expiration of the fifteen (15) day period following receipt by the Department without return comment of </u>notice by the insurer ~~in the event~~ that the insurer's domiciliary insurance department has promulgated rules or regulations governing Synthetic Guaranteed Investment Contracts that are substantially similar to this regulation, and <u>that the domiciliary insurance department</u> has <u>affirmatively</u> approved such plan of operation. Evidence of such approval <u>and reference to such rule or regulation</u> shall be included <u>with the notice</u> ~~in the submission~~; or
>
> (2) at the discretion of the Commissioner.

The above use of a narrow window of 15 days, in the case of a non-domestic company, balances the need of the company to move rapidly to complete the transaction, and the need of a Department to not automatically forego its right to review a plan of operation. In particular, such a window reduces the capacity of a domestic company to avoid a plan of operation review by putting the contract in a non-domestic affiliate, partner or trust.

Finally, it is recommended that this regulation specify that a portion of the insurer's risk charges be withheld from surplus and accumulated as a contingency reserve or liability. A suitable algorithm for accumulating (and releasing) such amounts should be solicited from the interested parties group. This is not a small point The rationale is as follows.

An insurance guarantee exists for which, in good times, there is no balance sheet presentation of liability nor of assets supporting liabilities. It is understood that the combination of capital requirement (asset haircuts), mark to market accounting, and actuarial adequacy opinion are plausible rationale which support this accounting treatment. However, the plausible shock value to reported surplus of unforeseen adverse events would be immediate (a desirable financial reporting feature) and could be substantial (an undesirable financial result). This accounting framework could produce substantial stress to surplus. Not all of the accumulated risk charge should be permitted to be recognized as profit (surplus) until it is earned and the insurer released from risk.

Again, it is recommended that a suitable algorithm for accumulating (and releasing) contingency risk charges be solicited from the interested parties group and made a requirement of the regulation.

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ATTACHMENT NINE-D

To: Mark Peavy, Life/Health Actuary, NAIC
From: Alfred A. Turco, Chair, Government Relations Committee, Stable Value Investment Association, Inc.
Date: Feb. 23 1998
Re: NAIC Model Regulation on Synthetic Guaranteed Investment Contracts

I am writing on behalf of the Stable Value Investment Association to comment on the Nov. 26, 1997, draft of the above-captioned model regulation. The Association, one of the leading authorities on retirement investing, was established in 1990 to advance public awareness about stable value products, to address issues affecting these products and to educate the public about the best ways to plan for retirement. Its members include product and service providers, such as banks and insurance companies that sell and manage stable value products, plan sponsors, investment managers, and consultants.

As an association committed to the availability of product and the belief that product diversity is ultimately beneficial to plan participants, we are concerned that the plan of operation filing requirements set forth in Section 5B and C of the draft model regulation add a new and potentially onerous layer of regulation for insurers that may impede the availability of new stable value synthetic products in the marketplace.

Specifically, Section 5B and C of the draft model regulation requires that non-domestic companies file a plan of operation for approval, as part of the contract filing process. This requirement may be waived at the discretion of the commissioner and will be waived if the insurer's home state has promulgated rules and regulations substantially similar to the model regulation, and if the home state has approved the plan of operation. If every state were to adopt the model regulation, this extraterritoriality provision would not, be onerous. However, based on regulatory experience, we believe it is likely that a number of states, including some of the largest ones, will not adopt the model regulation.

The filing and approval of a plan of operation is typically a time-consuming and expensive matter, both for the insurer making the filing and for the insurance department performing the review. A plan of operation and supporting materials are often quite voluminous. Typically, several rounds of correspondence are required before a plan of operation is approved. As part of the correspondence, changes are usually made to the plan of operation, either to clarify points, or to make substantive changes requested or required by the regulators.

Traditionally, approval of a plan of operation has been a matter of domiciliary state regulation. We believe that the amount of work required at insurance companies and insurance departments to write, review, and modify a plan of operation will increase dramatically, if each state in which a synthetic guaranteed contract is offered needs to review a plan of operation filing. More significantly, companies will also be faced with situations where different insurance departments require conflicting changes to a plan of operation. In such situations companies will have to choose between protracted negotiations to resolve the conflicts, or the creation of a different plan of operation for contractholders in the different states. This is especially troublesome in the use of commingled funds to hold assets that are wrapped by a synthetic guaranteed contract.

We are concerned, from the perspective of the stable value buyer, that the draft regulation may have the effect of reducing stable value product diversity by company and investment style. We know this result would be unintended. As well, the NAIC is examining the regulatory process as part of its overall commitment to streamline that process. For these reasons, we urge the working group to re-examine Section 5B and C of the draft regulation and to consider retaining the present filing system for a plan of operation. The Association is willing to discuss our concern with the working group in greater detail and in the appropriate forum.

Please feel free to call me with any questions you may have at (860) 647-4808.

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ATTACHMENT NINE-E

To: Mark Peavy (NAIC/SSO)
From: Stanton L. Cole, Actuary, American Council of Life Insurance
Date: March 6, 1998
Re: Synthetic Guaranteed Investment Contracts Model Regulation

The American Council of Life Insurance respectfully requests that the attached language replace the existing language of Sections 5B and 5C of the March 3, 1998, version of the Synthetic Guaranteed Investment Contracts Model Regulation. The proposed language is identical to that which we have suggested for the Separate Accounts Funding Guaranteed Minimum Benefits Under Group Contracts Model Regulation.

Proposed Section 5B serves to eliminate the duplication that exists in the current draft by combining Sections 5B and 5C of the current version. The additional language of proposed Section 5C will avoid the necessity of companies that are domiciled in states that have not adopted the model from having to make multiple filings for approval. In addition, our suggestion will be administratively helpful to state insurance departments since they will not be burdened by the need to review numerous plans of operation filed by many insurers.

We would be most appreciative if you would see that members of the Synthetic GIC Working Group receive a copy of this language prior to their meeting in Salt Lake City. Thank you for your help.

ACLI Suggested Revised Language to Sections 5B and 5C of the
Synthetic Guaranteed Investment Contracts Model Regulation

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

B. An insurance company will have satisfied the filing and approval requirements of this Section if the insurance company 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 the sixty (60) day period following the filing, in which event the plan of operation and the form of contract shall be deemed approved.

C. The filing and approval of the plan of operation required by Paragraph B. shall be waived upon notice by the insurance company in the event the insurance company's domiciliary insurance department or any other insurance department has promulgated this regulation or regulations governing the types of contracts that are substantially similar to the applicable requirements of this regulation, and has approved the plan of operation. Evidence of approval shall be included in the submission.

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ATTACHMENT NINE-F

To: Mark Peavy (NAIC/SSO)
From: Blaine Shepherd (Minn.)
Date: Feb. 27, 1998
Re: Synthetic GIC Model Regulation

1. Below is some wording for Section 5 that I have reviewed with Bob Brown and that he is okay with:

g) A description of the crediting rate formula, if any, and how it will operate to take into account differences between the market value record and the contract value record over time.

h) (new) A demonstration of financial results showing at a minimum the projected contract value records, the applicable fixed rate or rates of return, the projected market value records, and how such values and rates of return may be affected by changes in the investment returns of the segregated portfolio and reasonably anticipated...(pick up existing wording from the old (g))

i) (the old (h) and re-letter those following)

2. Here is my shot at a definition of "account asset" which Bob also agreed with:

"Account assets" means the assets in the segregated portfolio plus any assets held in the general account or a separate account to meet the asset maintenance requirements.

3. Finally, with regard to the asset valuation reserve (AVR) language in Section 10C, I would suggest it be moved to the end of Section 10A, where my concerns about what assets are being referred to would vanish. The wording seems to be somewhat out of place where it is anyway. Bob also said he supported this idea. Note that I am not sure who might already be working on this language, as I did not agree to provide input. But, here it is anyway...

If moved to the end of Section 10A as a new item (8), the wording might read better as:

(8) When the insurer complies with the asset maintenance requirements of this subsection, it need not maintain an asset valuation reserve with respect to such assets.

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ATTACHMENT NINE-G

Synthetic GIC Working Group
Conference Call
Feb. 25, 1998

The Synthetic GIC Working Group of the Life Insurance (A) Committee met by conference call at 11 a.m. on Feb. 25, 1998. Larry Gorski (Ill.) chaired the meeting. The following working group members or their representatives were present: Jack Gies (Conn.); Hal Phillips representing Woody Girion (Calif.); and Lynda Klebold (N.J.).

The first item on the agenda was the Jan. 30, 1998, letter from Mike Cioffi (Diversified Financial Products) (Attachment Nine-G1). The first point discussed was the issue of the logistics of the implementation of the Synthetic Guaranteed Investment Contracts Model Regulation in a state. As stated in Mr. Cioffi's letter:

> There should be an allowable time period during which the companies currently issuing Synthetic GICs on forms previously approved can continue to do business while providing the necessary time for refiling and state approval of the new standards. To force companies to discontinue operations as a result of a change in regulation solely would create an enormous hardship and greatly damage existing business relationships.

Larry Gorski (Ill.) responded by saying that it will take considerable time for a state to adopt the regulation, and companies should use that period to file the plan of operations and other necessary documentation. Lynda Klebold (N.J.) noted that the model states that "contracts that have been negotiated prior to the effective date need not be refiled with the commissioner." She also noted that one of the drafting notes in Section 3 states that "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." The working group agreed that no further elaboration is needed.

The next point in Mr. Cioffi's letter addressed the issue of allowable variability in the contract. Mr. Cioffi stated that it would be helpful to expand the model to address how the plan of operation should explain the range and variances which will exist between individual contracts. As stated in his letter, he asserted that this should provide sufficient comfort with respect to variability. Mr. Gorski said that he thinks the issue of variability is adequately addressed by the comprehensiveness of the list of items in Section 5E.

Also, Mr. Gorski characterized the drafting note in the beginning of Section 5 as a pretty strong statement in support of variable filings. Mr. Cioffi and Christine Stiver (Transamerica) expressed a concern that the existing drafting note is too weak. Mr. Cioffi asked if the drafting note could be rewritten to indicate that it is supportive of variable filings. Mr. Gorski responded that, while he does not want to eliminate variable filings, he does not want to add language which encourages variable filings. No regulator expressed any support for changing the language.

The next point addressed was the approval process for the plan of operations. Ms. Klebold requested that the minutes note that she believes the only circumstance under which a non-domestic state should be responsible for approving the plan of operations is where there isn't a regulatory framework in the domestic state's work process. She said that the situation for synthetic GICs differs from separate account products; she said that statutes exist for the home state to take care of that type of product. She further stated that the reason she is in a position to go extra-territorial on synthetic GICs is because there is no similar framework in statute. No regulator expressed an interest in changing the existing language in the regulation.

The working group then addressed the Feb. 2, 1998, letter from Zahid Hussain (Transamerica) (Attachment Nine-G2). Mr. Hussain emphasized the competitive difficulties the model presents for insurers, given that their competitors in the financial services sector will not be subject to the same constraints. A general discussion ensued that repeated the points previously made. At the end of that discussion, no regulator expressed an interest in changing the existing language.

Two additional items were then noted. First, a letter dated Feb. 23, 1998, from the Stable Value Investment Association had been received too late to be distributed prior to the conference call. Mr. Gorski indicated that letter will be discussed at the Spring National Meeting in Salt Lake City. Second, Mr. Gorski noted that a voicemail message had been received from Scott Cipinko (National Alliance of Life Companies—NALC) which stated that his organization continued to oppose the company size limitations imposed in Section 5A(1).

The working group then reviewed the Feb. 4, 1998, memo from Ms. Klebold (Attachment Nine-G3). First, the working group agreed to change the second sentence of "Scope and Application" and the definition of "crediting rate formula" to incorporate the phrase "reference future changes in market conditions." Second, Ms. Klebold suggested that Section 5A(2) be modified to: "It satisfies such other financial qualification requirements as set forth by the commissioner deemed necessary in a particular case to protect the insurer's policyholders and the public." A lengthy discussion ensued regarding the intent of Section 5A(2), i.e., whether it is the intent of the working group to allow the commissioner the flexibility to set financial standards without regard to the amounts specified in Section 5A(1). Mr. Gorski said it is his opinion that section 5A(2) allows the commissioner to set either higher or lower requirements, at his/her discretion, which are applicable to specific companies. Eric Keener (Ætna) stated that the language had been included to give the commissioner the discretion to lower the amounts specified in Section 5A(2), but he agreed that the language gives the commissioner the authority to either raise or lower the amounts in specific cases. Bob Brown (CIGNA) said the language was added to provide the commissioner some flexibility in allowing smaller companies to issue synthetic GICs on a company-by-company basis. Mr. Brown stated "you cannot let any company in the world write it without any qualifications." At the conclusion of the discussion, it was agreed that the commissioner should have the discretion to both raise and lower the suggested financial standards. It was also agreed that (1) Section 5A(2) will be rewritten as a stand-alone sentence (with words such as "the previous sentence notwithstanding") and (2) the words "or appropriate" will be added after "deemed necessary" in Ms. Klebold's suggested language.

Ms. Klebold also suggested that Section 5C(2) be reworded as follows: "At the discretion of the commissioner if, in his opinion, the filing and approval is not desirable or necessary for the protection of he public." A brief discussion ensued, during which Mr. Gorski and Jack Gies (Conn.) stated that it is not clear to them what the word "desirable" means in these circumstances. The working group agreed to incorporate Ms. Klebold's language, with the elimination of the words "desirable or."

The working group then discussed the points raised in Blaine Shepherd's (Minn.) letter of Jan. 28, 1998 (Attachment Nine-G4).

Mr. Shepherd's first point: Mr. Gorski stated those spelling changes had already been incorporated into the draft.

Mr. Shepherd's fourth point: It was agreed that the phrase in Section 10(A)(6) will be written as: "plan of operation (pursuant to Section 5E) or the actuarial opinion and memorandum (pursuant to Section 10B)." Also, it was agreed to change "for thirty additional years" to "from year thirty to the date of valuation."

Mr. Shepherd's "first" fifth point: Mr. Shepherd suggested alternative language in Section 10B(4) to the language that had been agreed to at the Winter National Meeting (see the Dec. 7, 1997, minutes for that language). Arnold Dicke (New York Life) suggested substituting the word "adequacy" for "sufficiency" since this would be consistent with the applicable standards of practice. Mr. Dicke said he will request the American Academy of Actuaries (AAA) general counsel to prepare a report on whether this language creates any issues for the Actuarial Standards Board. Mr. Dicke said he will also ask the counsel to comment on the phrase "good and sufficient" in Section 10D(1)(b). The working group agreed to insert Mr. Shepherd's language in the next draft. Also, Mr. Dicke stated that he will be responsible for forwarding this question to Alastair Longley-Cook (Ætna), who is chairing an AAA committee that is reviewing the Separate Accounts Funding Guaranteed Minimum Benefits Model. Finally, it was agreed that a definition of "account assets" is needed; Mr. Shepherd agreed to develop a definition.

Mr. Shepherd's "second" fifth point: Mr. Shepherd asked what is being referred to by the word "assets" at the end of Section 10C. After a lengthy discussion, it was agreed that the phrase "account assets" will replace the word "assets," pending a definition of account assets.

Mr. Shepherd's third and sixth points: Mr. Shepherd asked how additional reserves could be held in a separate account. Mr. Brown stated that it may be appropriate for the additional reserves to be in a separate account if the nature of the portfolio being wrapped is a lot different from the composition of the general account. Also, Mr. Brown stated that there may be instances where the client's money is placed in a separate account to fund "haircut" requirements. He said that both scenarios would be relatively rare, particularly the second scenario. Mr. Shepherd said he was satisfied with the explanation. Hal Phillips (Calif.) stated that he disagreed with Mr. Brown's explanation; he said that synthetic GICs are entirely general account products. He said that he is not convinced that assets supporting a synthetic GIC can ever be in a separate account. Mr. Gorski stated he that disagreed with Mr. Brown's first point, since the "haircut" will generally be a very small percentage of the plan assets and it will be very difficult to use a mechanism to isolate the assets representing the "haircut" as well as emulate the plan assets. Mr. Brown responded by saying that he had been referring to the total additional reserve, not just the "haircut." Second, he said that while it is true that these amounts probably will be relatively small, there might exist a pooled separate account that does a better job of emulating those outside assets. Mr. Gorski stated that, in his state, a separate account can only be utilized to fund guaranteed benefits subject to commissioner approval. He said that, at this point, the regulation goes beyond what is contemplated by Illinois law. Mr. Brown responded by saying that 1) he does not believe the regulation supercedes a state's statutes, and 2) the law Mr. Gorski cited was probably developed with the idea that separate accounts are composed entirely of equities, whereas in this instance a debt portfolio would be utilized. Mr. Brown said that, in any event, the mechanisms a company intended to use should be spelled out in the plan of operations. Mr. Phillips stated that California law is that you can only do a separate account on guaranteed stuff with the commissioner's approval; and California has never been given that approval so far. After a lengthy discussion, Mr. Gorski asked Mr. Phillips if he would like the addition of a drafting note to the effect that "some states will not permit the holding of these assets and reserves in a separate account." Mr. Phillips responded affirmatively. The working group agreed with the addition of drafting note.

Mr. Shepherd then noted that, at the Winter National Meeting in Seattle, he had raised some issues relative to Section 10A(5). He stated that he is now comfortable with the existing language.

Mr. Shepherd's second point: Mr. Shepherd asked for clarification regarding whether the description of the crediting rate formula required by Section 5E(g) encompasses "fully guaranteed contracts." Mr. Shepherd said he thought some sort of demonstration ought to be required where, the rate's not changing, but the asset performance would. Mr. Gorski stated that the basic question Mr. Shepherd is raising related to the definition of "crediting rate formula," i.e., whether the definition includes fully guaranteed contracts. Mr. Gorski said that, in his opinion, the definition is broad enough to encompass those contracts. Ms. Klebold noted that the definition of "contract value record" differentiates between the "crediting rate formula" and rates that are "declared at the inception of the contract and valid for the entire term of the contract." After a lengthy discussion, Mr. Shepherd agreed to work with Mr. Brown in developing language that clearly includes fully guaranteed contracts within the scope of Section 5E(g).

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

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ATTACHMENT NINE-G1

To: Mark Peavy (NAIC/SSO)
From: Michael A. Cioffi, Valuation Actuary, Diversified Financial Products, Inc.
Date: Jan. 30, 1998
Re: Comments with Respect to Synthetic Guaranteed Investment Contract Model Regulation

We believe the NAIC Synthetic Guaranteed Investment Contracts Model Regulation will provide the insurance department of each state with a very comprehensive regulation which will describe in unprecedented detail the requirements and operation of Synthetic GICs. As a major underwriter of Synthetic GIC contracts with substantial experience since 1991, we request that serious consideration be given to three issues which we believe are not fully addressed in the model regulation.

The first involves the Plan of Operation. Unlike specific contract coverage requirements, which may vary from state to state, the Plan of Operation should be a document describing in detail how an insurer manages their operations. There should not be conflicting state-by-state requirements related to these operational characteristics. For example, the procedures related to determining Fair Market Valuations (Section 5(e)(4)) and how investments reflect provision for benefits (Section 5(e)(6)) should be uniformly applied for all business.

The Model Regulation establishes the responsibility for this to the state of domicile. However, for an insurer in a state which has not yet adopted the Model Regulation or for an insurer in a state which does not believe it is necessary to adopt the Model Regulation (since many states view a Synthetic GIC as simply a Group Annuity Contract), the insurer may be required to have the Plan of Operation approved in many states. When the individual states disagree on required operational parameters, this leads to inconsistency of application and an undue competitive burden placed on such companies.

We believe that the insurer's domestic state should have sole authority in approving a Plan of Operation. It is reasonable that other states may request this document for informational purposes. In the situation where the state of domicile does not require a Plan of Operation then one may be requested for informational purposes by any of the states which have adopted the Model Regulation.

The second issue is our concern over the time frame for implementation and the lack of assurance that we will not be prohibited from continuing with our business operations in the interim. There should be an allowable time period during which the companies currently issuing synthetic GICs on forms previously approved can continue to do business while providing the necessary time for refiling <u>and</u> state approval of the new standards. To force companies to discontinue operations as a result of a change in regulation solely would create an enormous hardship and greatly damage existing business relationships.

The third issue not fully addressed by the model regulation is the issue of allowable variability in the contract. As is commonly known, the group annuity business requires the customization of its coverage and administrative characteristics around the operation of the underlying plan and investment program. One of the primary purposes of the Plan of Operation is to provide additional information about the business operation and the range and variances of the contract terms. This should provide sufficient comfort with respect to variability.

The proposed NAIC Synthetic GIC Regulation is thorough and reasonable with respect to issues regarding reserves, essential operating features, and required contract provisions and should provide the insurance department of each state with sufficient comfort with respect to synthetic GIC business. However, more consideration needs to be given to the issues surrounding the implementation requirements of the proposed regulation.

Thank you for the opportunity to present our comments.

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ATTACHMENT NINE-G2

To: Mark Peavy (NAIC/SSO)
From: Zahid Hussain, Vice President and Associate Actuary, Transamerica Asset Management
Date: Feb. 2, 1998
Re: Draft of Synthetic Guaranteed Investment Contracts Model Regulation

The following comments are submitted on behalf of Transamerica Life Insurance and Annuity Company. We appreciate the opportunity to provide these comments and hope that they will be considered timely enough for consideration by the Life Disclosure Working Group. In general, we believe this model regulation is a good step forward in the process of regulating synthetic GICs and is fair and reasonable with respect to such matters as reserves. There are, however, a couple of provisions in the model regulation which we believe need to be revised to make this regulation more useful to customers, issuers and regulators alike.

Our concerns relate mainly to the filing requirements that are imposed by this regulation on insurance companies. Although this business generally involves relatively few risks, it is proper and necessary to make sure that the issuers are setting aside enough reserves and capital to support the business and not jeopardize their financial safety. As such, we support the reserving requirements outlined in the regulation and the capital standards that have been adopted for 1997.

Insurance companies compete mostly against banks in this market. Bank regulators do not require each contract to be filed and concentrate their energies on making sure that the process in place at the bank prevents arrangements that are financially unsound. In addition, adequate reserves need to be set up. We believe insurance regulations should do the same; that is, concentrate on the financial aspects of the transaction to make sure adequate financial mechanisms are in place. Under such a regulatory structure, there would be no need to delay the transactions by a lengthy filing process which is costly to the customer, the insurer and the department of insurance.

1) Filing the plan of operations: We acknowledge that insurance companies should prepare a plan of operation and file it with the state that is regulating their solvency. The model regulation establishes the responsibility for this to the insurer's state of domicile. However, this filing requirement can be extended to include other states if the domiciliary state has not adopted the model regulation for one reason or another. This imposes a significant regulatory burden on many companies. Moreover, conflicting requirements from state to state would be impossible for the insurer to reconcile.

We believe that the insurer's domestic state should have the sole authority in approving a Plan of Operation. Other states may request the document for informational purposes but should not be able to require changes in the document.

2) Filing Requirements for Contracts: One of the distinguishing features of the market is the large size of transactions and the customizing that is required for each transaction. These contracts are negotiated individually with each side represented by their own counsel. As such, the contracts are fair and represent two knowledgeable parties agreeing to what they consider to be a financially advantageous transaction for themselves. Given that contracts are being reserved for adequately and that the arrangement is between two sophisticated parties, the case for requiring each contract to be filed is difficult to understand. At a minimum the regulation should give considerable leeway in customizing contracts if a template is required to be filed. The contract filing requirement imposes a significant competitive burden on insurance companies as the insurance industry is unable to produce contracts for execution as quickly as our competitors. Requiring the lengthy filings hurts the insurance companies and the customers since they have to face the delay in finalizing their contracts and obtaining a final contract in the form which was negotiated.

The stable value industry has been dominated by insurance companies since its inception. The regulatory difficulties faced by the insurance industry has pushed it out of synthetic GICs which would have been a very natural and profitable market for them. Today, there are only two or three insurers among the 10 largest providers of synthetic GICs.

The proposed model regulation is a sound beginning for regulating synthetic GICs. However, consideration must be given to the competitive landscape and in making the playing field as level as possible. Specifically, the regulation should not require the filing of contracts for approval as long as the contracts comply with the model regulation. Similarly, the Plan of Operations should be approved only by the state of domicile and not by each individual state.

Again, we appreciate the opportunity to provide these comments. We would be happy to discuss these concerns further, or work with regulators on specific changes to the draft regulation which could implement these comments.

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ATTACHMENT NINE-G3

To: Carolyn Johnson (NAIC/SSO)
From: Lynda Klebold, Chief, Life Bureau (N.J.)
Date: Feb. 4, 1998
Re: Synthetic Guaranteed Investment Contract Model Regulation

Receipt of the comments from other interested parties has prompted me to revisit the model regulation. I submit the following comments:

1. At Section 3. Scope and Application, at the second sentence, I recall the proposed wording to be "reference" as opposed to "be referenced to" in this section. In any, event, it appears that whatever wording is agreed upon must also be carried over to the definition of Crediting Rate Formula in subsection C of Section 4.

2. I have been somewhat uncomfortable with the wording at subsection a(ii) of Section 5 dealing with the financial qualifications of the insurer. I recommend this subsection be worded similar to "(ii) it satisfies such other financial qualification requirements as set forth by the commissioner deemed necessary in a particular case to protect the insurer's policyholders and the public." The source of the recommended wording is our regulation on hazardous financial conditions.

3. I am also uncomfortable with the discretion allowed the commissioner at subsection C(2) of Section 5. I recommend adding wording so the subsection reads similar to "at the discretion of the Commissioner if, in his opinion, the filing and approval is not desirable or necessary for the protection of the public." The source of this wording is our filing statute which allows the commissioner to exempt from filing certain forms.

Comments 2 and 3 are in reaction to the challenge I would expect to receive from our deputy attorney general reacting to the somewhat arbitrary nature of the original wording.

Many thanks.

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ATTACHMENT NINE-G4

To: Mark Peavy, Life/Health Actuary, NAIC
From: Blaine Shepherd, Valuation Actuary (Minn.)
Date: Jan. 28, 1998
Re: Comments on Draft of Synthetic Guaranteed Investment Contract Model Regulation

As discussed at the meeting of the Synthetic GIC Working Group in December, I am forwarding these comments on the draft model. The version I am working from in submitting these comments is the one sent to Larry Gorski on Nov. 26, 1997, by Brian Haendiges.

Before commenting on specific sections of the draft, I would like to expand on an observation I have made verbally a couple of times previously. In the model draft, the crediting rate formula and many related sections provide in some circumstances that crediting rates will be adjusted over time to ensure with some certainty that the contract value record will not stray too far from the market value record. In essence this limits the potential for the insurer to be required to make a payment under its book value guarantee (i.e., the insurer's risk is limited if market is close to or in excess of book). It should be noted, however, that the model regulation draft also permits a pure GIC-like structure, i.e., a single fixed guaranteed interest rate and a scheduled maturity, without any possibility to make rate adjustments because of diverging contract and market values.

At the time Minnesota was developing its synthetic GIC bulletin, there were assurances that synthetics were a relatively low risk product for the insurer and, further, that in a significant way this was because of the crediting rate adjustment feature. With this in mind we concluded that a fully guaranteed contract structure, in conjunction with assets not owned by the insurer, was a somewhat more risky undertaking. As a result our bulletin effectively requires that interest rate reset features be present in the contract if there is a fixed maturity date.

While this draft model regulation contains detailed reserving provisions based on market/present values, and many other provisions which we favor, we are concerned that the plan of operations might be deficient as it relates to gauging the risks to the insurer's general account in the instance of a fully guaranteed contract.

This concern with respect to fully guaranteed contracts is reflected in the second point below. The following are our suggestions on specific sections of the current draft:

1. In Section 5A there are capital letters on "risk-based" and "level of action" which should be removed; alternatively definitions could be developed.

2. Paragraph (7) in Section 5E of the draft pertains to the crediting rate formula "...and how it will operate to take into account differences between the Market Value and Contract Value Records, including a demonstration..." The wording goes on to discuss hypothetical return scenarios, etc., all having to do with enabling the regulator through a demonstration by the company "...to fully understand the risks under the Contract." However, we would submit that in all likelihood any such demonstration (i.e., quantification of risk under the contract) would not even be required for a fully guaranteed contract, because of the absence of a crediting rate formula. Thus, it would seem that for what could be the riskiest form of synthetic GIC, the current draft wording would not require that any information be provided to the regulator to facilitate an understanding of the risks. If this is true, we believe this is an area that needs direct attention in the draft. Any wording pertaining to demonstrations, changing investment returns, understanding of risks, etc., should apply to all contracts, not just those where a crediting rate formula exists and rate adjustments take place. Proper recognition and quantification of the risk element is crucial both to the general account of the company and to the actuary making the certification under paragraph (12) of this same section.

3. It would seem as though the wording "...or one or more separate accounts, as appropriate,..." in Section 10A(l) could be deleted. Why would there ever need to be a separate account established to hold reserves for a synthetic GIC? Similarly, it would seem that paragraph (5) in that same subsection could be deleted in its entirety. Both of these references may actually relate to the guaranteed separate account model regulation currently being developed.

4. Section 10A(6) I think should read, "...Plan of Operation (pursuant to Section 5E or the Actuarial Opinion and Memorandum,..." and the wording three lines down could be changed from "...for thirty additional years..." to "...from year thirty to the date of valuation..." The draft wording in the second case has been a source of confusion in some of the meetings I have attended.

5 Per our discussion in Seattle, I would offer the following wording for Section l0B(4)(i):

> (i) substantially conform with those portions of Section [insert regulatory reference to actuarial opinion and memorandum regulation] of these regulations that are applicable to asset adequacy testing and either (1) demonstrate the sufficiency of account assets based upon cash flow analysis, or (2) explain why cash flow analysis is not appropriate, describe the alternative methodology of asset adequacy testing used, and demonstrate the sufficiency of account assets under such methodology,

5. In Section 10C there is a reference to "...such assets..." which perhaps should be clarified to specify that the assets are those held by the insurer to meet the Asset Maintenance Requirements.

6. In Section 10D(2) I do not see the need for subparagraph (i), as it would not seem appropriate that additional reserves for a synthetic GIC should ever be established in a separate account.

Please forward these comments to the appropriate parties. Feel free to call me if you have any questions.

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ATTACHMENT TEN

Life Insurance (A) Committee
Conference Calls
Feb. 13, March 4 and March 9, 1998

The Life Insurance (A) Committee met by conference call on Feb. 13, 1998. Commissioner Terri Vaughan (Iowa) chaired the meeting. The following members or their representatives participated: Neil D. Levin, Vice Chair represented by Martin Carus and Rick Morse (N.Y.); Patrick E. Kelly represented by Lee McClellan (D.C.); James H. Brown represented by Lester Dunlap (La.); Linda Ruthardt represented by Cindy Martin (Mass.); Mark O'Keefe represented by Frank Cote (Mont.); Chris P. Krahling represented by Jerry Fickes (N.M.); John Crawford represented by Dan Keating (Okla.); and Lee Jedziniak represented by Leslie Jones (S.C.).

1. Appoint Working Groups

Commissioner Terri Vaughan proposed appointment of working groups and assignments to complete the 1998 charges. She asked if any states were interested in being added to any of the working groups. Dan Keating (Okla.) asked that Oklahoma be added to the Life Disclosure Working Group. Cindy Martin (Mass.) asked that Massachusetts also be added to that working group.

Commissioner Vaughan noted that a number of charges had not been assigned to a working group and asked the group to review those. She said the first charge was appropriate for the Replacement Issues Working Group and suggested that this charge not be dealt with until after the Replacement Issues Working Group is finished with a new Life Insurance and Annuities Replacement Model Regulation.

The second charge that was not assigned was in regard to sales of equity indexed products. Commissioner Vaughan proposed creation of a new working group to address those issues. She appointed New Mexico to chair that committee, with Jerry Fickes and Mike Batte sharing that responsibility. She asked for other states that were interested in participating in the working group. Iowa, Louisiana, Montana, Oklahoma and South Carolina asked to be members of the working group. Commissioner Vaughan instructed Carolyn Johnson (NAIC/SSO) to invite other states to participate in the group via the NAIC E-News.

The third charge that had not been assigned was related to the question and answer document developed by the Life and Health Actuarial (Technical) Task Force. Depending on what happens with the Codification project, this charge may no longer be necessary, so Commissioner Vaughan suggested postponing action on that until the progress of Codification becomes clear. The next two charges on the list are ongoing projects that will be dealt with by the Life Insurance (A) Committee. Commissioner Vaughan noted that the last charge on the A Committee's list is related to the other subject of the conference call, the Department of Labor (DOL) proposed regulations.

Leslie Jones (S.C.) moved and Mr. Keating seconded a motion to appoint the working groups as outlined by Commissioner Vaughan. The motion passed (Attachment Ten-A).

2. Comment on Proposed DOL Regulations

Commissioner Vaughan said she had called Superintendent Neil Levin (N.Y.) and asked if Rick Morse (N.Y.) could assist the A Committee in the response to the Department of Labor (DOL). She said Mr. Morse was one of the most knowledgeable regulators in this area. She asked Mr. Morse to summarize the issues before the A Committee. Mr. Morse said the issue really began in 1983 about the same time as New York started on development of its Regulation 139. He noted that the DOL regulation relies on certain portions of that New York regulation. Mr. Morse said New York's Regulation 139 was actually promulgated in 1989 and in 1993 the Supreme Court rendered its decision in *John Hancock Mutual Life Ins. Co. v. Harris Trust & Sav. Bank (Harris Trust)*. He noted that both the states of New York and Massachusetts submitted briefs to the Supreme Court on the *Harris Trust* case. The result of the Supreme Court ruling was a position that an insurer acts as a fiduciary with respect to the management and disposition of assets in its general account that are being held for the benefit of Employee Retirement Income Security Act (ERISA) policyholders. Mr. Morse said that in effect, this divides the general account into two parts. The Supreme Court ruling effectively made this position retroactive to the beginning of ERISA in 1975. Because of the retroactive effect of the Supreme Court decision, the insurance industry went to Congress and requested legislation to assist in the interpretation of this case. Congress adopted a law in 1996 that requires the DOL to develop regulations to clarify insurance company responsibilities. Mr. Morse noted that these draft regulations were to be released in June 1997 and final by the end of 1997, but they were released just before the end of 1997.

Mr. Morse outlined several major problems he sees in the proposed regulations: 1) there is a mandated five-year book value payout with only a 1% reduction when a lump sum payment is requested; 2) an insurer initiating any change must give notice and the plan sponsor can initiate termination; 3) the level of disclosure required may result in the release of proprietary information by the insurer; and 4) the disclosures required may increase the insurer's operating costs. Mr. Morse noted that the effective dates seemed to be sooner than the 18 months required by statute.

Commissioner Vaughan asked Mr. Morse to go over these points individually and asked for comment on them one at a time. Mr. Morse said the five-year book value payment of all unallocated amounts in the cumulation fund was retroactive to cover any contract issued since 1975. The regulations requires a 40% payment in 366 days, and this may create a problem because an insurer's assets backing the contract would generally be long-term, illiquid assets. Real estate and similar assets would be difficult to liquidate to meet the 40% cash demand at book value. He suggested this would result in a complete realignment of an insurer's portfolio. He also pointed out that a state court could not use a moratorium in a rehabilitation of the insurer because of the supremacy clause. Steve Kraus (American Council of Life Insurance—ACLI) said the regulation even goes beyond giving a five-year book out. He noted that the plan can also select a market value option to cash out. Mr. Morse said that New York's Regulation 139 allows a downward market value adjustment, but no upward adjustment, and this regulation allows for an upward adjustment also. He noted that if interests rates are going down the new money rate will be lower than the portfolio rate and that would increase antiselection and disintermediation. He suggested that non-ERISA policyholders would subsidize ERISA plans. He said the right of an ERISA plan to pull out at any time compounds the adverse effect on non-ERISA policyholders. He said that large plan sponsors would want to take advantage of the market and pull out of the plan and pocket the excess. Mr. Kraus agreed that this provision would be detrimental to all but very large sophisticated plans. Mr. Morse also noted that a real problem is that this applies retroactively to 1975.

Commissioner Vaughan said it sounds like it is important for the NAIC to comments on these regulations. She asked if there were any other areas with a potential conflict with state laws.

Mr. Morse agreed that this regulation does invade the sanctum of state regulation. He noted there are other areas that affect how a company does business, such as the tax laws, but this goes to the extreme because it is not prospective. He suggested this proposed regulation crosses the line to not allow states to carry out their functions. He also noted that the DOL has arguably exceeded the law's mandate. Commissioner Vaughan asked for an example of that. Mr. Morse responded that the book value payouts are not included in the statute. Commissioner Vaughan asked if the NAIC should take a position that the mandated book value payout should not be required. She asked if a five-year payout period was too short. Mr. Morse said that it should not be effective if a company is under court supervision or liquidation.

Mr. Kraus said the ACLI had prepared a sample regulation for the DOL's consideration and the ACLI draft suggested a 10-year book out and a negative market value adjustment. He noted also that the DOL regulation broadly defines an insurer-initiated amendment. He suggested that also went beyond the statutory authority.

Commissioner Vaughan said the DOL materials state that ERISA contracts are less than 3% of the average insurer's general account, so it did not appear there would be much affect. She noted that even if 3% is an average, it would be significantly more for some companies. Mr. Kraus opined that some were assuming incorrectly that it only applies to the type of contracts in the *Harris Trust* case. He noted that the DOL refused to define a "guaranteed benefit contract." If a company cannot decide if a particular contract is a guaranteed benefit policy, it will take a conservative approach and assume that it is.

Commissioner Vaughan asked if the NAIC should comment on the disclosure requirements. She asked if they were overly burdensome or required the disclosure of proprietary information. Mr. Kraus said the DOL regulation took what New York requires in its Regulation 139 and went far beyond that requirement. He also pointed out that some of the information required, such as actuarial opinions and risk-based capital information, could be misused. Ms. Martin opined that the language in the regulation is so broadly stated that a company would not know if it were in compliance unless it described everything. She asked if there was an alternative to suggest to the DOL. Mr. Kraus responded that New York's Regulation 139 is much easier because companies understand what it means. He suggested that the requirements of the proposed DOL regulation ask for much more than is required of other financial entities. He suggested that the perception of the DOL is that one contractholder is preferred over another, and everything should be disclosed so that there will be no preference.

Commissioner Vaughan noted that a comment letter to the DOL is due by March 23, 1998. She asked Mr. Morse and Ms. Johnson to work on drafting a comment letter and schedule a second conference call of the Life Insurance (A) Committee on March 4 to review that draft.

Marty Carus (N.Y.) suggested that the comment letter should be philosophically from a regulatory perspective. He said regulators do not want to be seen as a stalking horse for the industry. He said it was appropriate to focus on regulatory concerns. Commissioner Vaughan agreed and said she thought that had been everyone's perception from the beginning.

Having no further business, the Life Insurance (A) Committee adjourned and reconvened March 4, 1998, to review the first draft of the DOL comment letter.

Commissioner Vaughan summarized the four main points made in the letter and said she had studied the second paragraph for a long time and suggested that the group discuss that at length. Ms. Martin agreed that this was the most difficult paragraph of the letter to understand. She said it seemed to cover several different issues. Mr. Morse explained that this paragraph sets the stage. Paragraph (g) is the "prudence rule" that applies up until December 1998. It is not complete relief, although significant. Mr. Morse said that many companies would want to qualify for Paragraphs (b) to (f) rather than relying solely on Paragraph (g). He said Paragraph (g) creates a greater litigation exposure. Ms. Martin asked why there was only indirect reference to the fact that there was no definition of a guaranteed investment contract and Mr. Morse responded that the DOL could have created such a definition long ago if it wanted to, but did not. He suggested the A Committee would be spinning its wheels to talk about that issue here. Ms. Martin asked about the relief provided by Paragraph (g) and Mr. Morse explained that qualification under this subsection allows the company to manage the assets behind the contracts, taking into consideration all the assets in the general account. Commissioner Vaughan noted that if the assets are considered plan assets, they must be managed for the benefit of the ERISA plans, and the insurer is subjected to other fiduciary responsibility. She suggested that the paragraph be divided into two because it actually contains two major points. Mr. Carus pointed out that the language of Paragraph (g) ameliorates the conflict caused by the *Harris Trust* case but does not do it very well. Mr. Morse said that is the thrust of the rest of the letter. Mr. Kraus said that, if the provisions of Paragraphs (b) through (f) are met, the plan assets are eliminated from the general account. He noted that the statutory language says nothing about imposing additional requirements on transition contracts, so the DOL regulations go farther than the statute. Mr. Fickes suggested that perhaps the drafter was trying to be too nice in this paragraph. He said there are too many "may be..." or "appears to...." Commissioner Vaughan questioned the sentence that said a company will *need to* do what is necessary so that no plan assets are in the general account. She asked if that should perhaps say "typically seek to." Mr. Kraus responded that every company will seek to be in a position of having no plan assets in the general account because of the litigation exposure. Mr. Morse said that he would redraft this paragraph to divide it into two paragraphs and to add some language dealing with the facts that other ERISA standards will cause these to be viewed as general account assets. Mr. Carus questioned the last sentence of the second paragraph and asked why regulators would care. Mr. Morse responded that they would not be able to regulate properly. Commissioner Vaughan suggested that this sentence is the setup for points 1 through 4 that follow. Ms. Martin suggested that this paragraph also have a heading such as "Introduction."

Commissioner Vaughan asked the members of the committee to turn to the paragraph headed, "The proposed rules may preempt state rehabilitation and liquidation plans." Mr. Fickes said the fourth line of this paragraph talks only about the moratorium on the Mutual Benefit Life rehabilitation and suggested there were many rehabilitations with moratoriums. He also suggested adding higher yield bonds and depressed stocks to the list of depressed assets. Mr. Morse responded that he had mentioned Mutual Benefit Life because it had a significant pension business and questioned mentioning the higher risk bonds because the DOL might respond with the question, "Why don't regulators address the problem of companies having too many junk bonds?" Mr. Carus agreed that regulators did not want to present examples that would be detrimental and suggested making the paragraph read "...severely depressed assets such as bonds, real estate holdings and mortgages...." Commissioner Vaughan said she thought this paragraph was strongly worded and appropriately so.

Commissioner Vaughan asked the group to consider the section entitled "The shortened duration of investments for asset matching will likely result in lower returns for contractholders." Mr. Fickes noted that this paragraph mentions the regulators' concern about the duration of the assets, but he noted that longer duration obligations are actually good for the entire economy. Mr. Morse opined that the DOL has gone overboard in giving other financial instruments broad relief from ERISA but not the insurance industry. He suggested there was a bias somewhere in the agency and expressed concern that an argument such as this could be turned against insurance regulators. He suggested the DOL would say regulators are crying because the insurance industry is not competitive with other industries. Mr. Carus cautioned that the regulators document should not argue for the industry that their profit margin would go down. Mr. Kraus responded that a competitive marketplace is good for everyone. Mr. Carus said that is an argument for the industry to make and said regulators need to stick to the regulatory perspective. Commissioner Vaughan said she understood from the comments that regulators did not want to talk about the competitiveness of the industry and asked if the point made by Mr. Fickes should be expressed in this document. Mr. Carus suggested that the document should be narrowly focused and he was opposed to bringing in that issue.

Ms. Martin said this paragraph seemed to contain two ideas and suggested that it should be restructured.

Mr. Carus asked for clarification of the suggestion in this paragraph for the five-year interim period. He asked if the document was suggesting that the payouts could be expanded to 10 years or to 15? Mr. Morse responded that the idea was that during the five-year interim period, companies could move assets so that they could meet the DOL requirements in the current rule by the end of that period. Mr. Carus asked what would be more appealing to the DOL: a 10-year bookout period, or a five-year moratorium and then their five-year bookout period. Commissioner Vaughan said she heard regulators concerns on the last call that the problem was that 40% of the contract would be due in 366 days, which would require a great deal of restructuring of company assets. Mr. Morse said this five-year moratorium would allow companies time to realign their assets. Commissioner Vaughan said she thought the proposal in the letter was a midpoint, and was better than requiring only a five-year payout.

Mr. Kraus said regulators should take into account that the regulation as written now gives pension plans three choices and they can pick the one that is in their best interest: 1) the contractual provisions; 2) a five-year bookout; or 3) a market value adjustment. He suggested that a requirement to offer even more options would seem to exacerbate the problem of disintermediation. Commissioner Vaughan responded that the problem of the book value payout would be less if it was over a 10-year period; there would be less disintermediation. Mr. Kraus responded that he did not believe the DOL would buy that argument. He said the DOL's feeling is that plans are locked into contracts and changing from five years to 10 would not meet the DOL's goal. Mr. Carus said this provision causes regulators concern because of solvency issues and he suggested this paragraph needed to say more about the solvency concerns of regulators. Commissioner Vaughan said the DOL has already discounted the idea that disintermediation will be a problem when it said ERISA assets are only 3% of company assets. She asked where that 3% figure came from. Mr. Carus responded that the 3% of assets was a DOL statistic and said that what was really important was the percentage of surplus, and he suggested it could be as much as 50% of surplus. Ms. Martin asked if the ACLI was preparing numbers to refute the position of the DOL. Mr. Kraus pointed out that another problem is that the DOL thinks that only group annuities of the type in the *Harris Trust* case are the ones that will be affected, and that is just not correct. Mr. Carus suggested inserting in this paragraph a stronger statement of the concerns regarding the financial solvency of companies because the ERISA contracts represent a huge chunk of surplus. Commissioner Vaughan suggested dividing this into two sections; first a discussion of the disintermediation problem and then the remaining points about asset matching. Ms. Martin said this section really brings in both the solvency and the market conduct issues and suggested that all of the current language could be included with very little redrafting.

Commissioner Vaughan asked if everyone was comfortable with the five-year interim period as opposed to a 10-year bookout. Mr. Carus suggested taking out the option in the last sentence to offer at least a five-year installment book value plan. Commissioner Vaughan disagreed. She said there are actually several options 1) the DOL draft with its five-year payout; 2) the 10-year period the regulators had discussed at the last conference call; 3) a five-year moratorium and then after five years the offer of options, one of which must be five years and others could be longer period with a higher crediting rate; or 4) a five-year moratorium and then five years and a shorter payout option. Commissioner Vaughan said she thought it made more sense to have options and to give an opportunity for a better rate with a longer payout. The regulators agreed to take out the phrase "at least" so that the document now reads "...each insurer will be required to offer a five year installment book value payout...."

Commissioner Vaughan asked the regulators to consider the paragraph with the heading "An upward and downward market value adjustment will encourage disintermediation." She asked if this paragraph on disintermediation should be placed before the previous paragraph as part of the reorganization. Mr. Morse said he was more inclined to leave it here because it was not as closely related to the issue of solvency. Commissioner Vaughan asked if this paragraph needed to be strengthened or if it made its points as strongly as possible. Ms. Jones suggested adding to the heading "which usually has an adverse impact on persisting policyholders" to highlight the main point of the paragraph. The committee agreed to make that change but to leave the rest of the paragraph as it is.

Commissioner Vaughan asked if there were any comments on the paragraph headed "The Actuarial Opinion and Memorandum should be allowed to remain confidential." She asked if the American Academy of Actuaries (AAA) would be filing comments on this issue and Mr. Kraus responded that the AAA will file a comment letter on this point. Mr. Fickes said the AAA strongly believes the actuarial opinion should not be public information.

Commissioner Vaughan asked if there were any other issues that should be included in the NAIC letter. She asked if timing of this process was of concern. She said it could be a massive amount of work for insurance departments when this takes effect because there will be many filings. She asked if anyone had an analysis of the work facing the insurance departments. Mr. Morse said the states were preempted from refusing to approve the contracts, and would just rubber stamp them so the time commitment was really not that great.

Commissioner Vaughan suggested having another conference call of the committee to review a revised draft so that this would be ready to approve at the Spring National Meeting in Salt Lake City. She scheduled a third conference call on the issue for March 9. Commissioner Vaughan asked Ms. Johnson to draft a closing paragraph for the committee's review.

Having no further business the Life Insurance (A) Committee adjourned and reconvened March 9, 1998, to review the revised draft.

Commissioner Vaughan asked if there were any comments on the first paragraph. Ms. Martin suggested adding some language saying the NAIC wanted to work with the DOL, so that the document does not seem so adversarial in nature. Mr. Carus suggested adding in that same paragraph a summary of the major ways the NAIC coordinates the activities of state regulators.

Commissioner Vaughan asked if there were comments on Section II. Ms. Martin said it was not clear whether the concerns raised related to an insolvency would apply even if the DOL accepted the other suggestions in the letter. The committee agreed to revise the letter to make clear that preemption would still be a concern.

Commissioner Vaughan asked for comments on the other paragraphs in the letter and received several suggestions for clarifying language. She instructed Ms. Johnson to make the changes agreed upon for final review by the Life Insurance (A) Committee at the Spring National Meeting.

Having no further business, the Life Insurance (A) Committee adjourned at 2:30 p.m.

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ATTACHMENT TEN-A

Life Insurance (A) Committee
1998 Working Groups And Charges

Charges not assigned:

- 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.

- 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.

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

- 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.

- Analyze the regulation proposed by the U.S. Department of Labor to set standards for insurance policies and contracts that will be deemed to be in compliance with the fiduciary standards of ERISA, coordinate with committees analyzing similar issues, and provide comment.

Life Disclosure Working Group:

Tom Foley, Chair	North Dakota
John Hartnedy	Arkansas
Sheldon Summers	California
Frank Dino	Florida
Roger Strauss	Iowa
Lester Dunlap	Louisiana
Cindy Martin	Massachusetts
Paul DeAngelo	New Jersey
Jerry Fickes	New Mexico
Tom Jacks	North Carolina
Dan Keating	Oklahoma
Ted Becker	Texas

Charges:

- Complete development of Annuities Disclosure and Sales Illustrations Model Regulation, including Buyer's Guide/disclosure documents. Complete by Fall National Meeting. Approximate cost is $2,500.

- Review Life Insurance Illustrations Model Regulation for possible changes necessitated by development of equity indexed life insurance products and state experience in implementing the model. Complete by Winter National Meeting. Approximate cost will be $1,500.

- 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.

- Review other NAIC models for potential conflicts with the Life Insurance Illustrations Model Regulation. Identify areas for change and begin amendment process by Winter National Meeting. Anticipate no additional cost.

Replacement Issues Working Group:

Paul DeAngelo, Chair	New Jersey
Erin Klug	Arizona
Richard Rogers	Illinois
Rosanne Mead	Iowa
Lester Dunlap	Louisiana
Cindy Martin	Massachusetts
Robert Commodore	Minnesota
Cindy Amann	Missouri
Louis Belo	North Carolina
Phil Bisesi	Ohio
Joel Ario	Oregon
Ted Becker	Texas
Tom Van Cooper	Vermont

Charges:

- 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 recommendations to deal with issues of agent compensation and using policy values for financing. Complete by Fall National Meeting. Approximate cost will be $3,500.

Synthetic GIC Working Group:

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

Charges:

- 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.

Viatical Settlements Working Group:

Lester Dunlap, Chair	Louisiana
Michael Bownes	Alabama
Mae Gabor	Alaska
Gregory Y. Harris	Arizona
Kevin McCarty	Florida
Ron Kotowski	Illinois
Marlyn Burch	Kansas
Rick Diamond	Maine
Tom Jacks	North Carolina
Tom Foley	North Dakota
Dan Keating	Oklahoma
Joel Ario	Oregon
Rhonda Myron	Texas

Charges:

- 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.

Equity Indexed Products Working Group:

Jerry Fickes/Mike Batte	New Mexico
Roger Strauss	Iowa
Lester Dunlap	Louisiana
Frank Cote	Montana
Dan Keating	Oklahoma
Leslie Jones	South Carolina

- 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.