

## LIFE INSURANCE AND ANNUITIES (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 and Annuities (A) Committee met in the Riverside Ballroom of the Sheraton New York Hotel & Towers in New York, N.Y., at 9 a.m. on Sept. 16, 1998. A quorum was present and Terri Vaughan (Iowa) chaired the meeting. The following committee members or their representatives were present: Marty Carus representing Neil D. Levin, Vice Chair, (N.Y.); Clark Simcock representing Patrick E. Kelly (D.C.); Cindy Martin representing Linda Ruthardt (Mass.); Mike Batte representing Chris P. Krahling (N.M.); Dan Keating representing John Crawford (Okla.); and Leslie Jones representing Lee P. Jedziniak (S.C.).

#### 1. Report of Viatical Settlements Working Group

Dan Keating (Okla.), reporting for Lester Dunlap (La.), said the working group continues to review the Viatical Settlements Model Regulation and made two significant changes to the draft at its New York meeting. A new Section 10 and forms were added to regulate the interaction between viatical settlement providers and life insurance companies. In addition, the viatical settlement industry recommended a revised Section 6 containing reporting requirements. The two new sections will be reviewed further by the working group at its next meeting. Mr. Keating said the working group meeting was dominated by a more general discussion about the viatical settlement market. Mr. Keating moved and Leslie Jones (S.C.) seconded a motion to receive the report of the Viatical Settlements Working Group (Attachment One). The motion passed.

Tom Foley (N.D.) said he would like to present the North Dakota position. His commissioner is adamant about this issue and plans to write a paper that describes his position. In addition, Mr. Foley committed to prepare a redraft of the Viatical Settlements Model Regulation that represents the North Dakota position. Mr. Foley explained that when the viatical settlement industry began more than 10 years ago, all that happened was that a known death benefit was moved up a few months. He opined that this might not violate the basic principles of life insurance. However, the present activity runs the risk of significantly raising the cost of life insurance for everyone. Mr. Foley said the industry is now branching to people who are ill and even to well people. Regulators are starting to get evidence that some are encouraging people to buy insurance so that they can viaticate the policies.

Commissioner Terri Vaughan (Iowa) asked about the plan for resolving this debate. Mr. Foley responded that his sense is that the group will send a draft to the A Committee that is not unlike the draft now being reviewed. Marty Carus (N.Y.) opined that what we are now seeing is the ultimate securitization of people's lives. He opined that this issue requires considerable discussion and debate and may need to be debated at the A Committee or above because of the public policy issues. Mr. Carus said he helped draft the earlier version of the NAIC model and also was involved in developing the New York law. He opined that this type of market is not what regulators had in mind and this is the first he has heard of the expansion of the viatical settlement industry. Commissioner Vaughan asked if New York is part of the Viatical Settlements Working Group now and Mr. Carus responded no.

John Hartnedy (Ark.) said he has attended the Viatical Settlement Working Group meetings for the past year or so and he would like to point out that life insurance has changed radically over the years. He said the nonforfeiture laws and standard valuation law are being revised to allow for changes in the market place. He suggested letting the working group continue its process and then bringing the debate to the A Committee for airing. Commissioner Vaughan asked Mr. Hartnedy if he is suggesting a debate of both sides of the issue at the next A Committee meeting and Mr. Hartnedy responded in the affirmative. Commissioner Vaughan said that is a good idea and asked Carolyn Johnson (NAIC/SSO) to find a three-hour block of time at the Winter National Meeting to hold a hearing, perhaps on Saturday. Commissioner Vaughan asked Mr. Foley if he intends to make the North Dakota material widely available. He responded that a distribution could be made through the life insurance committee's interested parties list and the NAIC Internet site.

## 2. Report of Synthetic GIC Working Group

Commissioner Vaughan noted that a written report from Mr. Gorski is Attachment Two and she asked if there were any questions. Hearing no questions, Mr. Carus moved and Ms. Jones seconded a motion to receive the report of the Synthetic GIC Working Group. The motion passed.

## 3. Report of Equity-Indexed Products Working Group

Mike Batte (N.M.) said the working group had three items on its agenda. First, it discussed the possibility of changes to the *Market Conduct Examiners Handbook*. After review of the handbook, the working group decided the language is adequate to cover equity-indexed products because it is written very broadly. The second area, upon which the working group has not yet reached consensus, is what type of agent training is appropriate for equity-indexed products. This discussion will continue at the Winter National Meeting. The third issue on the working group's agenda was to consider guaranty fund issues. The Guaranty Fund Issues Working Group of the Insolvency (EX5) Subcommittee is considering this issue and will make recommendations to the Equity-Indexed Products Working Group. Mr. Carus moved and Cindy Martin (Mass.) seconded a motion to receive the report of the Equity-Indexed Products Working Group.

Commissioner Vaughan asked if the working group considered whether the market conduct examiners have adequate training to review the company's materials. Mr. Batte responded that the working group had not talked about this issue. Mr. Carus said New York's Insurance Department has looked at this issue and the department does not think its examiners have the appropriate background. The department is trying to remedy this and Mr. Carus gave examples of the types of

information sources that the examiners are studying. Mr. Carus suggested that the group handling the *Market Conduct Examiners Handbook* should review this issue and see if examiner training is necessary.

Commissioner Vaughan said the question of product approval is important and asked if the working group intends to discuss those issues. Mr. Batte responded that the working group looked at guidelines being established in the states. A number of states look at the disclosures and the sales material and focus on how the company advertises. Some look also at the agent's training materials. Commissioner Vaughan said she raises the question because the product approval process also raises issues of insurance department education and expertise. Mr. Carus opined that insurance department staff also needs expertise in the capital markets. To invest properly for equity-indexed products, a company needs to use derivatives and other hedging transactions. Commissioner Vaughan responded that this would be included in a financial examination and asked if the Financial Condition (EX4) Subcommittee is looking at this issue. Mr. Carus responded that he is not aware of such a charge and pointed out that in New York the examinations for market conduct and financial issues are combined. Commissioner Vaughan asked Ms. Johnson to check whether any groups under EX4 are looking at these issues. The motion to receive the Equity-Indexed Products Working Group report passed (Attachment Three).

#### 4. Report of Life Disclosure Working Group

Mr. Foley said that he was delighted to report that the Life Disclosure Working Group has finalized the Deferred Annuities Buyer's Guide and is ready to have the A Committee adopt that. He explained that companies have been voluntarily using the Equity-Indexed Annuities Buyer's Guide and he encouraged companies to continue to do so through 1998. If the Executive and Plenary adopt the new guide in December, companies can begin using the new buyer's guide, which incorporates equity-indexed products, in 1999. In addition the Life Disclosure Working Group is nearly finished with the Annuity Disclosure Model Regulation. The one outstanding issue is delivery requirements for the buyer's guide. He said the working group intends to have a conference call in October to finalize that and will bring the model to the A Committee in December. At the Winter National Meeting Mr. Foley fully anticipates the working group will shift its focus to variable products and return to some remaining life insurance issues.

Ms. Jones moved and Mr. Keating seconded to adopt the Life Disclosure Working Group report. Ms. Martin offered an amendment to the buyer's guide to strike the comment about Massachusetts in the equity-indexed annuities portion. She asked if it is possible to strike that also from the Equity-Indexed Annuities Buyer's Guide already adopted by the NAIC. Commissioner Vaughan asked Ms. Johnson to get that item on the Executive Committee agenda. The motion to adopt the minutes of the Life Disclosure Working Group, including the amended buyer's guides passed (Attachment Four).

#### 5. Suitability Working Group

Mr. Carus reported for Paul DeAngelo (N.J.) that an organizational meeting of the working group took place. The group decided to write a white paper first to outline the issues and then it will decide if a model is desirable. Mr. Carus said New York is required by its legislature to address this issue and has already begun work. Mr. Carus offered to provide information to the working group, which will look also at case law and articles on the topic of suitability of life insurance sales. Mr. Carus moved and Ms. Jones seconded a motion to receive the Suitability Working Group report (Attachment Five). The motion passed.

#### 6. Report of Annuities Working Group

Mr. Batte said the group has completed its charge to make changes to the Charitable Gift Annuities Model Act that was returned to the A Committee in June. In addition the Executive Committee asked that consideration be given to development of an alternative model. This was developed by the working group and adopted at its meeting. In addition the working group requests that it be

disbanded because it has completed its charge. Mr. Batte moved and Ms. Martin seconded a motion to adopt the Annuities Working Group report (Attachment Six). The motion passed.

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

Mr. Foley said the task force is asking the Life Insurance and Annuities (A) Committee to adopt Actuarial Guidelines ZZZ at this meeting. The task force has been working on Guideline XXX, (Valuation of Life Insurance Policies Model Regulation). The task force has received extensive analysis and a slight redraft from an ad hoc industry group. The revised draft has the consensus of the insurance industry and regulators have only a few issues left to review. Mr. Foley said the target is to adopt the model by Oct. 1. He asked that the Life Insurance and Annuities (A) Committee plan a conference call in early October to adopt the model also. He said a key component of the consensus is that all states adopt this regulation on Jan. 1, 2000, and not before. To accomplish this goal, it is critical that the Executive Committee and Plenary adopt this model in December. Mr. Foley explained that the reason this issue is so important is because the 1980 Commissioners Standard Ordinary (CSO) table is still in use with its mortality rates that are significantly larger than now appropriate. The Life and Health Actuarial Task Force has asked the American Academy of Actuaries to begin work on a new table but that will not be in place for several years, so this regulation is important.

Commissioner Vaughan asked if this proposal has any Year 2000 implications and Mr. Foley responded that he did not believe so. Mr. Carus asked if this is the appropriate time to construct a new table and Mr. Foley responded that is done approximately every 20 years. Mr. Carus asked how long it would take to develop the table and Mr. Foley responded that he has heard estimates from six months to six years. The key is getting data from insurers. Commissioner Vaughan said she had already discussed this issue with Mr. Foley and asked Ms. Johnson to schedule a conference call of the Life Insurance and Annuities (A) Committee for the morning of Oct. 5 to adopt the model.

Ms. Jones moved and Mr. Batte seconded a motion to adopt the report of the Life and Health Actuarial Task Force. The motion passed.

8. Approve Market Share Reports for the Top 125 Life and Fraternal Insurance Groups and Companies by State

Commissioner Vaughan reminded the members of the committee that a draft of the market share report had been mailed for their review. The report needs to be adopted by the A Committee so the NAIC can publish it. Mr. Carus moved and Ms. Martin seconded a motion to adopt the market share report. The motion passed.

9. Letter from Commissioner Vaughan to State Regarding Contract Filings

Commissioner Vaughan drew the attention of the regulators and audience to a letter she wrote to the commissioners alerting them to the need to review contracts quickly once the *Harris Trust* regulations are adopted by the U.S. Department of Labor. Commissioner Vaughan said this issue was discussed at the Commissioners Roundtable also (Attachment Seven).

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

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ATTACHMENT ONE

Viatical Settlements Working Group  
New York, New York  
September 15, 1998

The Viatical Settlements Working Group of the Life Insurance and Annuities (A) Committee met in New York A of the Sheraton New York Hotel & Towers in New York, N.Y., at 8 a.m. on Sept. 15, 1998. Lester Dunlap (La.) chaired the meeting. The following working group members or their representatives were present: Kevin McCarty (Fla.); Robert Heisler (Ill.); Marilyn Burch (Kan.); Tom Jacks (N.C.); Tom Foley (N.D.); Dan Keating (Okla.); and Rhonda Myron (Texas).

# 1. Discuss Draft of Viatical Settlements Model Regulation

Lester Dunlap (La.) asked the working group to review the drafting note at the end of Section 11 of the Viatical Settlement Model Regulation (Attachment One-A). He said it had been pointed out to him that this drafting note is probably not an appropriate addition to the model, since it actually delays the effective date of the regulation and it would be important to have the regulation effective as quickly as possible. The working group agreed to delete the drafting note that was added at the interim meeting in August in Kansas City.

Mr. Dunlap said the technical resource advisors from the viatical settlement industry and the insurance industry have submitted a draft recommendation for Section 10 of the model regulation on insurer responsibilities and have submitted two forms to be used to verify policy information. Doug Head (Medical Escrow Society), representing the Viatical Association of America (VAA), said the two groups met yesterday for several hours to iron out their differences and recommend two standardized forms, one for group and one for individual, as appendices to the model. He said the recommended regulation language has been agreed to by both groups. It sets a timely response and prohibits exorbitant fees for filling out the form. George Coleman (Prudential) confirmed that the representatives from the insurance industry feel the document contains the protection the insurers need and they are in agreement with the recommendation. Mr. Dunlap asked if the regulators had any questions of the technical resource advisors, and there was no response.

Rhonda Myron (Texas) moved and Robert Heisler (Ill.) seconded a motion to include the recommendations in the draft of the regulation. The motion passed. Mr. Dunlap thanked the technical resource advisors for their work and said their cooperation in this process makes things move much more easily.

Mr. Dunlap said there was considerable debate at the interim meeting about what is a "reasonable" payment. He said the original model set out a simple table and there was a motion at the interim meeting to replace that table with language giving states factors to use in determining whether a payment is reasonable. He said there are some who still feel this is not an appropriate direction. Tom Foley (N.D.) said he went home from the interim meeting and had a long conversation on the issue with Glenn Pomeroy, North Dakota Commissioner and President of the NAIC. Mr. Foley said North Dakota does not like the direction this model is going. Commissioner Pomeroy has concerns and plans to express them at the Life Insurance and Annuities (A) Committee and, if the model moves in this manner to the Executive (EX) Committee, Commissioner Pomeroy will express his concerns there also. Mr. Foley said that he and Commissioner Pomeroy are also writing articles on this issue. Mr. Foley asked the regulators to think back 10 years to when this industry began. He said it started for one disease, and those who had it had only a short time to live. The concept was that their death benefits would be paid a little bit early and that did not fundamentally alter the structure of life insurance. He reminded the interested parties that life insurance is designed to replace income dollars lost to the beneficiary from the person that died. Mr. Foley has two concerns now: this process has gotten away from the concept of paying death benefits a little early and it is a fundamental change to the way life insurance is viewed. This will mean a different lapse and payment structure, which will affect others who are buying life insurance.

Mr. Foley said the minimum payout table was developed because it was assumed the individual would die within two years with some substantial certainty. Now things are different and he asked the audience to think about the unintended consequences to the fundamental structure of life insurance. He asked if the NAIC should be in the position of putting out a model that encourages that activity. He said we have the investor, the viator, and the viatical settlement provider in between. The viatical settlement provider serves strictly as a go-between and reserves no risk. If a company takes 20% to 40% of the death benefit just to set up the transaction, the investor takes all of the risk.

Tom Jacks (N.C.) said the fact that the secondary market is growing means the need for a viatical settlement exists. He opined that this is an unavoidable change and regulators should deal with that fact. Mr. Foley said he does not think there needs to be a secondary market, but noted this was his response, not the position of North Dakota. He opined that the NAIC should not encourage long-range viatical settlements. Marlyn Burch (Kan.) said the horse is already out of the gate. Viatical settlements are going to exist and regulators need to plan the best way to regulate them. He opined that we could not step back to the way it was, but should deal with what is. Mr. Foley responded that he thought the maximum regulators should be endorsing is what is available for accelerated death benefits: six to 12 months.

Mr. Coleman said the accelerated death benefits model was developed with a focus on fairness. He said one of the problems with accelerated death benefits is lack of uniformity in state requirements. This makes it difficult for insurers to offer the benefit. A potential concern is that this movement to viaticate policies could encourage a change in the tax structure to tax the inside buildup of life insurance policies. Mr. Foley said he reviews the actuarial memoranda for all accelerated death benefits and he notes they are designed to be revenue neutral. In stark contrast, the viatical settlement requires a capital investment and other significant expenses so that consumers get much less. He asked the working group to design a model that would discourage viaticating a policy beyond a short period of time. Ms. Myron said she had concerns about cutting off the opportunity for an individual with a longer life span to viaticate his policy. She said consumers need maximum flexibility. Mr. Foley responded that when an individual buys life insurance the deal is that payment will be made at death to his beneficiary. The secondary market alters that significantly. Mike McNerney (Mutual Benefits Corporation) thanked Mr. Foley for this discussion because he said that it more clearly identifies the issue: should there be a viatical settlement industry? He said the viatical settlement industry has grown up because there is a need. He compared the use of a viatical settlement to borrowing from a cash value life insurance policy.

Mr. Dunlap asked Mr. Foley to draft, for the working group's consideration, alternative language to what was included at the interim meeting in Kansas City. He asked if Mr. Foley was interested in going back to the minimum table. Mr. Foley said the North Dakota position is that regulators should not encourage any cashing of a policy beyond a 6-to-12 month life span. Ms. Myron and Mr. Burch spoke in opposition to the concept of keeping the available viatications to such a short period of time. Pat

Jackson (Metropolitan Life) said it is difficult to limit the transferability of life insurance. She gave key man insurance and split dollar insurance as examples. She suggested it is difficult to draw the line. She said the insurance industry is interested in being fair to policyowners so that they get a fair return for the money they have put in. She also expressed concerns about the secondary market. She said there are examples of people who buy insurance and immediately transfer it. She said she was even aware that people are approached to buy insurance specifically for the purpose of transferring it.

Robert Shear (Accelerated Benefits Capital), president of the VAA, said the viatical settlement industry started because there is a need. He opined that two years is not long enough because ill individuals typically lose their jobs and their benefits are cut off. They need to help their families by replacing the lost income while they are still alive. Mr. McNerney presented proposed language for a revised Section 6, which includes questions about whether the policy is within the contestability period. He said this would give regulators data to determine whether policies are being purchased specifically to viaticate them. Mr. Head said the new Section 6 was developed with the assistance of the Texas Insurance Department. He noted Section 6 is improved to divide it into two categories for the policies where the insured is still alive and when he has died. Mr. Dunlap recommended inserting the proposal from the viatical settlement industry in the draft for discussion purposes.

Dan Keating (Okla.) said he was not able to attend the interim meeting but he had some questions about the latest draft. He asked why Subsection 3C had been changed to remove the word "solicit." Mr. Head responded that the term "solicit" is too narrow because the viatical settlement provider also engages in other activities related to the solicitation. Mr. Keating said that Subsection 3B is confusing because it seems to say that if someone does not renew his license, he needs to continue it. Ms. Myron said this issue was raised by Texas because, if a company does not renew its license and it is revoked, the insurance department has no authority over it. She agreed this section needs to be clarified. Mr. Keating said he agreed to some extent with the concerns raised by Mr. Foley, although he would not go quite that far. He suggested making a distinction between using the money to pay for illness, or using the life insurance purely as an investment.

John Hartnedy (Ark.) said he has seen the life insurance market change over time. Universal life and variable life have changed life insurance. He noted that regulators are now talking about changing the nonforfeiture law and the standard valuation law to respond to the changing marketplace. If the NAIC model regulates viatical settlements out of existence, it is not being responsive to changes in the marketplace. He opined the key is disclosure. If a consumer knows what is happening, regulators should not tell him what he can do. Mr. Hartnedy opined that pricing controls have never worked well. He said he understood why the first model contained minimum payouts because, at that time, there was very little competition, but it is a different marketplace now. He said he looks forward to doing away with the table in the model.

## 2. Adopt Minutes of Aug. 24-25, 1998, Meeting

Mr. Burch moved and Ms. Myron seconded a motion to adopt the minutes of the Aug. 24-25, 1998, meeting (Attachment One-B). The motion passed. Mr. Dunlap said the working group put in almost two solid days of work at the interim meeting and made significant progress, even though there are still issues that have not been resolved.

## 3. Schedule Interim Conference Call

Mr. Dunlap suggested holding an interim conference call the third or fourth week in October to continue this discussion. He noted he had to leave the meeting before reporting to the Life Insurance and Annuities (A) Committee, but he had asked Mr. Keating to give the report of the Viatical Settlements Working Group. Mr. Dunlap said he recognized there are still issues to resolve, but he is encouraged by the progress being made.

Having no further business, the Viatical Settlements Working Group adjourned at 9:55 a.m.

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ATTACHMENT ONE-A

### Viatical Settlements Model Regulation Draft: 9/15/98

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<u>Appendix A.</u>	<u>Informational Brochure (not yet completed)</u>

Appendix B. Individual Policy Verification FormAppendix C. Group Policy Verification FormSection 1. Authority

This regulation is adopted by the commissioner pursuant to the authority in Section [insert reference to state statute equivalent to Section 10 of the Viatical Settlements Model Act].

Drafting Note: States considering adoption of this version of the regulation should be sure the corresponding elements contained in the current Viatical Settlements Model Act have been put in place.

Section 2. Definitions

In addition to the definitions in Section [insert reference to equivalent to Section 2 of the Viatical Settlements Model Act], the following definitions apply to this regulation:

A. "Chronically ill" means:

(1) Being unable to perform at least two (2) activities of daily living (i.e., eating, toileting, transferring, bathing, dressing or continence);

(2) Requiring substantial supervision to protect the individual from threats to health and safety due to severe cognitive impairment; or

(3) Having a level of disability similar to that described in (1) above as determined by the Secretary of Health and Human Services;

B. "Insured" means the person covered under the policy being considered for viatication;

C. "Life expectancy" means the mean of the number of months the individual insured under the life insurance policy to be viaticated can be expected to live as determined by the viatical settlement provider considering medical records and appropriate experiential data.

D. "Net death benefit" means the amount of the life insurance policy or certificate to be viaticated less any outstanding debts or liens;

E. "Patient identifying information" means an insured's address, telephone number, facsimile number, electronic mail address, photograph or likeness, employer, employment status, social security number, or any other information that is likely to lead to the identification of the insured; and

F. "Terminally ill" means having an illness or sickness that can reasonably be expected to result in death in twenty-four (24) months or less.

Section 13. License Requirements for Viatical Settlement Providers

A viatical settlement provider, as defined in [insert reference to Section 2 of Viatical Settlement Act], shall not enter into or solicit a viatical settlement contract without first obtaining a license from the commissioner.

Drafting Note: States should consider including an effective date three to four months in the future, to allow existing companies to continue operation while licensing requirements are being implemented.

A. The application shall be on a form required by the commissioner.

B. Only those individuals named in the application may act as viatical settlement providers.

CA. In addition to the information required in Section [insert reference to state law equivalent to Section 3 of the Viatical Settlements Model Act], the commissioner may ask for such additional other information as is necessary to determine whether the applicant for a license as a viatical settlement provider, viatical settlement broker or viatical settlement representative complies with the requirements of Section [insert reference to state law equivalent to Section 3 of Viatical Settlements Model Act].

D. Viatical settlement providers shall acquire and maintain a surety in the amount of \$[insert amount]. A copy of the executed bond shall be filed with the commissioner at the time of application for a license.

Section 2. License Requirements for Viatical Settlement Brokers

A viatical settlement broker shall not solicit a viatical settlement contract without first obtaining a license from the commissioner.

A. A viatical settlement broker shall make application on a form required by the commissioner.

~~CB.~~ The application shall be accompanied by a fee of \$[insert amount]. The license may be renewed yearly by payment of a fee of \$[insert amount] and a current copy of a letter of good standing obtained from the filing officer of the applicant's state of domicile. If a viatical settlement provider, viatical settlement broker or viatical settlement representative fails to pay the renewal fee within the time prescribed, or a viatical settlement provider fails to submit the reports required in Section 6 of this Act, such nonpayment or failure to submit the required reports shall result in automatic revocation of the license. If a viatical settlement provider has, at the time of renewal, viatical settlements where the insured has not died, it shall do one of the following:

(1) Renew or maintain its current license status until the earlier of the following events:

(a) The date the viatical settlement provider properly assigns, sells or otherwise transfers the viatical settlements where the insured has not died; or

(b) The date that the last insured covered by viatical settlement transaction has died.

(2) Appoint, in writing, either the viatical settlement provider that entered into the viatical settlement, the broker who received commissions from the viatical settlement, if applicable, or any other viatical settlement provider or broker licensed in this state to make all inquiries to the viator, or the viator's designee, regarding health status of the viator or any other matters.

Drafting Note: If fees are covered in state law or a comprehensive fee regulation, delete reference to fees in Subsection B.

~~E.~~ ~~A viatical settlement broker shall acquire and maintain an errors and omissions policy in an amount commensurate with the broker's exposure, satisfactory to the insurance commissioner.~~

~~C.~~ ~~The license issued to a viatical settlement provider, viatical settlement broker or viatical settlement representative shall be a limited license which that allows solicitation only of viatical settlements. It to operate only within the scope of its license.~~

~~D.~~ ~~Prelicensing education and continuing education required of other agents and brokers in Section [insert section] shall not apply to viatical settlement brokers.~~

Drafting Note: Delete Subsection D if the state does not require prelicensing and continuing education.

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

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

~~(2) The broker has been found guilty of fraudulent or dishonest practices, has been found guilty of a felony or any misdemeanor of which criminal fraud is an element, or is otherwise shown to be untrustworthy or incompetent;~~

~~(3) The licensee has placed or attempted to place a viatical settlement with a viatical settlement provider not licensed in this state; or~~

~~(4) The licensee has violated any of the provisions of [insert citation to the Viatical Settlement Act] or this regulation.~~

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

### Section 3. Other Requirements for Brokers

~~A.~~ ~~In the absence of a written agreement making the broker the viator's agent, viatical settlement brokers shall be presumed to be agents of viatical settlement providers.~~

### Section 4. Appointment Requirements for Viatical Settlement Representatives

A viatical settlement representative, as defined in [insert reference to Section 2 of Viatical Settlement Act], shall not solicit a viatical settlement contract without first obtaining an appointment from a licensed viatical settlement provider or licensed viatical settlement broker.

A. The appointment shall be made on a form required by the commissioner.

B. The appointment shall be accompanied by a fee of \$[insert amount]. The appointment may be renewed yearly by payment of a fee of \$[insert amount]. Failure to pay the renewal fee within the time prescribed may result in automatic expiration of the appointment.



C. If the appointment is revoked by either party, the appointing viatical settlement provider or viatical settlement broker shall notify the commissioner of the revocation within thirty (30) days.

#### Section 45. Standards for Evaluation of Reasonable Payments

~~In order to assure that viators receive a reasonable return for viaticating an insurance policy, the following shall be minimum discounts:~~

<del>Insured's Life Expectancy</del>	<del>Minimum Percentage of Face Value Less Outstanding Loans Received by Viator</del>
<del>Less than 6 months</del>	<del>[80%]</del>
<del>At least 6 but less than 12 months</del>	<del>[70%]</del>
<del>At least 12 but less than 18 months</del>	<del>[65%]</del>
<del>At least 18 but less than 24 months</del>	<del>[60%]</del>
<del>Twenty four months or more</del>	<del>[50%]</del>

~~The percentage may be reduced by [5%] for viaticating a policy written by an insurer rated less than the highest [4] categories by A.M. Best, or a comparable rating by another rating agency.~~

~~B. Viatical settlement brokers shall not, without the written agreement of the viator obtained prior to performing any services in connection with a viatical settlement, seek or obtain any compensation from the viator.~~

A viatical settlement company or broker shall not enter into a viatical settlement that provides a payment to the viator that is unreasonable or unjust. In determining whether a payment is unreasonable or unjust, the commissioner may consider, among other factors, the life expectancy of the viator, the applicable rating of the insurance company that issued the subject policy by a rating service generally recognized by the insurance industry, regulators and consumer groups, and the prevailing discount rates in the viatical settlement market in [insert state], or if insufficient data is available for [insert state], the prevailing rates nationally or in other states that maintain this data.

Drafting Note: States may choose to include a table of minimum payments, based on available data.

#### Section 5. — Reporting Requirement

~~On March 1 of each calendar year, each viatical settlement provider licensed in this state shall make a report containing the following information for the previous calendar year:~~

~~A. For each policy viaticated:~~

- ~~(1) Date viatical settlement entered into;~~
- ~~(2) Life expectancy of viator at time of contract;~~
- ~~(3) Face amount of policy;~~
- ~~(4) Amount paid by the viatical settlement provider to viaticate the policy; and~~
- ~~(5) If the viator has died:
 
  - ~~(a) Date of death; and~~
  - ~~(b) Total insurance premiums paid by viatical settlement provider to maintain the policy in force;~~~~

~~B. Breakdown of applications received, accepted and rejected, by disease category;~~

~~C. Breakdown of policies viaticated by issuer and policy type;~~

~~D. Number of secondary market vs. primary market transactions;~~

~~E. Portfolio size; and~~

~~F. Amount of outside borrowings.~~

#### Section 6. — Reporting Requirement

On March 1 of each calendar year, each viatical settlement provider licensed in this state shall make a report of all viatical settlement transactions where the viator is a resident of this state and for all states in the aggregate containing the following information for the previous calendar year:

A. For viatical settlements contracted during the reporting period:

- (1) Date of viatical settlement contract;
- (2) Viator's state of residence at the time of the contract;
- (3) Mean life expectancy of the insured at time of contract in months;
- (4) Face amount of policy viaticated;
- (5) Net death benefit viaticated;
- (6) Estimated total premiums to keep policy in force for mean life expectancy;
- (7) Net amount paid to viator;
- (8) Source of policy (B-Broker; D-Direct Purchase; SM-Secondary Market);
- (9) Type of coverage (I-Individual or G-Group);
- (10) Within the contestable or suicide period, or both, at the time of viatical settlement (yes or no);
- (11) Primary ICD Diagnosis Code, in numeric format, as defined by the international classification of diseases, as published by the U.S. Department of Health and Human Services; and
- (12) Type of funding (I-Institutional; P-Private).

B. For viatical settlements where death has occurred during the reporting period:

- (1) Date of viatical settlement contract;
- (2) Viator's state of residence at the time of the contract;
- (3) Mean life expectancy of the insured at time of contract in months;
- (4) Net death benefit collected;
- (5) Total premiums paid to maintain the policy (WP-Waiver of Premium; NA-Not Applicable);
- (6) Net amount paid to viator;
- (7) Primary ICD Diagnosis Code, in numeric format, as defined by the International classification of diseases, as published by the U.S. Department of Health and Human Services;
- (8) Date of death;
- (9) Amount of time between date of contract and date of death in months;
- (10) Difference between the number of months that passed between the date of contract and the date of death and the mean life expectancy in months as determined by the reporting company;

C. Name and address of each viatical settlement broker through whom the reporting company purchased a policy from a viator who resided in this state at the time of contract;

D. Number of policies reviewed and rejected; and

E. Number of policies purchased in the secondary market as a percentage of total policies purchased.

Section 67. General Rules

A. With respect to policies containing a provision for double or additional indemnity for accidental death, the additional payment shall remain payable to the beneficiary last named by the viator prior to entering into the viatical settlement ~~agreement~~ contract, or to such other beneficiary, other than the viatical settlement provider, as the viator may thereafter designate, or in the absence of a designation beneficiary, to the estate of the viator.

B. Payment of the proceeds of a viatical settlement pursuant to [insert citation for Section 9D of Viatical Settlements Model Act] shall be by means of wire transfer to the account of the viator or by certified check or cashier's check.

C. Payment of the proceeds to the viator pursuant to a viatical settlement shall be made in a lump sum ~~Retention of a portion of the proceeds by the viatical settlement provider or escrow agent is not permissible. except where. Installment payments shall not be made unless the viatical settlement company provider has purchased an annuity or similar financial~~

instrument issued by a licensed insurance company or bank, or an affiliate of either. Retention of a portion of the proceeds by the viatical settlement provider or escrow agent is not permissible.

D. A viatical settlement provider, viatical settlement or-broker or viatical settlement representative shall not discriminate in the making or solicitation of viatical settlements on the basis of race, age, sex, national origin, creed, religion, occupation, marital or family status or sexual orientation, or discriminate between viators with dependents and without.

E. A viatical settlement provider, or viatical settlement broker or viatical settlement representative shall not pay or offer to pay any finder's fee, commission or other compensation to any viator's insured's physician, or to an attorney, accountant or other person providing medical, legal or financial planning services to the viator, or to any other person acting as an agent of the viator with respect to the viatical settlement.

~~F. — Contacts for the purpose of determining the health status of the viator by the viatical settlement provider or broker after the viatical settlement has occurred should be limited to once every three (3) months for viators with a life expectancy of more than one year, and to no more than one per month for viators with a life expectancy of one year or less. The provider or broker shall explain the procedure for these contacts at the time the viatical settlement contract is entered into.~~

~~GF. A Viatical settlement provider and brokers shall not knowingly solicit investors who could influence the treatment of have treated or have been asked to treat the illness of the viators insured whose coverage would be the subject of the investment.~~

~~HG. Advertising standards:~~

- ~~(1) Advertising should related to the viatical settlement shall be truthful and not misleading by fact or implication.~~
- ~~(2) If the advertiser emphasizes the speed with which the viatication will occur, the advertising must disclose the average time frame from completed application to the date of offer and from acceptance of the offer to receipt of the funds by the viator.~~
- ~~(3) If the advertising emphasizes the dollar amounts available to viators, the advertising shall disclose the average purchase price as a percent of face value obtained by viators contracting with the advertiser during the past six (6) months.~~

~~H. If a viatical settlement provider enters into a viatical settlement that allows the viator to retain an interest in the policy, the viatical settlement contract shall contain the following provisions:~~

- ~~(1) A provision that the viatical settlement provider will effect the transfer of the amount of the death benefit only to the extent or portion of the amount viaticated. Benefits in excess of the amount viaticated shall be paid directly to the viator's beneficiary by the insurance company;~~
- ~~(2) A provision that the viatical settlement provider will, upon acknowledgment of the perfection of the transfer, either:~~
  - ~~(a) Advise the insured, in writing, that the insurance company has confirmed the viator's interest in the policy; or~~
  - ~~(b) Send a copy of the instrument sent from the insurance company to the viatical settlement company that acknowledges the viator's interest in the policy; and~~
- ~~(3) A provision that apportions the premiums to be paid by the viatical settlement company and the viator. It is permissible for the viatical settlement contract to specify that all premiums shall be paid by the viatical settlement company. The contract may also require that the viator reimburse the viatical settlement provider for the premiums attributable to the retained interest.~~

#### Section 8. Disclosure

A. A disclosure document containing the disclosures required in [insert reference to state law enacting Viatical Settlements Model Act] and this regulation shall be provided before or concurrent with taking an application for a viatical settlement contract.

B. The disclosure document shall contain the following language: "All medical, financial or personal information solicited or obtained by a viatical settlement company or viatical settlement broker about a viator and insured, including the viator and insured's identity or the identity of family members, a spouse or a significant other, is confidential." The information shall not be disclosed in any form to any person, unless disclosure:

- (1) Is necessary to effect the viatical settlement between the viator and the viatical settlement provider; and
- (2) The viator and insured have provided prior written consent to the disclosure.

C. The disclosure shall include advising the viator and insured that the information may be provided to financing entities including individual and institutional purchasers.

#### Section 9. Prohibited Practices

A. A viatical settlement provider, viatical settlement broker or viatical settlement representative shall not provide patient identifying information to any person, unless the insured and viator provide written consent to the release of the information at or before the time of the viatical settlement transaction pursuant to Section 8B.

B. A viatical settlement provider, viatical settlement broker or viatical settlement representative shall obtain from a person that is provided with patient identifying information a signed affirmation that the person or entity will not further divulge the information without procuring the express, written consent of the insured for the disclosure. Notwithstanding the foregoing, if a viatical settlement provider, viatical settlement broker or viatical settlement representative is served with a subpoena and, therefore, compelled to produce records containing patient identifying information, it shall notify the viator and the insured in writing at their last known addresses within five (5) business days after receiving notice of the subpoena.

C. A viatical settlement provider shall not act also as a viatical settlement broker, whether entitled to collect a fee directly or indirectly, in the same viatical settlement.

D. A viatical settlement broker shall not, without the written agreement of the viator obtained prior to performing any services in connection with a viatical settlement, seek or obtain any compensation from the viator.

E. A viatical settlement provider shall not use a longer life expectancy than is realistic in order to reduce the minimum payout to which the viator is entitled.

Drafting Note: Market conduct examiners should review annual reports closely to detect a pattern of abuse in artificially raising the life expectancy.

#### Section 10. Insurance Company Practices

A. Life insurance companies authorized to do business in this state shall respond to a request for verification of coverage from a viatical settlement provider or a viatical settlement broker within thirty (30) calendar days of the date a request is received, subject to the following conditions:

(1) A current authorization consistent with applicable law, signed by the policyowner or certificateholder, accompanies the request;

(2) In the case of an individual policy, submission of a form substantially similar to Appendix B, which has been completed by the viatical settlement provider or the viatical settlement broker in accordance with the instructions on the form.

(3) In the case of group insurance coverage:

(a) Submission of a form substantially similar to Appendix C, which has been completed by the viatical settlement provider or viatical settlement broker in accordance with the instructions on the form, and

(b) Which has previously been referred to the group policyholder and completed to the extent the information is available to the group policyholder.

B. Nothing in this section shall prohibit a life insurance company and a viatical settlement provider or a viatical settlement broker from using another verification of coverage form that has been mutually agreed upon in writing in advance of submission of the request.

C. A life insurance company may not charge a fee for responding to a request for information from a viatical settlement provider or viatical settlement broker in compliance with this section in excess of any usual and customary charges to contractholders, certificateholders or insureds for similar services.

D. The life insurance company may send an acknowledgment of receipt of the request for verification of coverage to the policyowner or certificateholder and, where the policy owner or certificate owner is other than the insured, to the insured. The acknowledgment may contain a general description of any accelerated death benefit that is available under a provision of or rider to the life insurance contract.

#### Section 11. Effective Date

This regulation is effective [insert date]. A viatical settlement provider, viatical settlement broker or viatical settlement representative transacting business in this state may continue to do so pending approval of the provider, broker or representative's application for a license as long as the application is filed with the commissioner by [insert date].

#### APPENDIX A (not yet drafted)

**APPENDIX B** [All new material]

Standardized Viatical Settlement  
Verification of Coverage for Individual Policies

**Section One: (To be completed by the Viatical Settlement Provider or Viatical Settlement Broker)**

Insurance Company: _____	Name of Policyowner: _____
Policy Number: _____	Owner's Social Security Number: _____
Name of Insured: _____	Policyowner's Address: _____
Insured's date of birth: _____	Street
	City/State

Please provide the information requested in Section Two (below) with regard to the policy identified above and in accordance with the attached authorization.

In addition, please provide the forms checked below which are available from your company to complete a viatical settlement transaction:

- ☐ Absolute Assignment/Change of Ownership/Viatical Assignment Form
- ☐ Change of Beneficiary
- ☐ Release of Irrevocable Beneficiary (if applicable)
- ☐ Waiver of Premium Claim Form
- ☐ Disability Waiver of Premium Approval Letter

\_\_\_\_\_  
Date

\_\_\_\_\_  
Signature of a representative of Viatical Settlement Broker  
or Viatical Settlement Provider

\_\_\_\_\_  
Full name and address of Viatical Settlement Broker  
or Viatical Settlement Provider

**Section Two: (To be completed by the life insurance company)**

- 1) Face amount of policy: \$ \_\_\_\_\_
- 2) Original date of issue: \_\_\_\_\_ / \_\_\_\_\_ / \_\_\_\_\_ (Month/Date/Year)
- 3) Was face amount increased after original issue date? ☐ no ☐ yes If yes, when: \_\_\_\_\_ / \_\_\_\_\_ / \_\_\_\_\_
- 4) Type of Policy: \_\_\_\_\_ (Term/Whole Life/Universal Life/Variable Life)
- 5) Is policy participating? ☐ no ☐ yes If yes, what is current dividend election? \_\_\_\_\_
- 6) Current Net Death Benefit: \_\_\_\_\_ (Enter full amount payable, including any additional insurance, and/or dividends accumulated at interest, minus policy loans, outstanding interest on policy loans and/or accelerated death benefits paid)
- 7) Current cash value: \$ \_\_\_\_\_ (Enter full amount, including cash value of any additional insurance and/or dividends accumulated at interest, minus policy loans and outstanding interest on policy loans)
- 8) Terms of policy loans:
  - a) Amount of policy loans: \$ \_\_\_\_\_
  - b) Amount of outstanding interest on policy loan: \$ \_\_\_\_\_
  - c) Current interest rate: \_\_\_\_\_
- 9) Is policy in force? ☐ no ☐ yes
  - a) If yes, has policy ever been reinstated? ☐ no ☐ yes
  - b) If yes, date of reinstatement: \_\_\_\_\_ / \_\_\_\_\_ / \_\_\_\_\_

- 10) Has policy lapsed? ☐ no ☐ yes  
 a) If yes, when did policy lapse? \_\_\_\_/\_\_\_\_/\_\_\_\_  
 If policy has lapsed, is coverage continued under nonforfeiture option? ☐ no ☐ yes If yes, indicate which option, amount of coverage, duration, etc.: \_\_\_\_\_
- 11) Amount of Contract/Scheduled premiums: \$ \_\_\_\_\_
- 12) Current premium mode: \_\_\_\_\_ (Monthly, semi-annually, etc.)  
 a) When is next premium due? \_\_\_\_/\_\_\_\_/\_\_\_\_ (Month/Day/Year)
- 13) Does the policy include a Disability Premium Waiver provision/rider? ☐ no ☐ yes  
 a) If yes, are premiums currently being waived? ☐ no ☐ yes  
 b) If yes, since when? \_\_\_\_/\_\_\_\_/\_\_\_\_  
 c) How often is continued eligibility reviewed? \_\_\_\_\_  
 d) When is next review? \_\_\_\_/\_\_\_\_/\_\_\_\_
- 14) Can payment of all or part of the death benefit be accelerated under this policy? ☐ no ☐ yes  
 a) If yes, by what method is the benefit calculated, the lien method or the discount method? \_\_\_\_\_  
 b) If lien method, what is the interest rate? \_\_\_\_\_
- 15) Has a claim for Accelerated Death Benefit been submitted? ☐ no ☐ yes  
 a) If yes, was payment made under this provision? ☐ no ☐ yes  
 Amount paid: \_\_\_\_\_ Date paid: \_\_\_\_\_
- 16) Do current records show any assignments of record? ☐ no ☐ yes
- 17) Do current records show any outstanding liens or encumbrances of record? ☐ no ☐ yes
- 18) Please identify current primary beneficiaries: \_\_\_\_\_  
 a) Are they named irrevocably, or is owner otherwise limited in designation of new beneficiaries? ☐ no ☐ yes
- 19) Have any riders been added to this policy after issue? ☐ no ☐ yes  
 If yes, please identify: \_\_\_\_\_

20) If an ownership or beneficiary change or assignment were to be made on this policy, to whom would the completed forms be sent?

Name: \_\_\_\_\_ Title: \_\_\_\_\_

Company Name: \_\_\_\_\_ Department: \_\_\_\_\_

Address: (No P.O. Box, please) \_\_\_\_\_

City: \_\_\_\_\_ State: \_\_\_\_\_ ZIP: \_\_\_\_\_

Telephone No: \_\_\_\_\_ FAX: \_\_\_\_\_

The answers provided reflect information contained in the company's records as of: \_\_\_\_\_ (date)

Signature: \_\_\_\_\_ Name: (Printed) \_\_\_\_\_

Title: \_\_\_\_\_

Company: \_\_\_\_\_

Direct Telephone No: \_\_\_\_\_ Direct FAX No: \_\_\_\_\_

APPENDIX C [All new material]Standardized Viatical Settlement Verification  
of Group Life Insurance Benefits

Section One: (To be completed by the viatical settlement provider or viatical settlement broker)

Insurance Company: \_\_\_\_\_ Name of Employee/Member: \_\_\_\_\_

Employer/Policyholder Name: \_\_\_\_\_ Insured's Date of Birth: \_\_\_\_\_

Policy Number: \_\_\_\_\_ Insured's Social Security Number: \_\_\_\_\_

Certificate Number: \_\_\_\_\_ Employee/Membership Number: \_\_\_\_\_

Please provide the information requested in Section Two or Section Three, as appropriate, with regard to the individual and coverage described, in accordance with the attached authorization.

In addition, please provide the forms checked below which are available from your company to complete a viatical settlement transaction:

- ☐ Absolute Assignment  
☐ Change of Beneficiary (irrevocable if applicable)  
☐ Disability Waiver of premium claim or  
☐ Disability Waiver of premium award letter

\_\_\_\_\_  
Date\_\_\_\_\_  
Signature of a representative of Viatical Settlement Broker  
or Viatical Settlement Provider\_\_\_\_\_  
Full name and address of Viatical Settlement Broker  
or Viatical Settlement Provider

Section Two: (To be completed by the employer/group policyholder)

## 1) Basic Coverage:

a) Is the plan self-insured or is coverage provided under a group policy issued by a life insurance company? \_\_\_\_\_

If by a group policy, please provide the name of the insurance company for basic life insurance coverage: \_\_\_\_\_

b) Effective date of basic life insurance coverage: \_\_\_\_\_

c) Face amount of basic life insurance: \_\_\_\_\_

d) Does basic coverage plan have contestable provisions? ☐ no ☐ yese) Is basic coverage subject to a suicide provision? ☐ no ☐ yes

f) Monthly premium paid by employer/group policyholder for basic life insurance: \$ \_\_\_\_\_

g) Monthly premium paid by employee/insured for basic life insurance: \$ \_\_\_\_\_

h) Is basic life insurance coverage ☐ Term ☐ Universal Life?i) If Universal Life, please indicate cash value, if any: \_\_\_\_\_ Is this amount payable in addition to the face amount? ☐ no ☐ yesi) Is coverage in force? ☐ no ☐ yes

j) When is next premium due? \_\_\_\_\_

k) Has employee's coverage under this plan ever been reinstated? ☐ no ☐ yes

i) If yes, date of reinstatement: \_\_\_\_\_

## 2) Supplemental (Optional) Coverage

- a) Insurance Company for supplemental life insurance coverage: \_\_\_\_\_
- b) Effective date of supplemental life insurance coverage: \_\_\_\_\_
- c) Face amount of supplemental life insurance: \_\_\_\_\_
- d) Does supplemental coverage plan have contestable provisions? ☐ no ☐ yes
- e) Is supplemental coverage subject to a suicide provision? ☐ no ☐ yes
- f) Monthly premium paid by employer/group policyholder for supplemental life insurance: \$ \_\_\_\_\_
- g) Monthly premium paid by employee/insured for supplemental life insurance: \$ \_\_\_\_\_
- h) Is supplemental life insurance coverage ☐ Term ☐ Universal Life?
- i) If Universal Life, please indicate cash value, if any: \_\_\_\_\_ Is this amount payable in addition to the face amount? ☐ no ☐ yes
- j) Is coverage in force? ☐ no ☐ yes
- k) When is next premium due? \_\_\_\_\_
- l) Has employee's coverage under this policy ever been reinstated? ☐ no ☐ yes
- m) If yes, date of reinstatement: \_\_\_\_\_

## 3) Disability Waiver of Premium

- a) Does plan provide for waiver of premium in the event of employee/insured's disability?
- Basic ☐ no ☐ yes
- Supplemental ☐ no ☐ yes
- b) Are premiums currently being waived under disability premium waiver?
- Basic ☐ no ☐ yes
- Supplemental ☐ no ☐ yes
- c) Who pays premiums under disability premium waiver?
- Basic ☐ Insurance carrier ☐ Employer
- Supplemental ☐ Insurance carrier ☐ Employer
- d) What was the date of approval? \_\_\_\_\_
- e) Next review date? \_\_\_\_\_
- f) If the insured is no longer eligible for waiver, what amount of coverage can be converted to an individual policy? \$ \_\_\_\_\_
- g) Will a new suicide/contestability clause be in effect for the converted policy? ☐ no ☐ yes

## 4) Beneficiaries, Assignments and Limitations

- a) Who are the primary beneficiaries of the coverage(s)?
- Basic \_\_\_\_\_
- Supplemental \_\_\_\_\_
- b) Is any beneficiary under this policy designated irrevocably, or is insured otherwise limited in designation of new beneficiaries? ☐ no ☐ yes
- c) Can this coverage be assigned?
- Basic ☐ no ☐ yes
- If yes, to a corporation? ☐ no ☐ yes To someone not related to insured? ☐ no ☐ yes
- Supplemental ☐ no ☐ yes
- If yes, to a corporation? ☐ no ☐ yes To someone not related to insured? ☐ no ☐ yes
- d) Do records show any assignments of record? ☐ no ☐ yes
- e) Do records show any outstanding liens or encumbrances of record? ☐ no ☐ yes
- f) Will an assignee be notified if the master policy is canceled? ☐ no ☐ yes
- g) Can assignee convert the coverage without the permission of insured? ☐ no ☐ yes



## 5) Accelerated Death Benefits

a) Is there an Accelerated Death Benefit available under the coverage?

Basic ☐ no ☐ yes  
 Supplemental ☐ no ☐ yes

b) Has request for Accelerated Death Benefit been made? ☐ no ☐ yesc) Has payment been made to insured under this provision? ☐ no ☐ yes

i) Amount paid: \_\_\_\_\_ Date paid: \_\_\_\_\_

ii) Is this amount a lien against death proceeds? ☐ no ☐ yes Interest rate \_\_\_\_\_

## 6) Miscellaneous

a) Is coverage portable?

Basic ☐ no ☐ yes  
 Supplemental ☐ no ☐ yes

b) Is this plan administered by a third party? ☐ no ☐ yes

If yes, please provide the name, address and telephone number of administrator:

Name: \_\_\_\_\_ Title: \_\_\_\_\_

Company name: \_\_\_\_\_ Department: \_\_\_\_\_

Street Address: \_\_\_\_\_

(No P.O. Box please)

City: \_\_\_\_\_ State: \_\_\_\_\_ ZIP: \_\_\_\_\_

Telephone number: ( ) \_\_\_\_\_ Fax: ( ) \_\_\_\_\_

If a change of beneficiary form or assignment were to be made for this coverage, to whom should the completed forms be sent?

Name: \_\_\_\_\_ Title: \_\_\_\_\_

Company name: \_\_\_\_\_ Department: \_\_\_\_\_

Street Address: \_\_\_\_\_

(No P.O. Box please)

City: \_\_\_\_\_ State: \_\_\_\_\_ ZIP: \_\_\_\_\_

Telephone number: ( ) \_\_\_\_\_ Fax: ( ) \_\_\_\_\_

The answers provided reflect information in our files as of \_\_\_\_\_ (date)

Signature: \_\_\_\_\_ Name: \_\_\_\_\_

Date: \_\_\_\_\_ Title: \_\_\_\_\_

Company: \_\_\_\_\_

Direct telephone number: ( ) \_\_\_\_\_ Direct fax number: ( ) \_\_\_\_\_

Information not provided by the employer may be obtained from the insurance company if different from administrator identified above:

Name: \_\_\_\_\_ Title: \_\_\_\_\_

Company name: \_\_\_\_\_ Department: \_\_\_\_\_

Address: \_\_\_\_\_

City: \_\_\_\_\_ State: \_\_\_\_\_ ZIP: \_\_\_\_\_

Telephone number: ( ) \_\_\_\_\_ Fax: ( ) \_\_\_\_\_

## Section Three:

Under the terms of Section 10 of the NAIC Model Viatical Settlement Regulation covering insurance company practices, the insurance company or the third party administrator named above is requested to complete the information not provided by the employer in Section Two, above, Items number: \_\_\_\_\_

The answers provided to the identified questions reflect information in the files of the insurance company as of \_\_\_\_\_ (date).

Signature: \_\_\_\_\_ Name: \_\_\_\_\_

Date: \_\_\_\_\_ Title: \_\_\_\_\_

Company: \_\_\_\_\_

Direct telephone number: ( ) \_\_\_\_\_ Direct fax number: ( ) \_\_\_\_\_

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## ATTACHMENT ONE-B

Viatical Settlements Working Group  
Kansas City, Missouri  
August 24-25, 1998

The Viatical Settlements Working Group of the Life Insurance and Annuities (A) Committee met in Kansas City, Mo., on Aug. 24 and 25, 1998. Lester Dunlap (La.) chaired the meeting. The following working group members or their representatives were present: Elizabeth Bookwalter for Michael Bownes (Ala.); Kevin McCarty (Fla.); Marlyn Burch (Kan.); Tom Foley (N.D.); and Chris Orr for Rhonda Myron (Texas).

1. Presentation From Viatical Settlement Industry

Lester Dunlap (La.) said he requested information from representatives of the viatical settlement industry to help the regulators better understand the issues on the agenda for the meeting. Mike McNerney (Mutual Benefits Corporation) said there were representatives present from all segments of the viatical settlements industry: providers using private funding, providers using institutional funding, viatical settlement brokers, and entities providing services to the viatical settlement industry such as medical underwriting. Mr. McNerney explained the viator's initial contact is usually with a viatical settlement broker, who gathers information about the life insurance policy and medical information about the insured, and mails this packet to providers to solicit bids. A provider will conduct an underwriting process so that it can decide whether to bid on the policy. The viatical settlement broker needs to know who is licensed in a particular state so that packets are sent only to licensed companies in a state that requires licensing.

Mr. McNerney said the viatical settlement provider may use several different methods to evaluate the information: 1) the provider may have in-house medical staff; 2) the provider may hire outside medical staff under contract; 3) the provider may use an outside company in the business of evaluating policies; or 4) the manager of medical risk on staff might deal with outside parties, depending on the illness.

Philip Loy (American Viatical Services) said his company is in the business of third-party medical evaluations. His company receives the medical records after they have been compiled by a broker and evaluates the life expectancy of the individual. He said the medical records being evaluated could be 25 pages or 2,000. About 50% of those are typed; otherwise his staff tries to read the doctor's notes. The company takes two to three days to review the records and calls the attending physician for additional information. He emphasized his company does not ask the doctor for an opinion on life expectancy but tries to make an assessment of how informed the doctor is on new technology and on the patient's attitude. Mr. Loy said his company has an 80 to 85% accuracy rate, in that the individuals die within the time frame they predict or earlier. He noted, however, that most of the 15,000 individuals they have evaluated are still alive. In response to a question from a regulator, Mr. Loy explained that some of the review the company does is of persons without a terminal illness, but these persons are generally over the age of 68.

Mr. McNerney said the viatical settlement provider makes a bid based on the medical report and on a number of nonmedical issues. Terry Savage (Viaticus) listed some additional points that would be considered in the bid. He said the viatical settlement provider will consider whether the policy is still within the contestability period, the possibility of fraud, and verification of the facts of the policy from the insurer. Robert Shear (Accelerated Benefits Capital) said other factors include whether it is a group or individual policy, whether there is a waiver of premium in effect, whether there is an applicable suicide exclusion, and whether a group policy has a conversion privilege.

The working group members spent some time discussing the impact of the choice to viaticate a group insurance policy. Mr. Shear said his company's business is approximately one-third group policies. He noted that these are generally controlled by the employer, and his company decided to take this additional risk because most times the transaction turns out favorably. If the individual has to convert the policy, the premium may be higher and sometimes there is a cap on the coverage available. There might be a new suicide exclusion. His company discounts the policy 5 to 8% from what it would have paid had it not been a group policy. Mr. Shear said his company also adjusts the price downward if the insurer is in poor financial condition. He also

looks at prevailing interest rates because when rates are high, the cost of obtaining funds is higher. Mr. McNerney pointed out that some companies may also take into account an insurer that is slow to respond to requests for information.

Mr. McNerney explained that, if an individual purchases the viatical settlement, that individual may be responsible for paying the policy premiums until death. If the viatical settlement provider holds the policy, it will be responsible for the premiums. One of the factors that the company has to evaluate is the risk that it may have to pay higher premiums.

Marlyn Burch (Kan.) said his state heard many complaints from investors where the life turned out to be much longer than the expectancy and the investor had to keep paying premiums. Kevin McCarty (Fla.) and Elizabeth Bookwalter (Ala.) said they had experienced similar complaints. Mr. McCarty said that his securities commissioner would not get involved and the insurance department has no authority to regulate the investments side of the activity. Tom Foley (N.D.) asked for more information about what investors are told in regard to the rate of return and their responsibility for premiums. Mr. Dunlap said this raises important issues and asked the working group to consider asking for a charge in 1999 to deal with this issue. Mr. McNerney said the Viatical Association of America (VAA) has also appointed a committee to look at the issue. He said that group will be prepared to discuss the industry's viewpoint on how to deal with this issue.

Mr. McNerney next discussed minimum pricing. He said it is the industry's position that there should not be minimum pricing for viatical settlements. He opined that so many factors are involved in setting a price for a viatical settlement that a price schedule does not work. Mr. Shear presented different models for funding sources. First is conventional financing; a few companies get financing from banks. He said his company's cost of funds is approximately 9.5%. Companies also vary as to the percentage they finance. He said his company puts 15% of its own money in every viatical settlement. He said more companies did have that model, but have not done so since the advances in AIDS treatments. The second option is securitization of assets. In that case, a company will often find an insurer to insure against the possibility that the risk might be longer than expected. He said Cigna Re offers this type of insurance and suggested this may be the wave of the future. Third, Gary Chodes (Viaticus) said that some companies have their own funding. Viaticus is funded by CNA Insurance Company. Because of this, Viaticus no longer invests in the AIDS market. Viaticus also is not inclined to buy group coverage because of the higher risk. Mr. Chodes said it is expensive to develop the viatical settlement market and it is not an advantage to Viaticus to have CNA as a parent. He said an insurance agent might have an opportunity to arrange a viatical settlement once in his career. Most of the people who need viatical settlements hear about it through other marketing methods. Mr. Shear added that there is high cost for institution investors to get into the market. Fourth, Mr. McNerney explained the private investor marketplace, which currently provides two-thirds of the funding. He said the viatical settlement marketplace has been adjusting to the reality of the market, which is to find private investors. He suggested that the cost to raise funds is about 10% of the amount raised. Robin Shapiro (Enhance Consumer Services) opined that a minimum payout scheme is the wrong direction to take if the regulators want to encourage institutional investors. Mr. McNerney said that the price controls in the regulation complicate funding solicitation.

Doug Head (Medical Escrow Society) explained the function of viatical settlement brokers. He said the brokers have been in the industry from the beginning and can get a better price than a viator can by shopping the policy himself. The broker generally gets a commission of approximately 6% of the face value of the policy. In response to a question from regulators he noted that the 6% of face value is not dependent on the percentage of the face value that is received in the viatical settlement. Big policies subsidize small policies because the work for viaticating a \$100,000 policy is the same as for a \$1 million policy. The broker's commission is not subtracted from what the viator gets, but is reflected in the offer for the policy. Mr. Head noted that a broker needs an appointment from a company under Florida law and opined that was backwards. He said the broker represents the viator, not the viatical settlement provider.

## 2. Discuss Viatical Settlement Model Regulation Draft

The remainder of the meeting was devoted to a review of the Viatical Settlements Model Regulation draft and discussion on the key issues to be resolved.

### a. Life Expectancy

The June 22, 1998, draft of the model regulation defines life expectancy as determined by an independent medical review board or a qualified actuary. The VAA and the National Viatical Association (NVA) suggest a different definition because the life expectancy is expressed by providers in a range rather than one single number. In addition the industry representatives expressed concern about the concept of a review board. Mr. Dunlap said the language was not intended to mean a government agency but rather someone outside the process. Mr. McNerney encouraged the regulators to remove the reference to an actuary because that is not how viatical settlement providers determine life expectancy. He encouraged regulators to express life expectancy in a range of months. Chris Orr (Texas) said that, when preparing Texas data compilations, a single number rather than a range is needed. He asked what number from that range is used in the calculation of providers' reports for the Texas Insurance Department. Mr. McNerney said the top number in the range is used. The regulators discussed the pros and cons of using a range versus one number. The actuaries in attendance explained to the group that the number being used should be the mean of the number of months rather than the top number. Mark Peavy (NAIC/SSO) asked if Mr. Orr knew which number the companies were reporting to Texas. He asked if the life expectancy was the top, the bottom or the middle of the range. Mr. Orr responded that he did not know how this was reported. Mr. McCarty moved and Mr. Burch seconded a motion to include the definition of life expectancy drafted by the industry trade groups and insert it as Section 2C. The motion passed.

Mr. Foley asked if the definition covers the concept of a well person who viaticates a policy, as well as terminally and chronically ill. He opined that if anyone is going to viaticate a policy, he or she needs to be covered under this model act. Mr. Dunlap said, if a person who is not ill desires to viaticate his policy, the Louisiana position is that its law does not

cover that person. He said the Louisiana law was designed to protect those who are ill. He suggested adding this issue to a list for discussion during 1999 so that the drafting of this model to cover those who are ill can proceed.

b. Surety Bond

Mr. Head encouraged the regulators to eliminate the provision in Section 3B (Section 1D of the original model regulation) that required a surety bond. He said this is an additional expense that does not provide any protection. Holly Roth (Viaticus) said the viator already has the money and asked what risk was being bonded against. Mr. Burch moved and Mr. McCarty seconded a motion to eliminate the requirement for the surety bond. The motion passed.

c. Errors and Omissions (E&O)

Mr. Head also encouraged the working group to eliminate the requirement in Section 3D (Section 2E of the original model regulation) requiring an E&O policy. He said the contract was between the provider and the viator, not the broker. He pointed out that Wisconsin's regulation contains an E&O requirement and no brokers are able to get licenses in Wisconsin because coverage is unavailable. Keith Drach (Kelco) suggested that individuals handling money need an E&O policy; brokers do not handle money. Mr. Burch moved and Mr. McCarty seconded a motion to eliminate the requirement for an E&O policy. The motion passed.

d. Education

The working group heard comments on the requirement for preclicensing education and continuing education contained in Section 3E (Section 2D of the original regulation). The June 22, 1998, draft requires the same preclicensing and continuing education required of insurance agents and brokers. Mr. Head said he believes there is no correlation between the knowledge needed for viatical settlements and for life insurance. Mr. Dunlap disagreed because the viatical settlements representative needs to understand life insurance provisions and accelerated benefit provisions. He proposed adding a 1999 charge to discuss the issue of preclicensing education and continuing education. He opined that it would be appropriate to delete this provision for now because the viatical settlement industry needs some time to develop educational programs. The June 22, 1998, draft also includes a preclicensing and continuing education requirement for viatical settlement representatives in Section 4 and the working group agreed to delete that also.

e. Advertising

The June 22, 1998, draft changes the advertising standard in Section 7G to refer to the NAIC Rules Governing the Advertising of Life Insurance. Mr. Head asked the working group to reconsider that recommendation because a large percentage of the requirements relate to the life insurance industry and are beyond the legal resources of viatical settlement companies. The working group decided to go back to the language in the original adopted model. Mr. McCarty asked if the intent of the advertising standards is to apply them to the relationship between the viator and the viatical settlement provider, rather than that between the investor and the provider. The working group agreed that is the intent.

f. Section 7 Amendments

Representatives from the viatical settlement industry asked the working group to consider an amendment to Section 7E on the payment of finder's fees. They recommended modifying the provision so that, instead of prohibiting payment of such fees, it required disclosure of that fact to the viator. Mr. Burch said this suggestion appeared to water down the protections of Section 7E. Mr. Shear responded that the doctor could get a referral fee and the viator probably would want him or her to have that money. Mr. McNerney said the viatical settlement is not a well-known vehicle, and it is helpful if doctors, accountants, and others suggest the product to those who would be interested. Mr. Foley responded that the provision does not prevent those individuals from telling about viatical settlements, it just prevents them from being paid for that information. The working group decided not to make a change to Section 7E. Mr. Chodes asked that the record show that Viaticus would never make a payment to an entity that is not a licensed broker or representative. He said the viator might be paying for tax advice or financial planning advice but his company would never pay a finder's fee.

Ms. Roth requested that the working group consider making a change to Section 7F because the phrasing made it sound as if brokers and representatives solicit investors. She said that is inappropriate and the regulation should not imply that this happens. The working group agreed to clarify the language in Section 7F.

g. Reporting Requirements

Ms. Roth said it was unclear which state is meant in Sections 6A(2). She suggested rewording that provision and the beginning paragraph. The regulators agreed to make the change she suggested. The industry representatives also suggested deleting Section 6F. Mr. McNerney asked whether Subsection F requests a report that lists all of those providing funding. Mr. Dunlap responded that it was important to regulators to know where the money is coming from, and Louisiana wants to know the names of the specific investors. Mr. McCarty responded that Florida would not want the names of the investors to become a public record. Mr. McNerney responded that the industry would not object to providing the type of funding source. The regulators agreed to change the wording to make clear that the intent of Subsection F is to report on the type of funding used (private, institutional or other).

#### h. Confidentiality of Viator Information

Mr. Foley said he does not agree with the way Section 9A is written. He said individuals' identifying information should not be released under any circumstances. Mr. McNerney said this information needs to be given to persons like Mr. Loy to provide information about the medical condition and also is needed for soliciting investors. Mr. Foley responded that his concerns are with releasing that information to investors. Mr. Dunlap said this issue is the heart of the privacy discussion; whether the person who benefits when a person dies sooner should have personal information. Mr. McCarty said in a perfect world the investor would not know the identity, but in the real world investors use that information in the investment decision. They need to know the medical details, although they perhaps do not need to know the name and address of that individual. Mr. McNerney said an individual who buys a policy needs to service that policy by paying premiums and sending in a death certificate, so he needs to know identifying information. Mr. Foley expressed the grave concern that an individual who knows the identity of the person whose policy he has purchased will take action to shorten that individual's life. Mr. McCarty responded that Florida has had problems with fraud and with disillusioned investors, but he was not aware of any instances where the investor had taken the life of the viator. He opined that it was philosophically a good point, but questioned the need to fashion a remedy without an evil. The working group decided to include disclosure information and to leave in the draft the ability to identify the viator of the insurance policy. Mr. Dunlap said this issue would be discussed further at the Fall National Meeting.

#### i. Minimum Payouts

Mr. Foley polled the working group members as to the desirability of including a table of minimum payouts. Mr. Burch expressed concern that the working group was setting upper limits by the development of such a table. Ms. Bookwalter agreed with that assessment. Mr. Orr opined that there is not enough information at this time to create an accurate table. Based on the Texas data, he said that stopping at 24 months on the current NAIC table may be reasonable. He suggested it is also important to add some language to help regulators determine what is reasonable. He cautioned that the current table is not functional, reasonable or accurate. Mr. McCarty said he would recommend data collection now and reconsider the issue of adding a table later. Mr. Dunlap's position is that if regulators cannot come up with a reasonable alternative, he would prefer to leave the table that was in the original model in place. Mr. McCarty pointed out that the majority of the policies now being viaticated are in states that do not have a table, (Florida California, Texas and New York) and he suggested a 50% standard as a minimum is probably harmful rather than helpful.

Mr. Foley said there are two components to the price. The price is assigned based on the expectation of life so there is a flaw in the structure of the table because it does not put limits on the way the life expectancy is determined. He suggested designing Section 6 to enable regulators to monitor how the life expectancy is being assigned and to set consequences for being too optimistic. He said once the expectation of life has been contained, regulators can talk about expenses. Mr. Foley questioned a marketplace where an individual who has a life expectancy of less than a year can get 92% of the face value of his policy as an accelerated death benefit, but according to the table could only get 78% in a viatical settlement. He questioned the reason for such a large difference. Mr. Orr noted that not every policy has accelerated death benefits. Mr. McCarty said it is important to improve the process so that more people could get accelerated death benefits, but where it is not available, he would prefer a lesser sum to none at all. Mr. Orr said the Texas experience is that not many individuals viaticate policies when their life expectancy is less than 12 months. Mr. Shear said a great part of the difference is because an insurer has the law of large numbers on its side and has a lower cost of money than the viatical settlement provider.

Mr. Orr suggested making the table optional and letting states decide if they wanted a table. He said Texas has chosen not to include a table but will determine reasonableness on a case-by-case basis. Mr. Head said it is a broker's experience that an open market is the best tool for getting a good price. And he emphasized that the choice was not between getting 78% and 92% but between getting 78% and nothing. He said the viatical industry is eager to provide data that will show its payments are reasonable. Mr. Orr urged the working group to include language suggested by Texas that talks about reasonableness and let jurisdictions decide whether to use the table, the test or both. Mr. Foley asked if he was recommending use of the table as a reasonableness standard. Mr. Orr responded that the table is not accurate. Mr. Foley said the Texas data shows that the table is reasonably accurate until 24 months, but not after that. Mr. McCarty opined that there is no empirical data for the information on the table and what Texas is proposing is to look at any settlement that it does not feel is reasonable. Mr. McCarty moved that the model substitute the language from Texas for the current Section 5A and delete reference to the table. Mr. Burch seconded the motion and it passed with Mr. Foley voting in opposition. Included in the motion is a drafting note that states can set a table based on data if they wish. Mr. Dunlap said this issue would be discussed further at the Fall National Meeting and requested that the Texas letter with its descriptive language about reasonable tests be attached to the minutes (Attachment One-B1). Mr. Foley pointed out that the regulation now has no criteria for what is reasonable. He offered to create standards that are not in the form of a table. He opined that it is more important to know that the life expectancy assigned to the individual is really how long the average person has to live. He suggested requiring an actuarial report to certify that the company meets the standards of "reasonable" payments. Mr. Orr said states would not have time to review the reasonableness on their own. Mr. McCarty said an actuarial certification is a good idea. Mr. McNerney said he supported reasonable reporting and asked what was wrong with the concept of reporting the data and letting the state look at it to decide if it needs more information to determine what is reasonable. Mr. Burch responded that he would hate to use his small staff to review reasonableness and said he needs some standards. Mr. McCarty said it sounded to him like this should be a 1999 project.

#### j. Life Insurance Issues

Section 10 of the model regulation will provide for rules for the manner and form of requests for information from the viatical settlement industry to the life insurance industry. John Matthews (Allstate Life) explained that a group of

technical resource advisors from the viatical settlement industry and the life insurance industry met in June and had several conference calls since then to come to an agreement on a form for requests for information. He said there will be two forms; one for individual policies and one for group policies. The individual policy form is nearly complete but the issues for group policies are more complex. In addition he said the technical resource advisors will develop language to insert in Section 10 that describes how the forms will be used and a reasonable time in which to complete them. He said the technical resource advisors will have another face-to-face meeting before the Fall National Meeting. He expected that the group will recommend a response time of 30 calendar days. Mr. Foley asked if the technical resource advisors anticipate making the form optional or mandatory. Mr. Matthews responded that the technical resource advisors have not yet discussed that issue. He pointed out that the regulation does not say providers have to get insurance information so the company can decide whether it wants that much information from the insurer. Mr. Foley suggested tying the form to a requirement that the insurer also get notification of the fact that one of its policyholders is thinking of viaticating an insurance policy. Julie Spiezio (American Council of Life Insurance—ACLI) said that the body of Section 10 could say whether the form is required and contain a number of days in which to respond. Mr. Burch suggested that the working group determine now whether the form should be mandated and the working group agreed that, if a form is going to be used, it should be the one that will become an appendix to the regulation. Mr. Dunlap requested that the technical resource advisors come to the Fall National Meeting with their documents substantially complete so that there is time to review the issues and still allow the working group to adopt the model regulation at the Winter National Meeting in December.

k. Grandfather Language

Mr. Orr suggested adding to Section 11 the grandfathering language similar to that in the model act. The working group members agreed to add that language.

l. Informational Brochure

Mr. Dunlap reminded the working group that Ms. Roth had agreed to assist in development of an informational brochure that could be used by insurance departments to educate their consumers. Ms. Roth agreed to have that available at the Fall National Meeting.

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

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ATTACHMENT ONE-B1

To: Carolyn Johnson (NAIC)  
 From: Beth Hill (Texas), Director, Life/Health Group  
 Chris Orr (Texas), Insurance Specialist, Life/Health Group  
 Date: August 20, 1998  
 Re: Supplemental Comments to Proposed Amendments to the NAIC Viatical Settlement Model Regulation – 4/23/98 Draft

During the June 22, 1998, meeting, the working group requested some examples to our comment number 5 to Section 5, relating to Standards for Evaluation of Reasonable Payments of the proposed draft. Accordingly, enclosed are supplemental comments to this department's June 8, 1998, comments to the current draft of the Viatical Settlement Model Regulation.

In our June 8 comments we wrote:

Section 5. Standards for Evaluation of Reasonable Payments

Net Face Amount  
 Unreasonable Payment to Viators

5. Section 4, paragraph A(3), of the Model Act, states: "The commissioner may suspend, revoke, or refuse to renew the license of an viatical settlement provider, viatical settlement representative or viatical settlement broker if the commissioner finds that ... (3) The viatical settlement provider demonstrates a pattern of unreasonable payment to viators."

It appears that the only mechanism to determine reasonableness of payment is the table of minimum percentages of Net Face [Value/Amount] set forth in Section 5A of current draft. It is conceivable for a viatical settlement to be unreasonable or unjust and still possibly meet the minimum percentages (i.e., misrepresentation, viatication during the contestable period), if any.

The following text should be added to Section 5A of the current draft:

[In addition to the minimum payment requirement,<sup>1</sup> a viatical settlement company or broker shall not enter into any viatical settlement that provides a payment to the viator that is unreasonable or unjust. In determining whether a payment is unreasonable or unjust, the commissioner may consider, among other factors, the life expectancy of the viator, the applicable rating of the insurance company that issued the

<sup>1</sup> If a state does not adopt the minimum payment provision, then this text should not be included.

subject policy by a rating service generally recognized by the insurance industry, regulators and consumer groups, and the prevailing discount rates in the viatical settlement market in [insert State], or if insufficient data is available for [insert State], the prevailing rates nationally or in other states that maintain such data.

#### Examples of an Unjust Viatical Settlement

##### Misrepresentation

1. Consider a viatical settlement representative, viatical settlement broker or company representing to a viator with a 36-month life expectancy that the proceeds from the viatical settlement are tax-qualified. The regulatory authority could consider this an unjust settlement due to misrepresentation since the maximum life expectancy for a tax-qualified viatical settlement, as defined in the Health Insurance Portability and Accountability Act of 1996, is 24 months.

##### Viatical settlements During the Contestable and/or Suicide Period

2. Consider a 10% payout on a viatical settlement where the insured's life expectancy is 12 months and the subject policy is still within the two-year contestable and/or suicide period(s) at the time of viatication. In a state that adopts the minimum payout requirements, as proposed in Section 4A of the current draft, this viatical settlement clearly fails the test of a reasonable payment. (The minimum payout for an insured with a life expectancy of at least 12, but less than 18 months, is 70%.) In a traditional viatical settlement, the policy must be beyond the contestable and suicide periods before it can be viaticated. Viatical settlements for policies that are within the contestable and suicide periods, however, are usually much lower than the proposed minimum payout percentages. The proposed draft does not provide an exception to the minimum payment percentages for these non-traditional viatical settlements, nor does it define any criteria by which a regulatory authority could test the reasonableness of a specific settlement.

##### High Pressure Tactics

3. Consider a viatical settlement transaction where the viator is subjected to "high pressure tactics" by the viatical settlement representative, viatical settlement broker or viatical settlement company. Whether the viatical settlement meets or fails to meet the minimum payout requirement, the regulatory authority would need some basis of law with a mechanism to test the reasonableness of that specific settlement.

#### Summary

This department did not adopt the minimum payment concept and has not seen a need for such a requirement; however, we are concerned that consumers may be vulnerable in the absence of a prohibition against unjust payments, particularly when the market is less competitive or when the product is marketed to the elderly, to less sophisticated consumers, or to consumers who are physically or financially unable to make comparisons.

Regardless of whether a state adopts the minimum payment concept, the committee should consider adding to this section of the current draft a prohibition on unreasonable or unjust payouts, with a list of factors that may be considered in addition to the minimum percentage of net face amount. (See suggested text beginning on page 1.) For these rare circumstances, the regulatory authority would have a mechanism to judge whether a viatical settlement transaction is unjust on a case-by-case basis in light of the circumstances related to that transaction and within the context of the viatical settlement market.

We appreciate the opportunity to make these additional comments on the proposed revisions to the current draft. If you have any questions, please feel free to contact either Beth Hill at (512) 322-3406 or Chris Orr at (512) 305-7283.

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ATTACHMENT TWO

Synthetic GIC Working Group  
New York, New York  
September 13, 1998

The Synthetic GIC Working Group of the Life Insurance and Annuities (A) Committee met in the Royal A Room of the Sheraton New York Hotel & Towers in New York, N.Y., at 1 p.m. on Sept. 13, 1998. Larry Gorski (Ill.) chaired the meeting. The following working group members or their representatives were present: Sheldon Summers (Calif.); Jack Gies (Conn.); and Neil Vance (N.J.).

#### 1. Discuss Draft Synthetic Guaranteed Investment Contracts Model Regulation

The sole topic of discussion was the extent to which the plan of operation should be filed in nondomiciliary states. Brian Haendiges (Aetna) presented a document containing concepts relative to a possible approach in resolving this issue (Attachment Two-A). In essence, the proposal differentiates between the "financial" and "contractual" elements of the plan of operation (as defined in the current draft). Under the proposal:

- (1) The "financial" elements will remain in the plan of operation, while the "contractual" elements will be moved to a summary attached to the contract filing.

- (2) The state of domicile will review for approval all of the above information.
- (3) The nondomiciliary state, if it chooses to review contract filings, will receive only the contract for approval (which has the "contractual" elements as an attachment). The plan of operation will only be available upon request for informational purposes.

A lengthy discussion ensued relative to the proposal. At the conclusion of that discussion, the technical advisers were asked to continue work on refining their suggestions. Larry Gorski (Ill.) stated that a conference call will be held in approximately one month to address other outstanding issues. He also stated that discussion could occur relative to the previously discussed issue if the technical advisers have made further progress by that time.

## 2. Adopt Minutes

Jack Gies (Conn.) moved and Sheldon Summers (Calif.) seconded a motion to adopt the minutes of the Aug. 6 joint conference call with the Separate Accounts Working Group (see pages 270-271 of this volume of the *NAIC Proceedings*). The motion passed unanimously.

Having no further business, the Synthetic GIC Working Group adjourned at 2:30 p.m.

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## ATTACHMENT TWO-A

### Synthetic GIC Technical Advisory Group Proposal for Revising Draft Regulation

- Overall Objective—Develop acceptable model regulation that responds to regulator concerns and industry needs.

Regulators Objectives	Industry Objectives
<ol style="list-style-type: none"> <li>1. Solvency of Domestic and Nondomestic insurers</li> <li>2. Understand synthetic products submitted for approval, especially risks of synthetics</li> <li>3. Limit variability to avoid approving "unknown" or hard to predict combinations</li> </ol>	<ol style="list-style-type: none"> <li>1. Timely issuance of business</li> <li>2. Ability to obtain broad enough approvals to allow insurers to write a range of potential business without refile</li> <li>3. Consistent approach with today's environment               <ul style="list-style-type: none"> <li>- do not require states that currently don't require contract filings to begin to require them</li> <li>- do not impose a standard on a state that is stricter than the one they wish to (i.e., create a regulation that reflects typical view of many states rather than that of the few that want to see the most refined detail)</li> </ul> </li> </ol>

### Recommended Approach to Obtain above objectives (Specific language to be developed)

1. Divide current plan of operations filing requirements (Primarily Section 5E(1)) into two parts:
  - Part 1: Items that would not change materially from situation to situation and are solvency related.
  - Part 2: Items that are contractually linked, and might be expected more frequently to change from one deal to another.
2. Structure a new Section 5 that would focus on financial and other requirements to write synthetic business, e.g., minimum financial requirements plus those elements of the current plan of operations in which not much change would be expected over time.
  - Would be filed for approval in home state only
  - Would include a sample of the contract with it when filed with the domestic insurance department
  - Affirmative approval required, or alternatively 60-day deemer, as in current draft
  - Focus on Plan of Operations is treating it as a "master" Plan of Operations, i.e., one that could range of underlying contractual features
3. Restructure Section 6 to include both required contractual features and filing requirements with respect to the contract. The new Section 6 would be geared toward nondomiciliary filings
  - The Plan of Operations would not be filed for approval in the non-domiciliary state
  - Section 6 would be optional, i.e., there would be a drafting note that states that a state can choose whether to adopt this particular section
  - Requirements for filing in the state of issue of the contract are:
    - a. Current Section 6 required contract provisions



- b. Description of the range of variability with respect to contractual features, including an indication of what changes would cause the contract to need to be refiled.

Areas likely to be addressed in variability description (at a minimum) would include:

- crediting rate formula
- withdrawal methodology
- termination events

Investment guidelines would not be filed for approval/information—since they are noted in the Plan of Operations filing. However, such information may be requested by a Department on an ad hoc basis as part of its contractual review, if it is deemed necessary.

- c. Upon request by the nondomiciliary Department, an informational copy of the Plan of Operations, in the format of Section 5, along with indication of whether such filing is required in the home state, and if so, whether it has been approved. (Alternate option: merely require a statement that the plan of operations requirements of the domestic state have been met.)

- Include a drafting note that clarifies that a regulator may disapprove the contract (but not the plan of operations, as it was not submitted for approval in the non-domiciliary state) not only as a result of a review of the contract filing itself, but also, if in the best interests of policyholders, based on its review of the Plan of Operations, whether filed in the home state.
- Contract approval would be granted upon affirmative approval, or after a 30-day deemer.
- 30 days would start when filing mailed, not upon receipt by Department, which could be ambiguous.

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### ATTACHMENT THREE

#### Equity-Indexed Products Working Group New York, New York September 14, 1998

The Equity-Indexed Products Working Group of the Life Insurance and Annuities (A) Committee met in New York A of the Sheraton New York Hotel & Towers in New York, N.Y., at 10 a.m. on Sept. 14, 1998. Mike Batte (N.M.) chaired the meeting. The following working group members or their representatives were present: Rosanne Mead (Iowa); Lester Dunlap (La.); Frank Cote (Mont.); Dan Keating (Okla.); and Sam Meyer (S.D.).

#### 1. Discuss Enhancement to Market Conduct Examiners Handbook Relative to Equity-Indexed Products

Mike Batte (N.M.) said his review of the *Market Conduct Examiners Handbook* focused most on the section on sales and marketing, which is Section 7 beginning on page 18 of the *Examiners Handbook*. Frank Cote (Mont.) said he saw three or four areas that might apply to equity-indexed products, but he did not believe any changes are necessary. He said the discussion about reviewing agents' training materials, advertising, etc., is broad enough to cover equity-indexed products. Mr. Batte said he shared Mr. Cote's opinion. He said the *Examiners Handbook* is written in such a way to give a lot of latitude to market conduct examiners. No interested parties wished to comment on the *Market Conduct Examiners Handbook*.

Mr. Cote moved and Lester Dunlap (La.) seconded a motion that the working group make no recommendations for changes to the *Market Conduct Examiners Handbook*. The motion passed.

#### 2. Consider Recommendations on Agents Training

Mr. Batte drew the attention of the working group members to the extensive materials provided to the working group by Reece Boyd (American Council of Life Insurance—ACLI). Sam Meyer (S.D.) said that much of the material he received from the ACLI was very well done. He noted that insurers will be ultimately responsible for the activities of their agents, so are motivated to train them well. As a representative from the Agent Licensing (EX3) Working Group, Mr. Meyer said he does not favor creating a new line of authority for this hybrid product. He opined that we will probably see more in the future and it would be counter-productive to the direction of the Agent Licensing Working Group to create separate authorities. He suggested that the South Dakota insurance department now has the authority to send a bulletin to agents saying they cannot sell equity-indexed products without a Series 6 License from the National Association of Securities Dealers (NASD). He opined that most states would have the broad authority to do this. He expressed a reluctance to create new insurance examinations, if at all possible. Mr. Cote said he would be more in favor of requiring additional agents training. Mr. Meyer opined that the life examination could be revised to include questions, under the assumption that all companies will soon have an equity-indexed product. He noted that information would need to be included in prelicensing examination materials. Mr. Batte expressed the opinion that companies with adequate resources are producing fancy training materials and he is not concerned about those. He said if every company that sold equity-indexed products used materials like the ACLI sent to the working group, he would be very comfortable with leaving it up to the companies.

Paul DeAngelo (N.J.) said he was encouraged by the presentation from the National Association of Variable Annuities (NAVA) at the Summer National Meeting. He suggested the company becomes much more diligent if it has been the subject of a class action lawsuit. He expressed concerns that companies are shifting the burden to consumers because they give consumers a lengthy description of equity-indexed products and then ask them to sign that they understand what they have just read. He

opined that at some point regulators need to rely on the integrity of the company, and if they get complaints, deal with them on a one-to-one basis.

Mr. Meyer asked if the state securities regulators are regulating the equity-indexed products. He said the South Dakota securities commissioner has decided this is a security and requires a Series 6 examination. He noted that when the producer database is complete, regulators and companies will be able to look at any agent in America and see if he has passed appropriate NASD examinations. Mr. Batte said the working group's work plan adopted in June suggests three alternatives on training: 1) require the same training as for variable life insurance agents; 2) add an educational requirement for equity-indexed product agents; or 3) require the companies to demonstrate to the insurance department that they train their agents. Dan Keating (Okla.) said his state does not take the position that equity-indexed products are variable products so he does not believe the first alternative is appropriate. He said that if a whole new examination on equity-indexed products is not created, there would be only a couple of questions on the life insurance examination, so he did not think the second alternative is particularly valuable. He noted that Oklahoma requires companies to send all agent training materials as part of the approval process for equity-indexed products. He said this gives them a better feel for the training the company is doing and they have a discussion with the company if the training seems to be inadequate.

Mr. Meyer said he did not think state insurance regulators could consider equity-indexed products to be variable products because the Securities and Exchange Commission does not. Mr. Batte pointed out that insurance regulators could require similar training to that for securities sales without saying that it is a variable product. John Hartnedy (Ark.) said his state has taken a more aggressive approach. The state has prepared a dozen questions for companies to answer about equity-indexed products. These are designed to find out if the company knows how to invest to cover its risk and how it does its advertising aimed at consumers, and the state now asks for agents training materials. He pointed out that this is a result of the discussion at earlier meetings of the Equity-Indexed Products Working Group. He said Arkansas is definitely not treating equity-indexed products as variable products and his state would be comfortable with the third alternative on Mr. Batte's list. Mr. Dunlap asked Mr. Hartnedy if the materials provided to him gave him any idea of the experience of the agent that is selling equity-indexed products. Mr. Hartnedy responded that he was not able to gather that information from the materials submitted to him. Mr. Dunlap expressed concern about inexperienced agents selling equity-indexed products. Mr. Meyer said he had the impression that, if a company offered an equity-indexed product, all its agents could sell the product, whether they had six months or six years of experience. Mr. Dunlap said that he was not in favor of the first alternative of requiring the same education as for variable products. Rosanne Mead (Iowa) agreed with that position.

Mr. DeAngelo asked if the working group would consider surveying insurance companies to ask whether they sell equity-indexed products and then to address several questions to them about the agents experience and training. Ms. Mead opined that the ACLI could probably provide that information. She said she was interested in the percentage of companies in the market doing different things, rather than information from specific companies. Mr. Dunlap said he is acutely interested in who the companies are putting on the street to sell equity-indexed products. Mr. Batte asked if there were any volunteers to draft a survey and none of the regulators responded. Scott Cipinko (National Alliance of Life Companies—NALC) said he thought the NAVA presentation at the Summer National Meeting included some information from survey results. He offered to find out more about the information that might already be available.

Mr. Batte asked for specific working group comments on the alternative to add educational requirements specific to equity-indexed products. Ms. Mead said she had a concern with that because states are just now getting to the point where they will reciprocate on continuing education and she did not want to create a retaliation problem. Mr. Meyer said the additional requirements would be an administrative burden and South Dakota would not be receptive to the burden of tracking this. Mr. Cipinko suggested that the Insurance Marketplace Standards Association (IMSA) may also provide some information about standards for company agent training. He opined that the more recent trend toward a brokerage system has replaced the agency system to a great extent and that creates a problem with requiring agent training. Ms. Mead suggested sending a letter to the trade associations asking for input on this question. She suggested sending a letter to the ACLI, NALC and the National Association of Life Underwriters (NALU). Mr. Meyer suggested that the working group not overlook the trade associations that represent property and casualty agents, who also have an interest in this issue. Mr. Batte asked Carolyn Johnson (NAIC/SSO) to send a letter on behalf of the working group.

### 3. Discuss Guaranty Fund Coverage

Ms. Johnson explained that the Guaranty Fund Issues (EX5) Working Group is meeting at the same time as the Equity-Indexed Products Working Group and is considering a number of issues related to guaranty fund coverage. After that discussion takes place, the Guaranty Fund Issues (EX5) Working Group will make some recommendations regarding guaranty fund coverage for equity-indexed products. Mr. Batte suggested that the Equity-Indexed Products Working Group react to the suggestions of the Guaranty Fund Issues Working Group.

Having no further business, the Equity-Indexed Products Working Group adjourned at 11 a.m.

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## ATTACHMENT FOUR

Life Disclosure Working Group  
New York, New York  
September 13 and 15, 1998

The Life Disclosure Working Group of the Life Insurance and Annuities (A) Committee met in the New York A of the Sheraton New York Hotel & Towers in New York, N.Y., at 3 p.m. on Sept. 13, 1998. Tom Foley (N.D.) chaired the meeting. The following working group members or their representatives were present: John Hartnedy (Ark.); Roger Strauss (Iowa); Lester Dunlap (La.); Cindy Martin (Mass.); Paul DeAngelo (N.J.); Mike Batte (N.M.); Dan Keating (Okla.); and Mary Keller (Texas).

1. Adopt Deferred Annuities Buyer's Guide

Tom Foley (N.D.) announced that the number 1 goal of the working group at this meeting is to adopt the Deferred Annuities Buyer's Guide and the Annuity Disclosure Model Regulation. Paul DeAngelo (N.J.) moved and Roger Strauss (Iowa) seconded a motion to adopt the Deferred Annuities Buyer's Guide (Attachment Four-A). Mr. Foley noted that Brenda Cude (Professor, University of Georgia) reviewed the document for readability and then several technical resource advisors met with Ms. Cude to resolve unclear areas. Since then the draft has been on the NAIC's Web site for interested parties' review. He asked if anyone had any comments on the buyer's guide. Hearing no comments, a vote was taken and the motion to adopt the buyer's guide passed.

Mr. Foley noted that the document includes the Equity-Indexed Buyer's Guide that was adopted as a stand-alone document by the working group in December 1997. At that time companies were asked to voluntarily use that document and most companies apparently are doing so. The working group indicated then that the document would be folded into the Deferred Annuities Buyer's Guide. Mr. Foley said that regulators welcome companies using the old guide through the rest of 1998. He said he anticipates adoption of this guide by the full membership at the Winter National Meeting.

2. Consider Adoption of the Annuity Disclosure Model Regulation

Mr. Foley noted that the working group had received numerous comments on the last draft of the regulation dated June 23, 1998, including a suggested draft from the technical resource advisors. Mr. Strauss suggested starting with the technical resource advisors' draft, which is mostly acceptable, and letting the technical resource advisors explain why they are suggesting changes. Mr. Strauss said that most of the proposals in the technical resource advisors' draft were acceptable to him with one significant exception. He did not agree with the standards for delivery of the buyer's guide that technical resource advisors are recommending. Mr. Foley said that this is a key issue for discussion. He noted that the rationale when they were being developed was that the disclosure document and buyer's guide would be companion pieces. He said the buyer's guide could be delivered alone, for example as an insurance department education piece, but because of the questions that are contained in the buyer's guide, it would go well with the disclosure statement. He opined that the disclosure statement without a buyer's guide is a limp document. He suggested that if others agree with him, the requirement needs to say that the buyer's guide should be in hand at the time the disclosure document is delivered.

Mr. DeAngelo said that he had the same viewpoint. There is explanation in the buyer's guide for words used in the disclosure statement. Linda Lanam (Life of Virginia) said that she agrees in concept with those statements. She said the questions in the buyer's guide usually can be answered in a preprinted document. She agreed that the disclosure statement and the buyer's guide should be part of the decision-making process. The difficulties are logistical. She said the technical resource advisors agree that delivery of the buyer's guide in face-to-face sales at the time of application is possible.

Mr. Foley asked Ms. Lanam to summarize the changes being recommended by technical resource advisors. Ms. Lanam said the first suggestion involves the exception for immediate and deferred annuities in Section 3. The recommendation is to eliminate the 30-day free-look period and to separate the considerations for immediate and deferred annuities. Mr. Foley expressed concern about exempting immediate annuities from the model regulation. He said consumers need as much information as possible and opined that over the next few years immediate annuities would become more exotic with many variable concepts. Mr. DeAngelo suggested that the exemption be narrowed to that for immediate annuities with no guaranteed elements. Mike Batte (N.M.) agreed that, for an immediate annuity with nonguaranteed elements, a buyer's guide and disclosure statement would be helpful. Roger Wiard-Bauer (Life USA) said the buyer's guide had not so far applied to immediate annuities and he expressed concern that regulators and interested parties may not have thought through the impact on this product. The working group agreed to revise the draft to Section 3B to refer to immediate and deferred annuities that contain no nonguaranteed elements.

Ms. Lanam suggested that the reference to charitable gift annuities be deleted from the draft and be dealt with in a drafting note. She said the problem is that a state could adopt the model as is and not even regulate charitable gift annuities. Mr. Strauss said it would be helpful to have language to make clear how the exemption should read. Carolyn Johnson (NAIC/SSO) suggested putting the exemption for charitable gift annuities in brackets to alert states to consider whether they need that exemption. Ms. Lanam said similar treatment for funding agreements would be appropriate.

Technical resource advisors recommended deleting two of the definitions in Section 4: one for contract premium and one for premium outlay. Ms. Lanam said these are no longer necessary because they were created for a regulation on illustrations. The technical resource advisors would like to add a definition of structured settlement annuity to the regulation. Mr. Batte suggested adding definitions for the other exemptions also. He suggested that the definition for the charitable gift annuity could be taken from the Charitable Gift Annuities Model Act.

Mr. Foley asked if the suggested definition of a structured settlement annuity is a good definition. Riva Kinslick (Prudential) said it had been drafted by her company's tax attorneys. Mr. Batte explained that this definition really contains two alternatives. The first alternative says the structured settlement annuity can be a qualified funding asset under the Internal Revenue Code. The second alternative is an annuity that would have fit under the Internal Revenue Code except that it is not owned by an assignee under a qualified assignment. The working group agreed to make these changes to Section 4.

The working group next turned its attention to Section 5, which is the most controversial. Ms. Lanam said that it is not possible in many cases to deliver a buyer's guide in two days. Mr. Foley suggested beginning the discussion with a list of the different types of sales situations that might be encountered. The list included 1) face-to-face; 2) telephone contacts that lead to sales on the phone; 3) telephone contacts that generate leads that result in a face-to-face contact; 4) Internet contacts that lead to applications over the Internet; 5) Internet contacts that generate leads for face-to-face sales; 6) mail contacts that generate leads; and 7) mail contacts that lead to applications filed through the mail. The working group decided to discuss whether to apply the same standards for all these types of situations or whether to divide them into different categories. Cindy Martin (Mass.) said her comments to the working group included suggested language that separates out telephone sales. She suggested that the disclosure document and buyer's guide be mailed to the applicant within two business days if the sale is conducted by means of telephone; and in the case of other mass communication media, such as the mails or Internet, the disclosure document could be sent to the applicant no later than 48 hours after the application is received by the insurer. Ms. Lanam suggested changing the 48 hours to two business days because if an application is taken on Friday afternoon there is no way to fill it before 48 hours has passed. Mr. Foley said Ms. Martin's suggestion to talk about mass communication media goes a long way to anticipate what may happen in the future that we do not know about now. The working group asked Ms. Johnson to redraft Section 5 with a requirement for immediate delivery of the disclosure document and the buyer's guide in a face-to-face meeting and to require delivery of both documents within two business days for other types of sales. Mr. DeAngelo suggested that Ms. Johnson draw heavily on the suggestion by Ms. Martin. Ms. Martin explained that she set out telephone sales because they are received by the insurer when the telephone sale is made. Mr. Foley noted that it is easy to determine the time of receipt of an Internet or a mail document also.

Scott Cipinko (National Alliance of Life Companies—NALC) said direct mail is difficult. He said if the contract could be issued in that two-day period, it would be efficient but, if two mailings are necessary, the cost is doubled. Ms. Kinslick emphasized again how difficult it would be to deliver a buyer's guide in two days in other than a face-to-face sale. Mr. Foley suggested leaving this provision as the working group discussed for now and going through the rest of the draft.

Ms. Lanam suggested deleting Section 5C and D. She expressed concern about the terminology "plain language." The working group agreed to move the last sentence of the purpose clause to replace Subsection C. They agreed that it has the same concept without using the term "plain language." Ms. Lanam explained that Subsection D would result in insurers repeating the contract in the disclosure document. This would make the document longer and consumers would be less likely to read it. The working group agreed that it did not want that result and decided to delete Subsection D. Ms. Martin suggesting adding a provision to the requirements for the disclosure document specifically for equity-indexed annuities. The working group declined to include her suggestion.

The discussion next turned to the provisions that describe reasonable efforts insurers should make to ensure that the buyer's guide is available to prospective applicants. Mr. Strauss asked for clarification if those suggestions were in lieu or in addition to the two-day required delivery. Mr. Foley responded that the regulators had agreed to the two days, rather than at the time of application, in return for a commitment to make the buyer's guide more available.

In Section 6, Ms. Lanam suggested changing the reference to an "annual report" to a report "at least annually." She said some companies prepare quarterly reports but they are not accumulated in an annual report. The working group agreed to this suggestion. Mr. Foley asked if the provisions of Section 6 would be applicable to immediate annuities. The working group agreed to add clarifying language to show that these provisions would not necessarily apply to immediate annuities. Mr. Wiard-Bauer said the same problem would occur with annuities in the payout phase and he suggested language that clarifies this to insert as the lead-in for Section 6. Mr. Foley noted that one of the items in Section 6 is cash surrender value. He suggested delaying this until after the year 2000 because it would likely require programming changes. The working group agreed to add a drafting note to indicate that. Mr. Foley said an alternative would be to delete the requirement for cash surrender value. Mr. DeAngelo said he would like to see that information, but would be satisfied with a later effective date.

Mr. DeAngelo said guaranteed elements that are tied to an index are guaranteed, not in amount, but in form. He asked if they were included under the description of guaranteed or nonguaranteed elements. The working group decided to add definitions from the American Academy of Actuaries (AAA) report that suggests a new definition for "determinable." The working group members agreed that was an appropriate way to describe an equity-indexed product.

Mr. Foley asked Ms. Johnson to make the changes agreed upon by the working group and have a new draft available within 18 hours so that interested parties and regulators could review the draft before the working group reconvened.

The working group discussed how to deliver the buyer's guide. Mr. Batte said, as an example of reasonable effort, companies could give the address for their Web site in the initial contact and have the buyer's guide on the Web site. Lester Dunlap (La.) said this represents a commitment the industry has given regulators to assist in the education of the consumers. He said he thought this is a very important requirement. Mary Keller (Texas) asked how regulators would be able to enforce all the different suggestions for making the buyer's guide available. She opined that it was too difficult to make an enforcement case out of these examples. Mr. Foley said the heart of the matter is that the industry has committed to assisting regulators in getting out information. Ms. Keller asked how the regulators will know if someone has read the guide from the Web site. Mr. DeAngelo responded that regulators never know if someone has read the buyer's guide; it just needs to be available. Julie Spiezio (Amer-

ican Council of Life Insurance—ACLI) said that, because of the two day requirement, she did not know if her association's companies would support adoption of the model in the states. She said the agreement for reasonable efforts to get the buyer's guide out was tied to delivery of the buyer's guide with the contract. She said the regulators have broken that agreement.

The Life Disclosure Working Group adjourned at 5:50 p.m. and reconvened at 3 p.m. on Sept. 15, 1998. The following working group members were present: Tom Foley (N.D.), chair; John Hartnedy (Ark.); Roger Strauss (Iowa); Lester Dunlap (La.); Cindy Martin (Mass.); Paul DeAngelo (N.J.); Mike Batte (N.M.); Tom Jacks (N.C.); Dan Keating (Okla.); and Mary Keller (Texas).

Mr. Strauss said it appears to him that the working group is down to one issue on delivery of the buyer's guide. He drew attention to the alternative proposal from Mr. DeAngelo for Section 5 (Attachment Four-B). Mr. Strauss expressed concern that the debate could take longer than the regulators have at the meeting. He suggested that, if the working group agrees on everything except the delivery requirement, the working group could move the regulation to the Life Insurance and Annuities (A) Committee and ask for its recommendation. He suggested a small focus group could be appointed to resolve that final issue.

Mr. Foley asked the working group to look at the draft to see if there were any other issues that needs to be discussed. He asked the working group to review the definition of determinable elements from the AAA. Barbara Lautzenheiser (Lautzenheiser & Associates), chair of the AAA group that developed the definition, also suggested different definition of the terms "guaranteed elements" and "nonguaranteed elements." She suggested that it might be ambiguous to include only one of those three definitions. Mr. Batte moved and Mr. Strauss seconded a motion to incorporate the other two AAA definitions in the model. Mr. Foley said he would like to have the authority to tweak those definitions if need be. Mr. Batte amended his motion to include that authority and the motion passed.

Ms. Lanam said the technical resource advisors proposed deletion of Section 5B, which grew out of a proposal from the technical resource advisors. She said the change to Section 5A is a significant stretch on the part of the industry and they would definitely be in favor of deleting 5B. She said the discussion will delay the model significantly. Deletion of these requirements would allow the industry to comment on the delivery time period. Mr. DeAngelo pointed out that his suggestion for a replacement section contains only minimal efforts such as putting the buyer's guide on the company's Web site and announcing that fact in the company advertising. She asked if the industry would be comfortable with that minimal effort. Ms. Lanam said it is not clear. She asked if the language meant every advertisement, including television ads and billboards. Mr. Foley said that particular part of the draft could be reworded.

Mr. Foley asked how much additional time interested parties wanted to provide a buyer's guide. Ms. Lanam said an informal poll of the interested parties indicated a range of three to seven days. She committed to getting better information about the specific number of days for the working group. Mr. DeAngelo said he believed the buyer's guide was very helpful and said he wanted to get it out to the public. He did not want someone who was in other than a face-to-face situation to be disadvantaged. Ms. Lanam asked what was so bad about getting the buyer's guide and the contract at the same time, and Mr. DeAngelo responded that the purchaser is overwhelmed with that much material and will not read it. Ms. Martin said this issue has been discussed so long and she is upset that it still is not clear why regulators want the buyer's guide out at the time of application. She said an educated buyer is a better buyer and she is surprised the industry does not think of it as a good business practice.

John Hartnedy (Ark.) said that his state held focus groups on the life insurance illustration and to a person the participants did not want to read a 10-page document. They wanted something one page long. He opined that we have blossomed the problem of not understanding surrender charges into a requirement for a buyer's guide. Mr. Hartnedy said he is an avid supporter of disclosure, but he does not think delivery of the buyer's guide will increase everyone's knowledge. It should be available, but he is not in favor of requiring more mail. He does not want to make it hard for the industry if people would not read it anyhow. Mr. Foley opined that Mr. Hartnedy's view is in the minority.

Mr. Foley asked interested parties to comment on the Sept. 15, 1998, draft (Attachment Four-C) by Oct. 13, 1998, to Ms. Johnson and a conference call will be scheduled approximately a week later. Then the working group will be able to resolve this final issue and present the regulation to the A Committee at the Winter National Meeting. Mr. Batte requested that comments also estimate the additional cost for a second mailing in relation to the overall acquisition cost.

Mr. Foley asked if any members of the working group had other concerns about any part of the regulation. Ms. Martin asked NAIC legal staff to look at the enforceability of Mr. DeAngelo's proposal and other provisions of the model and those from the interested parties. Mr. Foley agreed that was a good recommendation.

Mr. Foley said if anyone had told him in December 1995 that it would take three years to prepare the annuity illustration model, he would not have believed it. Three years later, the annuity disclosure model (without illustrations) is not yet complete. He suggested that in December when this project is done the working group return its focus to life insurance issues.

### 3. Report from AAA on Self-Support and Lapse-Support Tests

Mr. Foley said that if the working group decides to go ahead with annuity illustrations, the issue of supportability will become very important. He called upon Steve Preston (Golden American) and Ms. Lautzenheiser to report on the AAA study on supportability. Ms. Lautzenheiser said this is the third report of the AAA to the working group. The group is exploring supportability and disclosure. She said the AAA will not make a recommendation because this is a public policy decision, but the AAA will help regulators by providing information on whether to require supportability or disclosure or both. She cautioned that testing does not measure the intent to pay, but rather the ability to pay. The disclosure could help measure intent to pay. Mr. Preston described the tests being used and the difficulty in balancing simplicity and flexibility. Mr. Foley thanked the AAA

for its report (Attachment Four-D) and said the working group should be ready in December to discuss this issue and give direction to the AAA.

#### 4. Variable Life Insurance Illustrations

Carl Wilkerson (ACLI) brought the working group up to date on the activity of the Securities and Exchange Commission (SEC) on variable life illustrations. He said the current proposal is for a hypothetical illustration and a personal illustration. Mr. Wilkerson provided the working group with a copy of the submission from the ACLI to the SEC and said that the ACLI proposal includes standards for a personalized illustration that are adapted from the NAIC Life Insurance Illustration Model Regulation. Mr. Wilkerson suggested that the SEC might make a decision on its illustration rules by the end of the year, but more likely in the spring. He offered his assistance in making contact with the SEC.

Mr. Foley said it appeared that the NAIC should provide its perspective to the SEC, but the problem is that Rick Morse (LeBoeuf, Lamb, Greene & MacRae, L.L.P.), formerly with the New York Insurance Department, left the regulatory community and no one else has his expertise. Mr. Foley asked if there were regulators in attendance who would be willing to discuss strategy in commenting to the SEC. Mr. Batte and Mr. DeAngelo offered to assist in that effort.

#### 5. Adopt Minutes of July 28, 1998, Conference Call

Mr. Batte moved and Mr. Strauss seconded a motion to adopt the minutes of the July 28, 1998, conference call (Attachment Four-E). The motion passed.

Having no further business, the Life Disclosure Working Group adjourned at 4:50 p.m.

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### ATTACHMENT FOUR-A

#### Buyer's Guide to Fixed Deferred Annuities Adopted by the Life Insurance and Annuities (A) Committee Draft: 9/16/98

Drafting Note: The language of the Fixed Deferred Annuity Buyer's Guide is limited to that contained in the following pages, or to language approved by the commissioner. Companies may purchase personalized brochures from the NAIC or may request permission to reproduce the Buyer's Guide in their own type style and format.

[The face page of the Fixed Deferred Annuity Buyer's Guide shall read as follows:]

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. . .

It is important that you understand the differences among various annuities so you can choose the kind that best fits your needs. This guide focuses on *fixed deferred* annuity contracts. There is, however, a brief description of variable annuities. If you're thinking of buying an equity-indexed annuity, an appendix to this guide will give you specific information. This guide isn't meant to offer legal, financial or tax advice. You may want to consult independent advisors. At the end of this guide are questions you should ask your agent or the company. Make sure you're satisfied with the answers before you buy.

What is an annuity?

An annuity is a contract in which an insurance company makes a series of income payments at regular intervals in return for a premium or premiums you have paid. Annuities are most often bought for future retirement income. Only an annuity can pay an income that can be guaranteed to last as long as you live.

An annuity is neither a life insurance nor a health insurance policy. It's not a savings account or a savings certificate. You shouldn't buy an annuity to reach short-term financial goals.

Your value in an annuity contract is the premiums you've paid, less any applicable charges, plus interest credited. The insurance company uses the value to figure the amount of most of the benefits that you can choose to receive from an annuity contract. This guide explains how interest is credited as well as some typical charges and benefits of annuity contracts.

A *deferred* annuity has two parts or *periods*. During the *accumulation period*, the money you put into the annuity, less any applicable charges, earns interest. The earnings grow tax-deferred as long as you leave them in the annuity. During the second period, called the *payout period*, the company pays income to you or to someone you choose.

### What are the different kinds of annuities?

This guide explains major differences in different kinds of annuities to help you understand how each might meet your needs. But look at the specific terms of an individual contract you're considering and the disclosure document you receive. If your annuity is being used to fund or provide benefits under a pension plan, the benefits you get will depend on the terms of the plan. Contact your pension plan administrator for information.

This Buyer's Guide will focus on individual fixed deferred annuities.

### Single premium or multiple premium

You pay the insurance company only one payment for a *single premium* annuity. You make a series of payments for a *multiple premium* annuity. There are two kinds of multiple premium annuities. One kind is a *flexible premium* contract. Within set limits, you pay as much premium as you want, whenever you want. In the other kind, a *scheduled premium* annuity, the contract spells out your payments and how often you'll make them.

### Immediate or deferred

With an *immediate* annuity, income payments start no later than one year after you pay the premium. You usually pay for an immediate annuity with one payment.

The income payments from a *deferred* annuity often start many years later. Deferred annuities have an accumulation period, which is the time between when you start paying premiums and when income payments start.

### Fixed or variable

- Fixed

During the accumulation period of a *fixed deferred* annuity, your money (less any applicable charges) earns interest at rates set by the insurance 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 period, the amount of each income payment to you is generally set when the payments start and will not change.

- Variable

During the accumulation period of a *variable* annuity, the insurance company puts your premiums (less any applicable charges) into a separate account. You decide how the company will invest those premiums, depending on how much risk you want to take. You may put your premium into a stock, bond or other account, with no guarantees, or into a fixed account, with a minimum guaranteed interest. During the payout period of a variable annuity, the amount of each income payment to you may be fixed (set at the beginning) or variable (changing with the value of the investments in the separate account).

### How are the interest rates set for my fixed deferred annuity?

During the accumulation period, your money (less any applicable charges) earns interest at rates that change from time to time. Usually, what these rates will be is entirely up to the insurance company.

### Current interest rate

The current rate is the rate the company decides to credit to your contract at a particular time. The company will guarantee it will not change for some time period.

- The *initial rate* is an interest rate the insurance company may credit for a set period of time after you first buy your annuity. The initial rate in some contracts may be higher than it will be later. This is often called a bonus rate.
- The *renewal rate* is the rate credited by the company after the end of the set time period. The contract tells how the company will set the renewal rate, which may be tied to an external reference or index.

### Minimum guaranteed rate

The *minimum guaranteed interest rate* is the lowest rate your annuity will earn. This rate is stated in the contract.

### multiple interest rates

Some annuity contracts apply different interest rates to each premium you pay or to premiums you pay during different time periods.

Other annuity contracts may have two or more accumulated values that fund different benefit options. These accumulated values may use different interest rates. You get only one of the accumulated values depending on which benefit you choose.

### What charges may be subtracted from my fixed deferred annuity?

Most annuities have charges related to the cost of selling or servicing it. These charges may be subtracted directly from the contract value. Ask your agent or the company to describe the charges that apply to your annuity. Some examples of charges, fees and taxes are:

#### Surrender or withdrawal charges

If you need access to your money, you may be able to take all or part of the value out of your annuity at any time during the accumulation period. If you take out part of the value, you may pay a *withdrawal* charge. If you take out all of the value and surrender, or terminate, the annuity, you may pay a *surrender* charge. In either case, the company may figure the charge as a percentage of the value of the contract, of the premiums you've paid or of the amount you're withdrawing. The company may reduce or even eliminate the surrender charge after you've had the contract for a stated number of years. A company may waive the surrender charge when it pays a death benefit.

Some annuities have stated terms. When the term is up, the contract may automatically expire or renew. You're usually given a short period of time, called a *window*, to decide if you want to renew or surrender the annuity. If you surrender during the window, you won't have to pay surrender charges. If you renew, the surrender or withdrawal charges may start over.

In some annuities, there is no charge if you surrender your contract when the company's current interest rate falls below a certain level. This may be called a *bail-out* option.

In a multiple-premium annuity, the surrender charge may apply to each premium paid for a certain period of time. This may be called a *rolling* surrender or withdrawal charge.

Some annuity contracts have a *market value adjustment* feature. If interest rates are different when you surrender your annuity than when you bought it, a market value adjustment may make the cash surrender value higher or lower. Since you and the insurance company share this risk, an annuity with an MVA feature may credit a higher rate than an annuity without that feature.

Be sure to read the Tax Treatment section and ask your tax advisor for information about possible tax penalties on withdrawals.

#### Free withdrawal

Your annuity may have a limited *free withdrawal* feature. That lets you make one or more withdrawals without a charge. The size of the free withdrawal is often limited to a set percentage of your contract value. If you make a larger withdrawal, you may pay withdrawal charges. You may lose any interest above the minimum guaranteed rate on the amount withdrawn. Some annuities waive withdrawal charges in certain situations, such as death, confinement in a nursing home or terminal illness.

#### Contract fee

A contract fee is a flat dollar amount charged either once or annually.

#### Transaction fee

A transaction fee is a charge per premium payment or other transaction.

#### Percentage of premium charge

A percentage of premium charge is a charge deducted from each premium paid. The percentage may be lower after the contract has been in force for a certain number of years or after total premiums paid have reached a certain amount.

#### Premium tax

Some states charge a tax on annuities. The insurance company pays this tax to the state. The company may subtract the amount of the tax when you pay your premium, when you withdraw your contract value, when you start to receive income payments or when it pays a death benefit to your beneficiary.

#### What are some fixed deferred annuity contract benefits?

##### Annuity income payments

One of the most important benefits of deferred annuities is your ability to use the value built up during the accumulation period to give you a lump sum payment or to make income payments during the payout period. Income payments are usually made monthly but you may choose to receive them less often. The size of income payments is based on the accumulated value in your annuity and the annuity's *benefit rate* in effect when income payments start. The benefit rate usually depends on your age and sex, and the annuity payment option you choose. For example, you might choose payments that continue as long as you live, as long as your spouse lives or for a set number of years.

There is a table of guaranteed benefit rates in each annuity contract. Most companies have *current* benefit rates as well. The company can change the current rates at any time, but the current rates can never be less than the guaranteed benefit rates.



When income payments start, the insurance company generally uses the benefit rate in effect at that time to figure the amount of your income payment.

Companies may offer various income payment options. You (the owner) or another person that you name may choose the option. The options are described here as if the payments are made to you.

- **Life Only** - The company pays income for your lifetime. It doesn't make any payments to anyone after you die. This payment option usually pays the highest income possible. You might choose it if you have no dependents, if you have taken care of them through other means or if the dependents have enough income of their own.
- **Life Annuity with Period Certain** - The company pays income for as long as you live and guarantees to make payments for a set number of years even if you die. This *period certain* is usually 10 or 20 years. If you live longer than the period certain, you'll continue to receive payments until you die. If you die during the period certain, your beneficiary gets regular payments for the rest of that period. If you die after the period certain, your beneficiary doesn't receive any payments from your annuity. Because the "period certain" is an added benefit, each income payment will be smaller than in a life-only option.
- **Joint and Survivor** - The company pays income as long as either you or your beneficiary lives. You may choose to decrease the amount of the payments after the first death. You may also be able to choose to have payments continue for a set length of time. Because the *survivor* feature is an added benefit, each income payment is smaller than in a life-only option.

#### Death benefit

In some annuity contracts, the company may pay a death benefit to your beneficiary if you die before the income payments start. The most common death benefit is the contract value or the premiums paid, whichever is more.

Can my annuity's value be different depending on my choice of benefit?

While all deferred annuities offer a choice of benefits, some use different accumulated values to pay different benefits. For example, an annuity may use one value if annuity payments are for retirement benefits and a different value if the annuity is surrendered. As another example, an annuity may use one value for long-term care benefits and a different value if the annuity is surrendered. You can't receive more than one benefit at the same time.

What about the tax treatment of annuities?

Below is a general discussion about taxes and annuities. You should consult a professional tax advisor to discuss your individual tax situation.

Under current federal law, annuities receive special tax treatment. Income tax on annuities is deferred, which means you aren't taxed on the interest your money earns while it stays in the annuity. Tax-deferred accumulation isn't the same as tax-free accumulation. An advantage of tax deferral is that the tax bracket you're in when you receive annuity income payments may be lower than the one you're in during the accumulation period. You'll also be earning interest on the amount you would have paid in taxes during the accumulation period. Most states' tax laws on annuities follow the federal law.

Part of the payments you receive from an annuity will be considered as a return of the premium you've paid. You won't have to pay taxes on that part. Another part of the payments is considered interest you've earned. You must pay taxes on the part that is considered interest when you withdraw the money. You may also have to pay a 10% tax penalty if you withdraw the accumulation before age 59 1/2. The Internal Revenue Code also has rules about distributions after the death of a contract holder.

Annuities used to fund certain employee pension benefit plans (those under Internal Revenue Code Sections 401(a), 401(k), 403(b), 457 or 414) defer taxes on plan contributions as well as on interest or investment income. Within the limits set by the law, you can use pretax dollars to make payments to the annuity. When you take money out, it will be taxed.

You can also use annuities to fund traditional and Roth IRAs under Internal Revenue Code Section 408. If you buy an annuity to fund an IRA, you'll receive a disclosure statement describing the tax treatment.

What is a "free look" provision?

Many states have laws which give you a set number of days to look at the annuity contract after you buy it. If you decide during that time that you don't want the annuity, you can return the contract and get all your money back. This is often referred to as a *free look* or *right to return* period. The free look period should be prominently stated in your contract. Be sure to read your contract carefully during the free look period.

How do I know if a fixed deferred 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 think about 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 much retirement income will I need in addition to what I will get from Social Security and my pension?

- Will I need that additional income only for myself or for myself and someone else?
- How long can I leave my money in the annuity?
- When will I need income payments?
- Does the annuity let me get money when I need it?
- Do I want a fixed annuity with a guaranteed interest rate and little or no risk of losing the principal?
- Do I want a variable annuity with the potential for higher earnings that aren't guaranteed and the possibility that I may risk losing principal?
- Or, am I somewhere in between and willing to take some risks with an equity-indexed annuity?

What questions should I ask my agent or the company?

- Is this a single premium or multiple premium contract?
- Is this an equity-indexed annuity?
- What is the initial interest rate and how long is it guaranteed?
- Does the initial rate include a bonus rate and how much is the bonus?
- What is the guaranteed minimum interest rate?
- What renewal rate is the company crediting on annuity contracts of the same type that were issued last year?
- Are there withdrawal or surrender charges or penalties if I want to end my contract early and take out all of my money? How much are they?
- Can I get a partial withdrawal without paying surrender or other charges or losing interest?
- Does my annuity waive withdrawal charges for reasons such as death, confinement in a nursing home or terminal illness?
- Is there a market value adjustment (MVA) provision in my annuity?
- What other charges, if any, may be deducted from my premium or contract value?
- If I pick a shorter or longer payout period or surrender the annuity, will the accumulated value or the way interest is credited change?
- Is there a death benefit? How is it set? Can it change?
- What income payment options can I choose? Once I choose a payment option, can I change it?

#### Final Points to Consider

Before you decide to buy an annuity, you should review the contract. Terms and conditions of each annuity contract will vary.

Ask yourself if, depending on your needs or age, this annuity is right for you. Taking money out of an annuity may mean you must pay taxes. Also, while it's sometimes possible to transfer the value of an older annuity into a new annuity, the new annuity may have a new schedule of charges that could mean new expenses you must pay directly or indirectly.

You should understand the long-term nature of your purchase. Be sure you plan to keep an annuity long enough so that the charges don't take too much of the money you put in. Be sure you understand the effect of all charges.

If you're buying an annuity to fund an IRA or other tax-deferred retirement program, be sure that you're eligible. Also, ask if there are any restrictions connected with the program.

Remember that the quality of service that you can expect from the company and the agent is a very important factor in your decision.

When you receive your annuity contract, **READ IT CAREFULLY!!** Ask the agent and company for an explanation of anything you don't understand. Do this *before* any free look period ends.

Compare information for similar contracts from several companies. Comparing products may help you make a better decision.

If you have a specific question or can't get answers you need from the agent or company, contact your state insurance department.

#### APPENDIX I—EQUITY-INDEXED ANNUITIES

This appendix to the Buyer's Guide for Fixed Deferred Annuities will focus on equity-indexed annuities. Like other types of fixed deferred annuities, equity-indexed annuities provide for annuity income payments, death benefits and tax-deferred accumulation. You should read the Buyer's Guide for general information about those features and about provisions such as withdrawal and surrender charges.

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)<sup>2</sup>, 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.

<sup>2</sup> S&P 500 is a registered trademark of the McGraw-Hill Companies, Inc., used with permission.

While immediate equity-indexed annuities may be available, this appendix 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% 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 equity-indexed annuity 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% ( $9\% \times 70\% = 6.3\%$ ). 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.

#### Low-Water Mark

The index-linked interest, if any, is determined 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 index value at the end of the term and the lowest index value. 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, equity-indexed 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
<b>Annual Reset</b>  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.
<b>High-Water Mark</b>  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.

<p><b>Low-Water Mark</b></p> <p>Since interest is calculated using the lowest value of the index prior to the end of the term, this design may credit higher interest than some other designs if the index reaches a low point early or in the middle of the term and then rises at the end of the term.</p>	<p>Interest is not credited until the end of the term. With 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 a comparison of the lowest anniversary value to date with the index value at surrender 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.</p>
<p><b>Point-to-Point</b></p> <p>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.</p>	<p>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.</p>

What is the impact of some other equity-indexed annuity 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.

What will it cost me to take my money out before the end of the term?

In addition to the information discussed in this Buyer's Guide about surrender and withdrawal charges and free withdrawals, there are additional considerations for equity-indexed annuities. Some annuities credit none of the index-linked interest or only part of it if you take out 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.

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.

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:

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

You should ask the following questions about equity-indexed annuities in addition to the questions in the Buyer's Guide to Fixed Deferred Annuities.

- How long is the term?
- What is the guaranteed minimum interest rate?
- What is the participation rate? For how long is the participation rate guaranteed?
- Is there a minimum participation rate?
- Does my contract have an interest rate cap? What is it?
- Does my contract have an interest rate floor? What is it?
- Is interest rate 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?
- What 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? If so, what is the rate of vesting?

Final Points to Consider

Remember to read your annuity contract carefully when you receive it. Ask your agent or insurance company to explain anything you don't understand. If you have a specific complaint or can't get answers you need from the agent or company, contact your state insurance department.

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#### ATTACHMENT FOUR-B

##### Annuity Disclosure Model Regulation Suggestion for Alternative Section 5A and B Drafted: 9/14/98

A. Insurers shall make an effort to assure that the Buyer's Guide is made available to prospective applicants before the time of application by including the Buyer's Guide on its Web site and including in its advertisements an announcement of the availability of the Buyer's Guide.

B. Notwithstanding such efforts, the disclosure document and Buyer's Guide shall be provided at the time of application if the application is to be completed in the course of a face-to-face meeting between the applicant and a producer. In the case of a sale conducted by means of the telephone, the disclosure document and Buyer's Guide must be mailed to the applicant within two (2) business days following the telephone call at which the sale is made. In cases of direct solicitation through the mails, the Internet, or other mass communication media, the disclosure document and Buyer's Guide must be sent to the applicant no later than 48 hours after the signed application is received by the insurer.

(1) With respect to direct solicitations through the mail, providing a Buyer's Guide in mailings inviting prospective applicants to apply for an annuity shall satisfy the requirement that the Buyer's Guide be provided within two (2) business days of receipt of the application for applications received as a result of such mail solicitation.

(2) With respect to applications received via the Internet, including the Buyer's Guide on its Web site or by electronic means shall satisfy the requirement that the Buyer's Guide be provided within two (2) business days of receipt of the application.

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Annuity Disclosure Model Regulation  
Draft: 9/15/98

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Section 1. Purpose

The purpose of this regulation is to provide standards for the disclosure of certain minimum information about annuity contracts to 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 goal of this regulation is to ensure that purchasers of annuity contracts understand certain basic features of annuity contracts. ~~Insurers shall define terms used in the disclosure statement in language that facilitates the understanding by a typical person within the segment of the public to which the disclosure statement is directed.~~

Section 2. Authority

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

Section 3. Applicability and Scope

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

- A. Registered or non-registered variable annuities or other registered products;
- B. Immediate and deferred annuities that contain no nonguaranteed elements ~~if the contract describing the benefits is provided at time of application or if it is provided at time of delivery and a thirty day free look is provided;~~
- C. (1) Annuities used to fund:
  - (a) An employee pension plan which is covered by the Employee Retirement Income Security Act (ERISA);
  - (b) A plan described by Sections 401(a), 401(k), 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer,
  - (c) A governmental or church plan defined in Section 414 or a deferred compensation plan of a state or local government or a 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; and]~~
- F. ~~[Funding agreements].~~

Drafting Note: States that regulate charitable gift annuities should exempt them from the requirements of this regulation. States that recognize or regulate funding agreements as annuities should exempt them from the requirements of this regulation.

## Section 4. Definitions

For the purposes of this regulation:

A. ~~“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. [“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, but 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. “Contract owner” means the owner named in the annuity contract or certificate holder in the case of a group annuity contract.

C. ~~“Determinable elements” means elements that are derived from processes or methods that are guaranteed at issue and not subject to company discretion, but where the values or amounts cannot be determined until some point after issue. These elements include the premiums, credited interest rates (including any bonus), benefits, values, non-interest based credits, charges or elements of formulas used to determine any of these. These elements may be described as guaranteed but not determined at issue. An element is considered determinable if it was calculated from underlying determinable elements only, or from both determinable and guaranteed elements.~~

~~[“Funding agreement” means an agreement for an insurer to accept and accumulate funds and to make one or more payments at future dates in amounts that are not based on mortality or morbidity contingencies.]~~

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

DE. ~~“Guaranteed elements” means the benefits, values, credits and charges under an annuity contract that are guaranteed and determined at issue, premiums, credited interest rates (including any bonus), benefits, values, non-interest based credits, charges or elements of formulas used to determine any of these, that are guaranteed and determined at issue. An element is considered guaranteed if all of the underlying elements that go into its calculation are guaranteed.~~

EG. ~~“Non-guaranteed elements” means the benefits, values, credits and charges under an annuity contract that are not guaranteed or not determined at issue, premiums, credited interest rates (including any bonus), benefits, values, non-interest based credits, charges or elements of formulas used to determine any of these, that are subject to company discretion and are not guaranteed at issue. An element is considered non-guaranteed if any of the underlying non-guaranteed elements are used in its calculation.~~

FH. ~~“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.” Structured settlement annuity” means a “qualified funding asset” as defined in section 130(d) of the Internal Revenue Code or an annuity that would be a qualified funding asset under section 130(d) but for the fact that it is not owned by an assignee under a qualified assignment.~~

## Section 5. Standards for the Disclosure Document and Buyer's Guide

A. ~~An applicant for an annuity contract shall be given both a disclosure document as described in Subsection B-C and the Buyer's Guide contained in Appendix A as early in the sales process as practicable. The company will make every reasonable effort, both locally and globally, to distribute the Buyer's Guide prior to the sales process. The disclosure document shall be provided at the time of application in a face-to-face meeting or, in the case of a sale conducted by means of the telephone, mailed to the applicant direct solicitation through the telephone, mails, the Internet, or other mass communication media, within two (2) business days after the application is received by the insurer. If the insurer elects to deliver the Buyer's Guide only at the time of contract delivery, an additional period of ten (10) days shall be added to any otherwise applicable right of return period for the owner to review the contract and Buyer's Guide. If, however,~~

B. ~~The insurer shall makes reasonable efforts to assure that the Buyer's Guide is made available to prospective applicants, preferably before, but no later than the time of application, no additional review period shall be required. Note: An insurer may demonstrate it has made reasonable efforts by:~~

~~1-(1) Working, individually or within an association, with regulators in its state of domicile to present public service announcements regarding the availability of the Buyer's Guide;~~

~~2-(2) Encouraging its producers to use the Buyer's Guide in mailings to or in seminars for potential purchasers or in other communications with clients;~~

~~3-(3) Including in any newsletters sent to contract owners an announcement of the availability of the Buyer's Guide; or~~

~~4-(4) Including the Buyer's Guide on its Web site and encouraging individual representatives or other intermediaries to do the same;~~



~~and other similar efforts.~~

~~BC.~~ At a minimum, the following information shall be 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, emphasizing its long-term nature ~~and describing in plain language, including examples where appropriate:~~
  - (a) The guaranteed, ~~and non-guaranteed~~ and determinable elements of the contract, and their limitations, if any, and an explanation of how they operate;
  - (b) 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 income options both on a guaranteed and non-guaranteed basis;
  - (d) Any value reductions caused by withdrawals from or surrender of the contract;
  - (e) How values in the contract can be accessed;
  - (f) The death benefit, if available and how it will be calculated;
  - (g) A summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract; and
  - (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.
- (5) Information about the current guaranteed rate for new policies that contains a clear notice that the rate is subject to change.

~~C. All disclosure and marketing material shall be written using plain language with the negatives and positives of all features and concepts clearly presented. Insurers shall define terms used in the disclosure statement in language that facilitates the understanding by a typical person within the segment of the public to which the disclosure statement is directed.~~

~~D. Any concepts that are not specified in the requirements in Section B for the disclosure document that are included in the contract or offered with the contract by the company shall be included and clearly explained in the disclosure document.~~

#### Section 6. ~~Annual Report; Notice to Contract Owners~~

For annuities in the payout period with changes in non-guaranteed elements and for the accumulation period of a deferred annuity, the insurer shall provide each contract owner with an annual report, at least annually, on the status of the contract that shall contain at least the following information:

- A. The beginning and end date of the current report period;
- B. The accumulation and cash surrender value, if any, at the end of the previous report period and at the end of the current report period;

Drafting Note: States adopting this regulation with an effective date before July 1, 2000 should consider a delayed effective date for including the cash surrender value that is after June 30, 2000 because it appears programming changes may be required for many insurers.

- C. The total amounts, if any, that have been credited, ~~or~~ charged to the contract value or paid during the current report period; and
- D. The amount of outstanding loans, if any, as of the end of the current report period.

#### Section 7. 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 8. 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 9. 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 FOUR-D

### Report on Annuity Supportability of the Disclosure Working Group of the Committee on State Life Insurance Issues September 1998

This report was prepared by the American Academy of Actuaries Disclosure Working Group (ADWG) of the Committee on State Life Insurance Issues at the request of the Life Disclosure Working Group of the NAIC. Members of the Academy work group are:

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With appreciation to the many interested parties for their active participation and contributions.

## I. Introduction

As a professional organization, the American Academy of Actuaries, through the Academy's Disclosure Working Group (ADWG), is pleased to assist the NAIC Life Disclosure Working Group (LDWG) in exploring annuity supportability options. In providing technical assistance, the Academy does not take a position on the public policy issue of whether annuity supportability testing should be required. The Academy is serving the public through helping to explore alternatives for consideration by the LDWG's public policy decisions.

## II. Supportability Testing and Supportability Disclosure

As discussed in prior reports, the ADWG believes annuity supportability testing is limited to demonstrating the "ability to pay." As such, it can only demonstrate what a company can reasonably afford to pay if testing assumptions happen to reflect future actual conditions.

The ADWG has also considered concepts using supportability disclosure. This approach may provide consumers with more information on the company's intent to pay illustrated benefits, although such information will still be limited.

Both supportability testing and supportability disclosure may be useful tools in achieving regulators' public policy goals.

## III. Supportability Testing Research: Polling Regulators and Industry

### 1. Polling LDWG Members

The ADWG talked individually with each member of the LDWG (see appendix A for a summary of the poll).

Currently LDWG is focusing its priorities on disclosure issues, especially surrender charge levels and durations.

The need for annuity supportability testing is subject to a variety of opinions by LDWG members. A few members actively desire such testing, a few do not see a need for testing at this time, and still other members would simply accept testing as long as test methods were acceptable to concerned regulators. After the current set of disclosure issues are resolved, the ADWG suggests the LDWG discuss the need for annuity supportability testing, develop a consensus on its priority and objectives, and determine how to accomplish these objectives.

### 2. The New York Insurance Department

The ADWG has also been contacted by the New York Insurance Department. They identified an immediate deadline, imposed by legislation, that requires supportability testing.

### 3. Industry Input

The American Council of Life Insurance (ACLI) distributed the ADWG's June report through a number of its committees, including the Cost Disclosure Committee and the Actuarial Committee. Comments from member companies are anticipated by early September, which is after the publication date of this report.

## IV. Supportability Testing Research: The Six Test Options

Additional research by the ADWG has verified that any of the six tests contained in the ADWG's June 1998 report could be made to work, subject to limitations on accuracy, flexibility, verifiability, or time necessary to complete the testing. Results from the additional research are summarized in appendix B. The advantages and drawbacks each test, as described in the June report, are summarized in appendix C.

The key result of the additional research is identification of the "option cost" as being (after the solvency criteria) perhaps the most critical component that influences test results. An "option cost," which decreases illustrated values, is an additional cost charged against the earned interest rate in a level interest rate scenario. The option cost is calculated using stochastic modeling for a large variety of interest rate environments and "post-issue" changes in the credited rate, subject to a solvency criteria. Essentially it is a "single number" representing the cost of readjustments to asset/liability matching for "post-issue" changes in the interest rate environment.

In general, the ADWG considers the use of stochastic methods to be the most complete for measuring the company's "ability to pay." Such methods calculate "option costs" that are specific to a company and product. Thus, the information received by a consumer best reflects the true ability of a company to pay nonguaranteed benefits. Stochastic methods are also better able to handle product variations and future innovations.

## V. Policy Directions

The ADWG recommends that the LDWG consider setting policy directions for the following four areas:

### 1. Competing Objectives:

The annuity marketplace has a wide variety of products and company approaches to managing such products. It is also a highly competitive area with frequent product variations and innovations.

This creates two competing objectives for supportability testing:

- a. **Simplicity**
  - i) to support smaller companies
  - ii) to allow for easier regulatory verification of results
  - iii) to keep the cost of complying with a new regulatory requirement as affordable as possible
- b. **Flexibility**
  - i) to allow for variations in product designs to be more thoroughly demonstrated by companies to consumers
  - ii) to allow variations in management practices to be more thoroughly demonstrated by companies to consumers
  - iii) to allow a supportability test to respond to new concepts and innovation that will occur in future product designs (i.e., building in flexibility into the design of a supportability test)

The ADWG recommends that regulatory requirements satisfy both the simplicity and flexibility objectives, which, in turn, suggests that any supportability testing regulation would probably need to include testing alternatives.

### 2. General Regulatory Approaches

In writing a regulation, the ADWG has identified four general approaches to incorporating supportability testing:

- i. Stochastic test.
- ii. Simplified test with standardized "option costs."
- iii. Company choice of (a) a stochastic test, or (b) a simplified test with standardized "option costs."
- iv. Simplified test that:
  - a. Uses standardized "option costs," and
  - b. Contains an opportunity for a company, at their discretion, to develop and use customized "option costs" based on stochastic testing.

In all of the simplified tests, the standardized "option costs" would be based on periodically updated external studies and set by regulation.

The ADWG recommends that approaches iii or iv be considered. These two approaches best satisfy the competing objectives for simplicity and flexibility. Each method allows a simplified approach to satisfy certain needs. Also, each approach allows for a stochastic test methodology to be employed, creating "option costs" specific for the product and company. The two approaches differ, however, by the degree of stochastic based factors that can be included. Alternative iii

allows for full stochastic testing, where alternative iv could be designed to limit stochastic customization to only the "option costs."

While the ADWG considers the stochastic test (alternative i) to be the most complete test from an actuarial perspective, it is not recommended at this time because it does not satisfy the objective of simplicity.

The simplified test with a standardized "option cost" (alternative ii) is also not recommended at this time. While such a test could be developed, it would not satisfy the objective of flexibility.

### 3. Specific Test(s) to Be Used

As stated earlier, any of the six tests presented in the ADWG's June 1998 report could be a reasonable basis for a supportability test, with each test identified having certain limitations. Finishing the development of any of the tests would require a number of parameters to be set, including passing criteria. Some of the unique issues for each test are:

- Tests #1 (stochastic method) and Test #2 (defined scenario stochastic method) are both stochastic tests. Test #1 would require a measurement standard to determine if the interest rate environments tested were reasonably varied. Test #2 would require identification of a limited number of prescribed interest rate environments. (Testing has shown the valuation set, the New York 7, is not a good set for an illustration standard).
- Test #3 (static scenario method – product-based), #4, (the margin approach) and #5 (static scenario method - standardized) are all simplified tests that are similar to "static assumption pricing." Any can be developed to serve as a simplified test.
- Test #6 (the Treasury approach) could also work, but is felt by the ADWG to be too removed from the actual assets that would back the policy values. It is the only test that is not recommended at this time.

The advantages and drawbacks of each method are summarized in appendices C.

The ADWG encourages the LDWG to decide to develop further (at most) one of the stochastic and one of the simplified methods. Full definition of six different methods is beyond the level of work that can be accomplished at this time. Also, the ADWG believes that further testing of generic product designs will not provide grounds for eliminating any of the tests.

### 4. Use of Supportability Disclosure

The ADWG believes consumers' understanding of non-guaranteed elements would be increased from disclosure supportability information. The ADWG encourages the LDWG to consider how such disclosure can be encouraged. More information is contained in the supportability disclosure sections of the ADWG's February and June 1998 reports.

## VI. Recommendations

To summarize the ADWG recommendations identified above:

First, the ADWG suggests the LDWG discuss the need for annuity supportability testing, develop a consensus on its priority and objectives, and determine how it would like to accomplish these objectives.

If a model regulation is to be developed that contains an annuity supportability test, then the ADWG further recommends :

Recommendation #1: The competing objectives of simplicity and flexibility should both be incorporated into testing requirements.

Recommendation #2: The requirements should consider either of the following general testing approaches:

iii. Company choice of (a) a stochastic test, or (b) a simplified test with standardized "option costs."

iv. Simplified test that:

- a. Uses standardized "option costs," and
- b. Contains an opportunity for a company, at their discretion, to develop and use customized "option costs" based on stochastic testing.

Recommendation #3: The LDWG should make an explicit decision to develop further one stochastic and one simplified test for use in a regulation.

Recommendation #4: The LDWG should consider supportability disclosure.

## VII. Academy's Willingness to Assist

The Academy's Disclosure Work Group believes the key aspect of the original charge is completed. Research has been completed that provides useful information about annuity supportability testing options for consideration by the LDWG as they develop their public policy priorities.

Based on public policy directions set by LDWG, the ADWG is able and willing to assist in completing the development of an annuity supportability test for use in a regulation. We look forward to the LDWG discussions and decisions on this matter.

#### Appendix A: Regulators' Perceived Need for Supportability Testing

To better understand regulators' range of concerns and determine how widely particular concerns were shared, in August 1998 ADWG members contacted members of the LDWG and asked them a set of questions touching a number of areas. The sections below summarize the results of the interviews in the seven areas discussed.

#### Problems to be Addressed by Regulation

LDWG members mentioned a range of problems and considerations that the regulation and the regulatory process should address. Among the problems and areas cited were:

- Surrender charges
- Buyer's Guide
- Assurance the "numbers are sound"
- Suitability of sales, especially to seniors
- Replacements, especially with surrender charges
- Actuarial stuff can wait longer than the end of year
- Customers not understanding that annuities sold by banks are not bank contracts
- Annuities have the fewest customer complaints
- Concern about "baiting and switching," including first-year bonuses
- Complaints are one to six years after the sale and focus on:
  - i) inadequate disclosure of surrender charges including the durations to which they apply and
  - ii) projected high interest rates when the company does not intend to continue to pay
- What about products that mix life and annuity features - how should they be included?
- Life tests need not be modified to include cost of capital and asset and liability matching
- Concerns may not be best addressed by supportability as much as by additional disclosure (Seniors and two-tier annuities)
- Projections too far into the future have no meaning
- Increase in lapses can be due to unfavorable publicity for a company
- Concern the company will illustrate increases in rates after certain durations (as has been done with universal life illustrations)
- Profits should be level for the life of policy or at least be intended that way
- Higher profit objectives at later years should somehow be disclosed
- Paid interest rates, rather than illustrated rates, are the cause of surrenders and complaints to insurance departments
- Need to focus on interest rates and what consumers should expect.
- Consumer should review buyer's guide, then disclosure, then (potentially) the illustration, then the contract
- Surrender Charges - length and how (date of deposit and with each deposit)
- Concern about unique products
- Not a lot of concern with bonus products, disclosure not found to be misleading
- Not concerned about disclosure of payout rate
- Bonus rates need to be disclosed
- Any interest rate is an implicit illustration and must be treated in that way
- Reductions in crediting rates after a company is sold to a new buyer
- Illustration of rates that the company does not intend to pay
- For nonguaranteed elements (NGEs), there are three types of insurers
  1. companies that are highly confident they can provide the NGEs
  2. companies that have trouble providing the NGEs
  3. a blend of 1 and 2, where the company may believe it can provide NGEs, but is not highly confident.
- Concern is over #2 and #3, but evidence is anecdotal
- Silence on renewal rates implies the first-year rate will continue in renewal years; a possible solution is to require that the rate be supportable over the life of contract; also need to show expected renewal rates
- Agents don't explain surrender charges well, but it could be the memory of consumers
- Concern that some agents may be dishonest or simply don't understand the products
- In general, very few complaints on annuities - "No big deal"
- Consumer disclosure by itself is helpful
- Regulators are also concerned that products and illustrations are supportable; regulators should be able to rely on a company's certification, but should not be expected to police the application of supportability standards
- Supportability standards could build on the actuarial opinions and risk-based capital standards related to company solvency, except applied to a product level
- Concern that because annuities are so important to companies (i.e., a large part of their sales), products may be brought to market too quickly and may not be supportable; disclosure alone will not get to this, but certification may help control it
- Concern that a company will reduce its credited rates to earn a higher spread; yet, if the actuary has to disclose this to regulators, what will the regulators do with this information? What if the regulator finds out it was not disclosed, what will they do?

## Options for Regulatory Solutions

Too much disclosure is as bad as none  
 Need to monitor telemarketing  
 The Internet - need methods to police licensure of companies and agents  
 Better surrender charge disclosure (amount and duration)  
 Illustrations consistent with company interest crediting strategy; some states require filing of strategy, but we also want consumers to be aware of the strategy  
 Want public to understand what will happen (based on past history of the company), i.e., what are this company's business practices?  
 Favor use of supportability test; there should be controls  
 Complex products - same supportability test is acceptable, but the amount of disclosure should increase with complexity  
 Don't want to force illustrations and lots of paper if the company is not doing it now  
 A supportability test may help, but it needs to be simple  
 Supportability disclosure will not work (for example, balancing language or a complex "prospectus" that people will not read)  
 Disclosure on the risks of products may be more helpful to the regulator than to the consumer  
 Disclose as much as possible  
 Use disclosure, but keep it very simple (one-half a page); make the Buyer's Guide available if requested  
 Should have disclosure on annual reports to remind consumer about the surrender charges, etc.  
 High powered testing may not be helpful - every actuary will be able to set assumptions to justify the rate the company wishes to use that was developed by their normal means; it becomes a regulatory hurdle that does not serve a real worthwhile purpose  
 The illustration implies the company's intent and ability to pay the illustrated scale; verifying management integrity is very difficult and will not be forced by many calculations  
 If the consumer has the basic understanding that, as interest rates change, the credited rate will change, then what is the point of dealing with all kinds of different interest rates in the future?

## Preferences for Any of the Six Tests Identified in the Academy's June Report

Don't yet understand the tests, but favor controls on what is given to the customer  
 There needs to be consistency among companies—a level playing field  
 One regulator preferred the static scenario-standardized; the small companies would accept it, it would be harder to have regulators verify stochastic testing, though it is more thorough  
 Suggest the Academy Disclosure Working Group get feedback of small companies  
 Static method-standardized is my choice; there are fewer actuarial assumptions  
 Could use two tests and require passing both  
 Test results are only as good as assumptions, so minimize assumptions  
 Don't understand the need for capital and cost of capital issue  
 Margin approach (due to focus on spread) or standardized static scenario (due to consistency with life tests)  
 Complex tests seem to add cost without justifying efforts  
 Keep self-support test as simple as possible but make sure "gaming" is as small as possible (e.g., 2% of the time would be an okay level)  
 Would choose a self-support solution closer to the "disclosure" end of the spectrum, rather than stochastic testing  
 Doubtful that a self-support test is needed  
 Life tests work well – can those margins and simplifications be used for annuities?  
 In the introduction of new products, regulators should have some assurance that the tests selected will work for those products  
 If complex testing will lessen abuses, then maybe they can be justified

## Use of Layered Approach

Use of stochastic annually and simplified more frequently would be acceptable  
 Having a choice is probably okay; it would allow smaller companies to avoid stochastic testing  
 Interesting concept with which I'm comfortable

## Equity-Indexed Annuities (EIAs)

Should be important part of the disclosure rules  
 Prefer it is in fixed annuity regulation, not a stand-alone rule  
 Concerned about EIAs being too complex and companies taking too much margin  
 Consumer disclosure for EIA is generally good  
 Equity-indexed disclosures that companies are asking customer to sign to indicate understanding are themselves very difficult to understand and may be incomplete  
 Should allow use of hypotheticals  
 It would be acceptable to have the same supportability test for equity-indexed products, but a separate view may be needed  
 EIAs can have the non-guaranteed element problem (i.e., showing a nonsupportable participation rate when it is guaranteed only one year at a time).  
 It would be nice to have same self-support test for EIAs as other annuities; perhaps testing would be limited to just the participation rate issue

EIAs need extra disclosure

A self-support test is probably not needed if all the pieces are guaranteed

Hope the supportability testing will decrease the potential for misleading consumers into the purchase of EIA products

Any tests should apply to EIA products as soon as the tests are adopted

#### Illustration of Annuitization Options

This should be a more important part of sales process

Purchase rates should be better to encourage annuitization

Payouts should be illustrated (not just accumulation)

Disclosure of guaranteed and current purchase rates would be good

Not used, but if they are, they should be subject to same principles as other illustrations.

Prefer emphasizing income benefits, but industry and public may have little interest in them

Don't believe a supportability test on the income options is of benefit

Important for two-tier annuities

Possible problem for all annuities if current purchase rates may not be available in the future

Not a big issue for regular annuities, but could be if insurers start to compete on future annuity income amounts

Not that important

No need to test for self-support; just provide caveats if showing a current purchase rate

#### Other

The LDWG should discuss the observations the Academy is collecting and, using all the comments, discuss the future directions

#### Appendix B. Summary of Additional Research

##### Research Testing Description

The additional research was completed on the bonus single premium deferred annuity (SPDA) product outlined in the ADWG's June 1998 report. This product has a bonus of 3% in the first year's credited interest rate. The research solved for the highest renewal credited rate that could be supported under each test. The table below summarizes these renewal interest rates for each of the six test methods. The table shows results for three different yield curves (which are summarized in a second table below). For each test, an initial approach was defined to allow for completion of the test. For any of the six tests, the approach will need further refinement before it can be used in a regulation.

The stochastic method (#1), with a solvency criteria of 85%, established the parameters that were then used in the other test methodologies. This includes use of an optimal investment strategy. The additional research was a test of the six testing methodologies, not a test of specific parameters or passing criteria. Using parameters derived from the stochastic test gave similar results under each of the six test methods, which indicates that any of the six test method could be developed further into a supportability test.

##### Conclusions

- For all six methodologies, the additional research shows each of the tests to be a viable alternative. Further work is necessary to refine approaches and define passing criteria before any of the methods can be used in a regulation.
- The additional research did not identify reasons to eliminate any specific test.
- Any further research of any of the six methods would benefit from company specific testing of real products currently available on the marketplace. The ADWG testing can only work with generic product designs, which may not uncover real life issues.
- After criteria for passing (e.g., solvency criteria), the "option cost" has been identified as perhaps the most important factor in supportability testing.

**TABLE 1**  
**Research Results for Renewal Credited Interest Rates**

	<u>Test Method</u>	<u>12/97 Yield Curve</u>		<u>12/92 Yield Curve</u>		<u>Plus 3% Yield Curve</u>	
		<u>Renewal</u>	<u>Difference</u>	<u>Renewal</u>	<u>Difference</u>	<u>Renewal</u>	<u>Difference</u>
1.	Stochastic Method	4.50%	—	4.60%	—	6.30% <sup>1</sup>	—
2.	Defined Scenario Stochastic Method (using 1/2 NY 7 Volatility) <sup>2</sup>	5.15%	0.65%	5.55%	0.95%	8.60% <sup>3</sup>	2.30%
3.	Static Scenario Method - Product Based	4.63%	0.13%	4.74%	0.14%	6.82% <sup>3</sup>	0.52%
4.	Margin Approach <sup>4</sup>	4.35%	-0.15%	4.33%	-0.27%	6.81%	0.51%
5.	Static Scenario Method - Standardized	4.33%	-0.17%	4.44%	-0.16%	6.52% <sup>3</sup>	0.22%
6.	Fixed Asset Method (Treasury Approach)	4.53%	0.03%	4.32%	-0.28%	7.67% <sup>3</sup>	1.37%

**Footnotes:**

<sup>1</sup> The Plus 3 scenarios "blew-up," in that an unreasonably large margin (25% IRR) was needed to pass the 85% solvency criteria. In real life, this would probably force a shorter investment strategy. If this method is chosen for further development, additional refinement in the methodology can be done to prevent the problem. A more realistic estimate of the appropriate renewal credited rate is 7.3%.

<sup>2</sup> The additional research started with the New York 7 Cash Flow testing scenario. Because a of strong excess lapse component in the modeling, it was not possible to pass the "up" scenarios even with a modification to the asset mix at issue. Credible results were obtained using one-half the upward increase in the "up" scenarios, which became the basis for completing the additional research. Refinements in the scenarios would be necessary if this method is chosen for further development.

<sup>3</sup> For the Plus 3 scenario, the Stochastic Method (#1) set the cost of capital parameter used in Methods #3, # 4 and #5. This produced the similar renewal interest rates shown in the table. Methods #2 and #6 were independent of the cost of capital from Method #1, which resulted in the higher renewal interest rates shown.

<sup>4</sup> The Margin Approach (Method #4) used a passing criteria based on 50% of policies in-force. The passing criteria could be refined further to improve accuracy, if this method is chosen for further development.

**TABLE 2**  
**Yield Curves Used in Testing**

<u>Maturity</u>	<u>12/97 Yield Curve</u>	<u>12/92 Yield Curve</u>	<u>Plus 3% Yield Curve</u>
2	5.66%	4.77%	8.36%
5	5.71	5.93	8.64
7	5.77	6.40	8.84
10	5.75	6.71	8.98

**Appendix C: Advantages and Drawbacks of Supportability Test Options**

This appendix summarizes the supportability test options identified in the June 1998 ADWG report.

**1. Stochastic Method**

*Description:* Test illustrated benefits using modeling methods from cash flow testing and asset/liability management. Use many runs of different interest rate environments after issue to "stress test" a product and its supporting assets. Has strong reliance on actuarial judgment to set all key factors and their sensitivity to a dynamic interest rate. Criteria for passing is based on a solvency criteria (set in the regulation) and pricing criteria (set by each company and which may vary by each company and product).

*Advantages:* It is very complete from an actuarial perspective and addresses solvency testing and persistency issues. It looks at all factors from the unique position of the company selling the product.

*Drawbacks:* Relies on subjective actuarial assumptions, including how a company will react to different interest rate environments. Also, it is even stricter than the asset adequacy testing completed by Valuation Actuaries. It does not allow sufficiencies from one product to offset possible deficiencies in a different product. Requires the most time of any method to set assumptions and complete testing when new illustrated scales must be reviewed. Test results are only as valid as the actuarial assumptions used in the testing. It is also expensive, complicated and difficult to verify. It is likely too difficult to be completed for frequent interest rate changes.

**2. Defined Scenario Stochastic Method**

*Description:* The Regulation could define a limited number of future interest rate scenarios to be tested using the Stochastic Method described above. Again, company and product specific assumptions for lapses, expenses, etc, would be used, although an annuity generally recognized expense table could be developed. This concept is similar to the use of the New York 7 scenarios in



Valuation Actuary cash flow testing. Specific scenarios would need to be identified for annuity supportability testing. The scenarios and the associated passing criteria would need to be developed.

*Advantages:* This may have rigor similar to the full stochastic method, but with the caveat that the method is applied to a well defined set of interest rate scenarios.

*Drawbacks:* The drawbacks from the full Stochastic Method also apply here.

### 3. Static Scenario Method - Product Based

*Description:* A product specific "option cost" determined periodically using stochastic methods would be used in a static scenario test (similar to the Life Insurance Illustration Regulation self-support and lapse-support tests). Other factors would also need to be incorporated, possibly include a decrease in gross interest rates due to the shortening of investments to maintain asset liability matching and also the capital costs associated with risk-based capital needs. Other factors could be similar to the life self-support test - e.g., persistency, expenses with possible use of a generally recognized expense table, FIT, premium taxes, etc.

Additional persistency stress tests could also be developed.

*Advantages:* Uses modeling methods familiar to most actuaries and is compatible with many pricing methods.

*Drawbacks:* The "option cost" (asset/liability charges) must still be calculated by the company, which could involve a significant amount of work (especially for smaller companies that do not perform cash flow testing). Also, early profits (or losses) from terminating policyholders are accumulated and affect the passing criteria in later years. The cost of capital calculation may result in unanticipated variations in illustrated rates. For example, the proposed test may result in highly capitalized companies illustrating lower interest rates than companies with lower capitalization (all other items being equal).

### 4. Margin Approach

*Description:* Standardizing assumptions are used for asset liability charges ("option costs") Asset shares are not used. Instead, an accumulation formula uses an annual margin (or spread) between the gross interest rate and the credited interest rate, with appropriate adjustments for any bonuses, expenses, and cost of capital charges (possibly based on the risk-based capital method described in the Static Scenario Method). Reserves, FIT, and DAC Tax items are all excluded from the calculations for simplicity. Lapse rates are not part of the accumulation formula and are only used for determining the earliest year in which a positive accumulation must be present. This is somewhat similar to assuming a 100% persistency assumption in the Static Scenario test.

*Advantages:* It limits the factors involved in testing the illustrated interest rate and relies on the other regulatory standards to determine if the company is being managed appropriately (including reserves, valuation actuary testing and risk-based capital measures). It standardizes areas that are difficult for actuaries to determine (e.g., asset/liability matching for changes in interest rates). In other areas, such as earned interest rates and risk-based capital, it still uses company-specific factors that are easy to verify. Each tested year has to "stand on its own." This means that each benefit or year tested meets the passing criteria on a stand alone basis and does not provide or receive subsidy from any other policy benefit or year. It may be simple enough to be completed by a non-actuary, once actuarial assumptions are provided. It may be possible for companies to complete testing more frequently than other more complex methods.

*Drawbacks:* Standardized assumptions do not fit all situations. It does not have as strong of a theoretical foundation as asset adequacy or asset share testing. It is different than approaches currently being used by pricing or valuation actuaries. Also, the test does not capture losses from early surrenders if cash values are too high. If the regulation allows for tests to be completed by non-actuaries, actuarial professional standards may not apply and other regulatory controls may need to be developed.

### 5. Static Scenario Method - Standardized

*Description:* The Standardized Static Scenario Method is most similar to the Life Insurance Illustration Regulation self-support test. An asset share projection is performed using current experience assumptions, including the assumption of a static (i.e., unchanging) interest rate environment. The same type of items are included, such as expenses (possibly with a generally recognized expense table), FIT, persistency, etc. Extra factors to be included are standardized "option cost" charges for asset/liability risk and a standardized "cost of capital" charge. Different passing criteria would be needed, compared to the life tests, and would be based on the percent in-force compared to the life test requirements.

*Advantages:* It is a familiar method (similar to the life test). The standardized asset/liability charge makes the calculations simpler than stochastic calculations. By using the expected persistency method, the criteria for passing reflects variations in product design and experience.

*Drawbacks:* If a standardized asset/liability charge is used instead of a company's own stochastically calculated charge, then the charge will not fully reflect a product's individual risk situation. (Using RBC criteria adds some product specificity, however.) Ideally, the required capital objectives could be inconsistent with those assumed by the company. However, these objectives may not be well defined for a company and may be difficult to apply in a regulation, which is why the test utilizes standardized values. Using risk-based-capital factors in the cost of capital charge will introduce an element of extra charge for extra risk.

## 6. Fixed Asset Method (Treasury Approach)

**Description:** For the Fixed Asset Method, the asset base used for the illustration is standardized to be the treasury yield curve plus an additional margin identified in the regulation (the additional margin to be determined by thorough research by the Academy). The resulting yield is reduced for expenses. Asset liability management is assumed to be satisfied by determining the appropriate investment horizon for the liabilities (illustrated values). This supportability test relies on other regulatory tools to identify problem companies (via reserve, risk-based capital or other methods).

**Advantages:** It includes the actual investment horizon appropriate for a product, but does not reflect asset/liability matching or the actual assets used by a company. It does produce a conservative, standardized illustrated interest rate that reflects differences based on the yield curve position for treasury interest rates and the level of company expenses.

**Drawbacks:** While the rate should be supportable, in actuality it may or may not be supportable for a specific company. The standardized asset base means that the test results do not reflect the actual assets used by a company. This means that any extra value added by companies can not be illustrated for consumers. Nor can illustrations reflect the extra risks associated with items such as lower quality assets, incomplete asset/liability management, higher risk-based capital costs, or higher profits or contributions to surplus. Calculating the investment horizon for a product design is not easy, but it would only need to be calculated once. The "additional margin" over Treasury rates would need to be reevaluated from time to time.

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## ATTACHMENT FOUR-E

Life Disclosure Working Group  
Conference Call  
July 28, 1998

The Life Disclosure Working Group of the Life Insurance and Annuities (A) Committee met by conference call at 2 p.m. on July 28, 1998. Tom Foley (N.D.) chaired the meeting. The following working group members or their representatives participated: Hall Phillips for Sheldon Summers (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Eleanor Perry for Cindy Martin (Mass.); Paul DeAngelo (N.J.); Mike Batte (N.M.); Dan Keating (Okla.) and Ted Becker (Texas).

The purpose of the conference call was to hear final comments on the Annuities Buyer's Guide. After the conference call, Carolyn Johnson (NAIC/SSO) would prepare a clean document with the revisions agreed upon by the working group and send that draft to Brenda Cude (Professor, University of Georgia) for review. After Ms. Cude makes technical revisions for readability, Ms. Johnson should produce a revised version to distribute to interested parties before the Fall National Meeting. Tom Foley (N.D.) said the working group intends to adopt the buyer's guide along with the Annuity Disclosure Model Regulation at that meeting. He noted that the model as revised at the Summer National Meeting has been distributed and no comments have been received so far. Any further comments should be submitted to Yvonne Frazier (NAIC/SSO) by Aug. 18, 1998.

The working group reviewed the comments received on the buyer's guide. Mr. Foley noted that a Table of Contents was added to the guide at the Summer National Meeting and he asked the members of the working group if they wished to retain the Table of Contents. The working group members decided not to include a Table of Contents.

The working group members reviewed the technical comments received and made numerous technical changes to the draft. Roger Strauss (Iowa) said that at some point the working group needs to stop making technical changes so that review by Ms. Cude can be completed. He opined that it is always possible to make further revisions but at some point this must come to an end.

In addition to the technical changes, the working group agreed to add a description of an additional indexing method for equity-indexed annuities, the low-water mark method. The language added to the draft was submitted by interested parties. Interested parties also suggested deleting several of the questions at the end of the guide. After discussion the working group decided to retain most of those questions.

There was considerable discussion over a suggestion from Paul DeAngelo (N.J.) to add this question: "What renewal rate is the company crediting on annuity contracts of this type issued last year?" Linda Lanam (Life of Virginia) said due to the current threat of litigation a question such as Mr. DeAngelo posed would raise concerns. She said she would instruct agents in her company to not answer the question. Mike Batte (N.M.) pointed out that some companies are offering bonus rates, and their pricing philosophy is that they do not intend to pay that amount later. That is valuable information that consumers must have. Jim Mumford (Equitable of Iowa) said this question is fraught with danger. He opined that disclosure of rates paid in the past is not an indicator of future rates. Mr. DeAngelo responded that companies are illustrating life insurance policies 30 years into the future and do not seem to be concerned about that. Mr. Foley pointed out that this is not history; the question asks what is currently happening. Mr. Foley instructed Ms. Johnson to include Mr. DeAngelo's question in the draft and asked interested parties to comment on that question to Ms. Johnson.

Mr. Foley said that after review of the guide by Ms. Cude, a decision will be made as to whether an additional conference call will be necessary. He emphasized again his desire to adopt the buyer's guide at the Fall National Meeting.

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

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## ATTACHMENT FIVE

Suitability Working Group  
New York, New York  
September 13, 1998

The Suitability Working Group of the Life Insurance and Annuities (A) Committee met in the New York A of the Sheraton New York Hotel & Towers in New York, N.Y., at 9 a.m. on Sept. 13, 1998. Paul DeAngelo (N.J.) chaired the meeting. The following working group members were present: Richard Rogers (Ill.); Rosanne Mead (Iowa); Cindy Martin (Mass); Tom Jacks (N.C.); Joel Ario (Ore.); and Tom Van Cooper (Vt.).

1. Discuss Work Product

Paul DeAngelo (N.J.) said this is an organizational meeting of the Suitability Working Group. The charge of the working group is to "consider issues related to marketing and suitability of sales of life insurance and annuities, particularly in regard to replacement and sale of annuities to seniors, and consider the need for amendments to the Rule Governing the Advertising of Life Insurance." Mr. DeAngelo suggested that the working group review the advertising rule, then review issues of suitability, and then go back to the advertising rule to see if changes are needed on the issue of suitability. He suggested starting by collecting as much material as possible on the issue of suitability. He asked the working group to consider what the end product of the project should be: a model act; a model regulation or a white paper. He said he favored drafting a white paper first and then the working group may come to the conclusion that it should write a model. Joel Ario (Ore.) agreed with that approach. He said the issue is likely to create enough controversy that there is a need to debate all aspects. He suggested a white paper would be a good foundation for anything further. Cindy Martin (Mass.) suggested that there may be enough standards out there already within the insurance industry or the securities industry so that the regulators could go ahead and draft a model. Mr. DeAngelo said one of the issues is whether there is sufficient authority to adopt a regulation. He said this is an issue in New Jersey. If a state needs statutory authority, then a model act should be developed; but if sufficient authority exists under the Unfair Trade Practices Act, a regulation could be drafted.

2. Discuss Information Sources

Mr. DeAngelo said he recently attended a meeting of the National Association of Variable Annuities (NAVA) and representatives from the National Association of Securities Dealers (NASD) described their suitability standards. He thought it would be appropriate to ask for a similar presentation to this working group. Mr. DeAngelo agreed to contact the NASD and see if they are willing to come to an NAIC meeting; if not the Winter National Meeting in Orlando, then the Spring National Meeting that will be in Washington, D.C.

Mr. DeAngelo noted several other sources for information. He distributed to the members of the working group the Minnesota suitability standards and asked if any of the other states on the working group had suitability standards. Rosanne Mead (Iowa) said that Iowa does have such standards. Mr. DeAngelo asked Carolyn Johnson (NAIC/SSO) to review other state laws and identify any states that have suitability standards. Mr. Ario offered to contact those states and gather more information.

Mr. DeAngelo suggested there may be case law on this issue. Ms. Mead offered to research this area. She opined that there is likely a great deal of material in the securities industry and asked if the regulators were interested in seeing that, or whether her search should be limited to suitability of insurance purchases. Mr. DeAngelo left that to her discretion, depending on what materials are available in the insurance arena. Mr. DeAngelo said there also may be published articles on this issue. He asked the working group members to come back with information and provide that to Ms. Johnson in time to review before a conference call in early November.

Al Dawson (LeBoeuf Lamb Greene & MacRae) said New York passed a statute last year requiring the insurance department to report to the legislature before the end of 1999 on whether New York should have suitability standards. Marty Carus (N.Y.) offered to provide information on that project. Mr. DeAngelo suggested that it would be helpful for New York to join the working group and Mr. Carus said he would evaluate their resources. Mr. DeAngelo said there may be information available on the Internet and Richard Rogers (Ill.) offered to review that resource.

Mr. Ario said representatives from the insurance industry may have perspectives that have not been published and asked if the working group wants to solicit their input. Mr. DeAngelo said he would appreciate and welcome their views, although he suspected they may wait to react to what the working group does. He said that if any organizations or trade associations have ethical standards, copies would be very helpful. He suggested that self-imposed standards would be better than regulator-imposed standards. Mr. Ario said that the Insurance Marketplace Standards Association (IMSA) has little in the way of suitability standards other than a phrase about "needs-based selling."

Marybeth Stevens (American Council of Life Insurance—ACLI) asked if there would be an interested parties list for this group. Mr. DeAngelo said those who were interested in receiving information about the working group activities should provide their business cards to Ms. Johnson.

Having no further business, the Suitability Working Group adjourned at 9:30 a.m.

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## ATTACHMENT SIX

Annuities Working Group  
New York, New York  
September 15, 1998

The Annuities Working Group of the Life Insurance and Annuities (A) Committee met in the Imperial B Ballroom of the Sheraton New York Hotel & Towers in New York, N.Y., at 1 p.m. on Sept. 15, 1998. Mike Batte (N.M.) chaired the meeting. The following working group members or their representatives were present: John Hartnedy (Ark.); Sheldon Summers (Calif.); Roger Strauss (Iowa); Howard Max (Md.); Tom Jacks (N.C.); and Tom Foley (N.D.).

1. Adopt Charitable Gift Annuities Model Act

Mike Batte (N.M.) reminded the working group that they adopted the Charitable Gift Annuities Model Act in December 1997. After it was considered by the A Committee and adopted, it went to the Executive Committee. The Executive Committee returned the model to the A Committee with instructions to make amendments on two issues and to consider drafting a companion model exempting charitable organizations from regulation. Mr. Batte drew the attention of the working group members to a comment letter from the American Council of Life Insurance (ACLI) suggesting an additional drafting note on the issue of guaranty fund coverage. Roger Strauss (Iowa) moved and Tom Foley (N.D.) seconded a motion to adopt the Aug. 27, 1998, draft with the addition of the drafting note recommended by the ACLI. Leslie Jones (S.C.) noted that an additional suggestion from the ACLI is to amend the Life and Health Insurance Guaranty Association Model Act. She asked if it is this working group's responsibility to make that change. Mr. Batte responded that this working group is only concerned about the Charitable Gift Annuities Model Act and she anticipated that the ACLI would make that suggestion to the Insolvency (EX5) Subcommittee. The motion to adopt the model with the amendment passed with California abstaining (Attachment Six-A).

2. Adopt Alternative Model Exempting Charitable Gift Annuities From Insurance Regulation

Mr. Batte explained that the draft before the working group is similar to Texas law. It provides for a conditional exemption. If certain conditions are met the charity is not subject to insurance department regulation. Howard Max (Md.) asked for clarification of the impact if the charity did not meet the exemption in a particular year. He asked if it would be considered an insurer and perhaps subject to premium tax. Mr. Batte responded that if a charity can, it will retain the minimum amount. If it cannot, it will no doubt stop issuing charities, rather than try to be licensed as an insurer. Mr. Max responded that Maryland does regulate charitable organizations, but to a lesser degree than insurers. He said Maryland has trouble getting the reports required by their law and it requires a great deal of insurance department follow-up. He said he thought this type of provision would be difficult for charities, many of whom would not understand the impact of having lower assets in a particular year. Mr. Strauss responded that ignorance of the law is no excuse, we cannot act on the basis that someone might not be aware of the law. Mr. Batte asked if Maryland would likely adopt one of the models before the group. Mr. Max responded that Maryland already has a law and regulation in place so probably would not change to one of these models. Mr. Strauss moved and Mr. Hartnedy seconded a motion to adopt the Charitable Gift Annuity Exemption Model Act. The motion passed with California and Maryland abstaining (Attachment Six-B).

3. Adopt Minutes of Aug. 27, 1998, Conference Call

Mr. Strauss moved and Mr. Max seconded a motion to adopt the minutes of the Aug. 27, 1998, conference call. The motion passed (Attachment Six-C).

4. Any Other Matters Brought Before the Working Group

Mr. Strauss noted that this project is the only charge to this working group. He moved and Mr. Foley seconded a motion to ask the A Committee to discharge this working group. The motion passed.

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

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## ATTACHMENT SIX-A

Charitable Gift Annuities Model Act  
Draft: 9/15/98

Adopted by the Life Insurance and Annuities (A) Committee  
Underlining and overstrikes show amendments to the draft adopted earlier by the  
Life Insurance and Annuities (A) Committee but returned by the Executive 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 Annuity Act.

Section 2. Definitions

- A. (1) "Charitable gift annuity" means a transfer of cash or other property by a donor to a charitable organization in return for an annuity payable over one or two lives, under which the actuarial value of the annuity is less than the value of the cash or other property transferred and the difference in value constitutes a charitable deduction for federal tax purposes.
- (2) "Charitable gift annuity" does not include a charitable remainder trust or a charitable lead trust or other similar arrangement where the charitable organization does not issue an annuity and incur a financial obligation to guarantee annuity payments.
- B. "Charitable organization" means an entity described by:
- (1) Section 501(c)(3) Internal Revenue Code of 1986 [26 U.S.C. Section 501(c)(3)]; or
  - (2) Section 170(c), Internal Revenue Code of 1986 [26 U.S.C. Section 170(c)].

Section 3. Certificate of Authority

- A. A charitable organization shall not receive transfer of property, conditioned upon its agreement to pay an annuity to the donor or other annuitant unless and until it has obtained from the commissioner a certificate of authority to issue charitable gift annuities.
- B. A charitable organization shall file with the commissioner its application for a certificate of authority. The application shall be in form prescribed and furnished by the commissioner and shall be verified by two (2) of the applicant's officers. The application shall include or be accompanied by such proof as the commissioner may reasonably require that the applicant is qualified under this Act. At filing of the application the applicant shall pay to the commissioner the applicable filing fees as specified in [insert citation].
- C. If after such investigation as the commissioner deems advisable, the commissioner finds that the applicant is in sound financial condition and is otherwise qualified, the commissioner shall issue to the applicant a certificate of authority. If the commissioner does not so find, the commissioner shall deny issuance of the certificate of authority and notify the applicant in writing stating the reasons for denial.
- D. The certificate of authority of a charitable organization issued under this Act shall continue until suspended or revoked by the commissioner or terminated by the organization, subject to continuance each year by payment on or before March 1 of the continuance fee of \$[insert amount] and filing of the annual report.
- E. A person acting on behalf of a charitable organization to solicit the transfers of property in exchange for annuity payments shall not be required to be licensed; however, the person shall be authorized in writing by the charitable organization to act on its behalf. The charitable organization shall keep a file of current written authorizations.

Section 4. Surplus and Reserves

- A. A charitable organization authorized by this Act shall maintain a segregated account for its charitable gift annuities. The assets of the account are not liable for any debts of the charitable organization other than those incurred pursuant to the issuance of charitable gift annuities. The assets of the account shall at least equal in amount the sum of the reserves on its outstanding annuities plus a surplus of 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]~~ the charitable organization's domestic state standard valuation law;
  - (b) Any mortality table permitted under ~~[insert citation to the state standard valuation law]~~ the charitable organization's domestic 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]~~ the charitable organization's domestic 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, are not protected by any insurance guaranty association, and are not or backed in any way by the State of [insert state].

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

#### Section 10. Other Applicable Code Provisions

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

- A.(1) [insert citation to receivership law];
- B.(2) [insert citation to laws on hazardous financial condition];
- C.(3) [insert citation to laws governing unfair trade practices]; and
- D.(4) [insert citation to laws governing investments].

B. The provisions of [insert reference to state guaranty association law] do not apply to charitable gift annuities.

Drafting Note: In order to ensure consistency and uniformity in state insurance laws, it is recommended that states adopting this model act also amend their state guaranty association statutes to comply with Section 5(4)(7) of the Life and Health Guaranty Association Model Act. That provision states that for the purpose of providing guaranty association protection to policy owners, insureds, beneficiaries, annuitants, payees and assignees, a "member insurer" shall not include "(a) an organization that has a certificate or license limited to the issuance of charitable gift annuities under [insert appropriate section of the state code]."

#### 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 SIX-B

Charitable Gift Annuities Exemption Model Act  
 Draft: 8/28/98  
 Adopted by the Life Insurance and Annuities (A) Committee

## Table of Contents

Section 1.	Definitions
Section 2.	Charitable Gift Annuity Is Not Insurance
Section 3.	Notice to Donor
Section 4.	Notice to Department
Section 5.	Effect of Failure to Provide Required Notice
Section 6.	Not Unfair or Deceptive Trade Practice
Section 7.	Effective Date

## Section 1. Definitions

A. "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.

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)).

C. "Qualified charitable gift annuity" means a charitable gift annuity described by Section 501(m)(5), Internal Revenue Code of 1986 (26 U.S.C. Section 501(m)(5)), and Section 514(c)(5), Internal Revenue Code of 1986 (26 U.S.C. Section 514(c)(5)), that is issued by a charitable organization that on the date of the annuity agreement:

- (1) Has a minimum of \$300,000 in unrestricted cash, cash equivalents, or publicly traded securities, exclusive of the assets funding the annuity agreement; and
- (2) Has been in continuous operation for at least three (3) years or is a successor or affiliate of a charitable organization that has been in continuous operation for at least three (3) years.

## Section 2. Charitable Gift Annuity Is Not Insurance

A. The issuance of a qualified charitable gift annuity does not constitute engaging in the business of insurance in this state.

B. A charitable gift annuity issued before [insert effective date of this statute] is a qualified charitable gift annuity for purposes of this Act, and the issuance of that charitable gift annuity does not constitute engaging in the business of insurance in this state.

## Section 3. Notice to Donor

A. When entering into an agreement for a qualified charitable gift annuity, the charitable organization shall disclose to the donor in writing in the annuity agreement that a qualified charitable gift annuity is not insurance under the laws of this state and is not subject to regulation by the insurance commissioner or protected by an insurance guaranty association.

B. The notice provisions required by this section shall be in a separate paragraph in a print size no smaller than that employed in the annuity agreement generally.

## Section 4. Notice to Department

A. A charitable organization that issues qualified charitable gift annuities shall notify the commissioner in writing by the later of ninety (90) days after the effective date of this Act or the date on which it enters into the organization's first qualified charitable gift annuity agreement. The notice shall:

- (1) Be signed by an officer or director of the organization;
- (2) Identify the organization; and
- (3) Certify that:
  - (a) The organization is a charitable organization; and



(b) The annuities issued by the organization are qualified charitable gift annuities.

B. The organization shall not be required to submit additional information except to determine appropriate penalties that may be applicable under Section 5 of this Act.

#### Section 5. Effect of Failure to Provide Required Notice

The failure of a charitable organization to comply with the notice requirements imposed under Section 3 or 4 of this Act does not prevent a charitable gift annuity that otherwise meets the requirements of this Act from constituting a qualified charitable gift annuity. The commissioner may enforce performance of the requirements of Sections 3 and 4 of this Act by sending a letter by certified mail, return receipt requested, demanding that the charitable organization comply with the requirements of Sections 3 and 4 of this Act. The commissioner may fine the charitable organization in an amount not to exceed \$1,000 per qualified charitable gift annuity agreement issued until such time as the charitable organization complies with Sections 3 and 4 of this Act.

#### Section 6. Not Unfair or Deceptive Trade Practice

The issuance of a qualified charitable gift annuity does not constitute a violation of [insert reference to unfair trade practices law].

#### Section 7. Effective Date

This Act shall be effective [insert date].

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ATTACHMENT SIX-C

#### Annuities Working Group Conference Call August 27, 1998

The Annuities Working Group of the Life Insurance and Annuities (A) Committee met by conference call at 2 p.m. on Aug. 27, 1998. Mike Batte (N.M.) chaired the meeting. The following working group members or their representatives participated: John Hartnedy (Ark.); Sheldon Summers for Woody Girion (Calif.); Roger Strauss (Iowa); Howard Max (Md.); Carolyn Thomas for Tom Jacks (N.D.); Tom Foley (N.D.); and Kip May (Ohio).

##### 1. Consider Revisions to the Charitable Gift Annuities Model Act

Mike Batte (N.M.) said that the working group last met in December 1997 and completed work on a Charitable Gift Annuities Model Act. This was adopted by the Life Insurance and Annuities (A) Committee in March but was referred back to the committee by the Executive Committee in June 1998. The A Committee was instructed to address concerns about the reserve section and to address guaranty fund issues. The Executive Committee also instructed the A Committee to consider drafting a change to Section 4 that was suggested by the Life and Health Actuarial Task Force to address the concern about possible inconsistency from state to state in the Standard Valuation Law. The suggested wording requires the charity to follow the Standard Valuation Law of its domestic state. Mr. Batte asked Mike Surguine (NAIC/SSO) to comment on the concerns of the Guaranty Fund Issues (EX5) Working Group. Mr. Surguine explained that the working group and its technical resource advisors suggest additions to both Sections 9 and 10 because regulators see an advantage to making absolutely clear that there is no coverage for charitable gift annuities under the guaranty fund.

Mr. Batte asked if any of the regulators on the call had any comments or reservations about the changes proposed to address these two issues. The regulators did not express any reservations. Mr. Batte said the working group should review the draft and will consider adoption at the Fall National Meeting.

##### 2. Draft Exempting Annuities From Insurance Department Regulation

Mr. Batte said he was not aware of any other NAIC models that exempted entities from insurance regulation totally. Tom Foley (N.D.) asked if the working group's charge is to consider whether this is a good idea or to draft something. Mr. Batte responded that the charge to the A Committee is to consider the issue. Roger Strauss (Iowa) asked if states would be expected to adopt both models. Mr. Batte responded that it is contemplated that states would choose one or the other; either a limited type of regulation or a total exemption. He said some states have each type and some states are silent on the issue. He opined that the NAIC is really developing these models for those states. The working group reviewed a copy of a Texas statute that exempts charitable gift annuities from regulation if they meet certain requirements. Mr. Strauss moved that the working group develop an exemption model based on the Texas statute. John Hartnedy (Ark.) seconded the motion. Mr. Hartnedy asked what happened under the Texas statute if the charity has not been in business for three years. Mr. Batte responded that, if the charity does not meet the qualifications in the statute, it does not have an exemption from insurance department regulation. Mr. Hartnedy noted that the Texas law does not have any provision for reserves. He asked if that meant a charity could take all of the money and spend it and Mr. Batte responded in the affirmative. Mr. Batte noted that a national charitable giving organization has been very helpful to the charities in showing them how to set aside appropriate reserves. Frank Minton (Charitable Giving, Inc.) said it is the practice of most charities to hold the gift until the annuitant dies. The main purpose of

the draft is to screen out charities without sufficient financial strength. Mr. Hartnedy asked if there were any legal requirements for what charities have to hold in reserve. Mr. Minton responded that many of the regulating states require a segregated reserve fund. A state that adopts the exemption act being drafted would only require charities to have a certain amount of assets and to have been in existence for a certain number of years.

Mr. Foley asked for more background information on the mechanics of how and why individuals would contribute money to a charity through a charitable gift annuity. Mr. Minton emphasized that the rate of return on a charitable gift annuity is lower than that provided by an insurer because individuals who choose this vehicle are making a gift to the charity of their choice. He offered to provide to the members of a working group a paper that he had written explaining more about the mechanics of charitable gift annuities. Mr. Strauss cautioned that the tax consequence to the donor of the charitable gift annuity is not really the issue before the working group. Mr. Batte responded that information that makes the regulators feel more comfortable about the motivation of the donor will be helpful.

Howard Max (Md.) noted that the \$300,000 requirement would allow a charity to be exempt one year but not another. Mr. Batte responded that this was true and opined that in a year when the charity did not have enough assets, it would not negotiate charitable gift annuities.

Having no further business, the Annuities Working Group adjourned at 2:45 p.m.

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#### ATTACHMENT SEVEN

To: NAIC Members  
From: Terri Vaughan, Chair, Life Insurance and Annuities (A) Committee  
Date: August 17, 1998  
Re: *Harris Trust Case*

As you know the Department of Labor proposed a very extensive regulation on Dec. 22, 1997, in response to the *Harris Trust* case. The purpose of this letter is to alert you to the likelihood of extensive contract refilings at the time the regulation becomes effective.

The proposed regulation requires extensive disclosure regarding general account contracts and procedures, including both initial disclosures and annual reports to contractholders. The proposed regulation also provides that the relief provided by the proposal is available only if a policyholder may terminate the policy and receive, at the policyholder's option, either a lump sum payment, net of any market value adjustment, or a book value payment in substantially equal annual installments over a five-year period, together with interest, regardless of the contractual terms for termination.

The NAIC filed a comment letter with the Department of Labor suggesting several modifications to the proposal. Even if the Department accepts the NAIC's suggestions, it is likely that companies will have to amend the contracts affected by the regulation to comply. In addition, the companies may have to seek state approval for other actions the need to take in order to comply with the regulation. For example, certain "insurer-initiated amendments" may need to be approved by the states and, to the extent states regulate product disclosure, the required disclosure under the regulation may have to be approved before companies can give it to policyholders.

Because of the consequences of non-compliance, companies will need to be in compliance as quickly as possible. You should be aware of the need to approve these filings as quickly as possible after they are filed. Please consider putting in place a process to quickly handle the large number of filings you will likely receive.