

## LIFE INSURANCE AND ANNUITIES (A) COMMITTEE

### Reference:

1998 Proc. 4th Qtr. 607  
1999 Proc. 1st Qtr. 505

Terri Vaughan, Chair—Iowa  
Diane Koken, Vice Chair—Pa.

### CONTENTS

Life Insurance and Annuities Committee June 9, 1999, Minutes .....	487
Viatical Settlements Working Group June 7, 1999, Minutes	
(Attachment One).....	490
Cover Memorandum Regarding Advisory Package on Viatical Settlements	
(Attachment One-A).....	492
Advisory: Emerging Issues in the Sale of In-Force Life Insurance Policies	
(Attachment One-B).....	493
Advisory Brochure Drafts (Attachment One-C) .....	495
Viatical Settlements Model Regulation Shopper's Guide Appendices B	
and C: Verification of Coverage for Individual Policies	
(Attachment One-D).....	499
Viatical Settlements Working Group May 26, 1999, Minutes	
(Attachment One-E).....	503
Viatical Settlements Working Group April 26-27, 1999, Minutes	
(Attachment One-F) .....	505
Equity Indexed Products Working Group June 6, 1999, Minutes	
(Attachment Two) .....	507
Equity Indexed Product Checklist (Attachment Two-A).....	508
Equity Indexed Products Working Group April 30, 1999, Minutes	
(Attachment Two-B).....	509
Life Disclosure Working Group June 8, 1999, Minutes (Attachment Three).....	509
Suitability Working Group June 6, 1999, Minutes (Attachment Four).....	511
Advertisements of Life Insurance and Annuities Model Regulation	
May 10, 1999, Draft (Attachment Four-A) .....	512
Suitability Working Group White Paper May 21, 1999, Draft	
(Attachment Four-B).....	519
Suitability Working Group March 30, 1999, Minutes	
(Attachment Four-C).....	529
Summary of Hearing on Structured Settlements (Attachment Five).....	531

### MINUTES

The Life Insurance and Annuities (A) Committee met in Kansas City, Mo., at 8 a.m. on June 9, 1999. A quorum was present and Terri Vaughan (Iowa) chaired the meeting. The following committee members were present: Greg Martino representing Diane Koken, Vice Chair (Pa.); Tom Foley representing Kathleen Sebelius (Kan.); Lester Dunlap representing James H. Brown (La.); Michael Batte (N.M.); and Joan Williams and Dalora Schafer representing Carroll Fisher (Okla.).

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

Lester Dunlap (La.) reported that the Viatical Settlements Working Group met at an interim meeting in April and held a conference call in May and used the majority of the time at both of these meetings to work on its charge to complete a viatical advisory package. The focus of this package is to inform the end-product user of important issues and to illustrate regulator concerns. The impetus for the viatical advisory was testimony from Tom Foley (Kan.) at the A Committee hearing held at the Winter National Meeting in 1998. Mr. Dunlap reported that work on the project is substantially complete. The three elements of the package are a cover memo, a narrative description of the issues and the concerns of regulators, and three brochures intended to be distributed to interested parties. The plan is to complete the technical review of these documents and to hold a conference call to adopt the final product. Mr. Dunlap asked the A Committee to consider a conference call in early July to adopt the package so that it could be submitted to the Executive Committee for a vote in October. The Viatical Settlements Working Group also discussed its other charges. Mr. Dunlap noted that several states' securities regulators have joined in discussion of investment issues.

Commissioner Terri Vaughan (Iowa) complimented the working group on the viatical advisory package. She noted that a tremendous amount of work has gone into this project. She asked Mr.

Dunlap to make sure that the viatical advisory package is widely distributed with an opportunity for comment before bringing the matter before the Life Insurance and Annuities (A) Committee. Commissioner Vaughan asked how the working group intends to attack the charges about "wet paper," insurable interest and sales of policies by healthy people. Mr. Dunlap responded that the first step is for the working group to have a thorough debate on the issue and to vote on whether to proceed with development of a model on life settlements. He noted that the viatical settlement industry has already drafted a model on life settlements for the National Conference of Insurance Legislators (NCOIL) so that could be a starting point for an NAIC model. Mr. Dunlap emphasized that it is important to hold a discussion before deciding whether to proceed. Nancy Ellison (Ore.) said that she believes viatical settlements sold to investors are securities and should be regulated. She said they were not able to convince their legislature of this position because of what is happening at the NAIC. She expressed grave doubts about whether it is good to expand the market to sales of policies by healthy individuals. Irrespective of the "wet paper" or "clean sheeting" issues, this is an important issue. She agrees that life insurance is an asset, but it is different because it covers your life. It raises fundamental issues, including someone benefiting when your life is shorter rather than longer. She said that Oregon will be involved in the debate on this issue.

Mr. Dunlap explained to the A Committee that the Viatical Settlements Model Regulation had three appendices that were removed before the model was adopted by the A Committee because these documents were not yet complete and the working group felt it was important to go forward with the regulation. Kansas has agreed to prepare a revised draft of Appendix A, which is a shopper's guide. The working group finalized Appendices B and C, which are forms to be used for the sharing of information between the viatical settlement provider and the life insurance company. Mr. Dunlap noted that these documents will be brought to the parent committee for adoption as one package when the shopper's guide is complete.

Commissioner Vaughan asked if a decision not to draft a model would say that life settlements should not be allowed. Mr. Dunlap responded in the affirmative. He said, the way the models are drafted now, life settlements are neither prohibited nor regulated.

Greg Martino (Pa.) moved and Acting Commissioner Mike Batte (N.M.) seconded a motion to receive the report of the Viatical Settlements Working Group (Attachment One). The motion passed.

## 2. Report of Equity Indexed Products Working Group

Acting Superintendent Batte reported that the Equity Indexed Products Working Group met by conference call and at the Summer National Meeting. The charge for 1999 is to develop a checklist to be used in review of filings of equity indexed products. He said the working group has recruited new members who are experts on the issue of equity indexed products and spent much of the meeting time discussing what should be included on a checklist. The working group anticipates having this project completed to report to its parent at the Fall National Meeting.

Acting Superintendent Batte moved and Mr. Foley seconded a motion to receive the report of the Equity Indexed Products Working Group (Attachment Two). The motion passed.

## 3. Report of Life Disclosure Working Group

Mr. Foley said that, when the Life Disclosure Working Group adopted the Life Insurance Illustrations Model Regulation, regulators were concerned about the situation where the agent was not able to leave a sales illustration with the applicant because he or she did not have a printer. At the Summer National Meeting, the working group saw a demonstration on a way to freeze the illustration, including the signatures, in such a way that it could be preserved. He said this provided even tighter controls than with a paper document. The working group held a discussion about potential conflicts between the Life Insurance Illustrations Model Regulation and the Life Disclosure Model Regulation, as well as other models with potential conflict. Between the Summer National Meeting and the Fall National Meeting, the models with potential conflicts will be reviewed and discussion will take place at the Fall Meeting on how to resolve these conflicts.

Mr. Foley said the working group reviewed examples of life insurance sales illustrations and discussed ways to make the illustrations shorter and easier for consumers to understand. Mr. Foley moved and Acting Superintendent Batte seconded a motion to receive the report of the Life Disclosure Working Group.

Commissioner Vaughan said Mr. Foley brought exciting news of the activities of the working group. She encouraged the working group to be creative and open minded about embracing new technology for electronic illustrations. She also applauded the working group's interest in making illustrations shorter and easier. She said that, as she travels around the state of Iowa, she hears often from agents that consumers are overwhelmed by the sales illustration. She asked if the working group has given any thought to focus groups to identify ways to make the illustration easier for consumers to understand. Mr. Foley responded that he was not aware of any focus groups, but that this idea had appeal. He said the working group is exploring several options.

Acting Superintendent Batte agreed that the working group is going in the right direction and he said he was encouraged by the discussion. Mr. Foley said the life insurance industry reminds the working group often of the expense and time that was spent in developing the illustrations in response to the Life Insurance Illustrations Model Regulation. Commissioner Vaughan agreed that it would not be appropriate to make changes every year, but she encouraged the working group to look at potential changes for the longer term. George Coleman (Prudential) said the interested parties are trying to assist the working group to find creative ways within the current model to make illustrations easier for consumers. He said the industry certainly does not want the working group to mandate changes that would cause companies to make expensive changes to their software.

The motion to receive the report of the Life Disclosure Working Group (Attachment Three) passed.

#### 4. Report of Suitability Working Group

Mr. Dunlap, vice chair of the working group, reported for Paul DeAngelo (N.J.). The working group held a conference call to discuss amendments to the Life Insurance Advertising Model Regulation and also discussed the initial draft of a white paper on suitability issues. Comments are being requested on these documents for working group consideration. Mr. Foley moved and Mr. Martino seconded a motion to receive the report of the Suitability Working Group (Attachment Four). The motion passed.

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

Mr. Foley said the Life and Health Actuarial (Technical) Task Force adopted Actuarial Guidelines ZZZZ on equity-indexed life insurance valuation. The task force discussed releasing a fact sheet expressing concerns where guaranteed investment contracts are issued with bailout provisions. The task force anticipates sending this memo to the states and Mr. Foley acknowledged there is some controversy over whether the task force should do this. The working group will undertake significant discussion on the unified valuation system that has been outlined by the American Academy of Actuaries. Mr. Foley said he is cautiously optimistic that revisions to the Actuarial Opinion and Memorandum Regulation will be ready for adoption soon.

The task force also agreed to request comments on a draft amendment to the Standard Valuation Law to allow confidentiality protection for some kinds of information. Commissioner Vaughan said the confidentiality issue is being discussed in many groups at the NAIC. The purpose of the amendments is to strengthen the confidentiality provisions that states already have to ensure that regulators will be able to share and receive information from other American regulators and international regulators and can protect the confidentiality of that information. The amendments make clear that this information is protected even from subpoena.

Dalora Schafer (Okla.) moved and Acting Superintendent Batte seconded a motion to adopt the report of the Life and Health Actuarial (Technical) Task Force.

Commissioner Vaughan asked what the letter regarding the bailout provision will look like. Mr. Foley responded that Larry Gorski (Ill.) is drafting a letter that makes regulators aware of these issues that the task force considers important. In the earlier draft of the letter, there were opinions of the Life and Health Actuarial (Technical) Task Force, but these are being taken out in a redraft by Mr. Gorski. Mr. Foley said he hoped to request a joint conference call with the A Committee to review this letter when it is completed. He expressed a desire to get the information to the states quickly within the NAIC process. Commissioner Vaughan asked about the procedure for this and Mr. Foley responded that within the next few weeks Mr. Gorski will complete the redraft of the letter and this will be released for comment and discussed in a conference call. Commissioner Vaughan said that, as she understands the NAIC policy, a formal statement of position must go through the entire NAIC hierarchy but a letter to alert state regulators to an issue does not. She expressed the caveat that the task force should be sure that the document is fully exposed to interested parties to submit comments. Jana Lee Pruitt (TransAmerica) said she appreciates that concern and the interested parties are desirous of providing information about the issue. She said the task force allowed a 30-day exposure period but, since Mr. Gorski will probably not have the document ready for two weeks, that only allows 15 days to review the document and submit reasons why insurers need those provisions. She asked that the 30-day exposure period be changed to 60 days so that they had 45 days to react. Mr. Foley said this issue has been around for at least three months and suggested that the interested parties send their comments on why they need these provisions to Mark Peavy (NAIC/SSO) as soon as possible rather than waiting until after the letter has been exposed to provide information. He said there are members of the Life and Health Actuarial (Technical) Task Force that are very concerned about this issue and feel the need to get this information out as quickly as possible. Commissioner Vaughan said that, as chair of the A Committee, she is concerned that there be enough time for comment. She said there will be at least 30 days after the document has been produced before the A Committee will review it at a conference call. The motion to adopt the report of the Life and Health Actuarial (Technical) Task Force passed.

#### 6. Discuss Charge on Structured Settlements

A summary of the hearing on structured settlement is Attachment Five. Commissioner Vaughan said the next step in discussing this charge is to ask NAIC staff to put together a summary of the laws on structured settlements already in place in the states, as well as the model suggested by industry trade associations. These differences can be reviewed by the A Committee at the Fall National Meeting and recommendations discussed.

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

---

#### ATTACHMENT ONE

##### Viatical Settlements Working Group Kansas City, Missouri June 7, 1999

The Viatical Settlements Working Group of the Life Insurance and Annuities (A) Committee met in Kansas City, Mo., at 10 a.m. on June 7, 1999. Lester Dunlap (La.) chaired the meeting. The following working group members were present: Kevin McCarty (Fla.); James Genetti for Dale Freeman (Idaho); Robert Heisler (Ill.); Roger Strauss (Iowa); Marlyn Burch (Kan.); Trent Heinemeyer for Glenn Pomeroy (N.D.); Dalora Schafer (Okla.); Nancy Ellison for Joel Ario (Ore); Maliaka Essamel Din for Jeanne Bryant (Tenn.); and Rhonda Myron (Texas).

Lester Dunlap (La.) welcomed the securities regulators in attendance: Syver Vinge (N.D. Securities Commissioner); Maliaka Essamel Din (Tenn.), whose department regulates securities and insurance in the Department of Commerce; and Scott Borchert (Minn.), whose Commerce Department also regulates securities and insurance.

#### 1. Discuss Viatical Advisory Package

Mr. Dunlap asked the working group to consider the latest draft of the Viatical Advisory Package. The first document is a cover memo that indicates this is a release from the NAIC (Attachment One-A). The second document describes the emerging issues that are of concern to insurance regulators (Attachment One-B). In addition, the package will contain three brochures (Attachment One-C) that are designed to be distributed to consumers. Mr. Dunlap said the emerging issues document had undergone revision at a meeting of the technical resource advisors and others on June 6, and asked the working group to focus its

attention on this revised document. Doug Head (Medical Escrow Society) summarized the main features of the document. The introduction lays out a brief history of the viatical settlement industry and the last paragraph in that section was recently added to alert readers to the concerns of securities regulators. The section on "wet paper" contains a consensus of the insurance industry and the viatical settlement industry that this is a problem. There are differing interpretations of where to draw the line. The next section is entitled "Other Settlements." Mr. Head noted that the American Council of Life Insurance (ACLI) is not comfortable with the term "life settlements" that was used previously, but a more acceptable term has not yet been devised. The next section on investor issues is a topic of concern to the regulators. The pricing section was written by the viatical industry and not reviewed by the whole group of technical resource advisors. He said this deserves a more thorough look. Julie Spiezio (ACLI) pointed out that the ACLI and its members still have a concern with what appears to be official acceptance of the term "life settlements." She emphasized that the life insurance policy continues to exist and the term might imply otherwise.

Mr. Dunlap asked for comment on the draft. Rhonda Myron (Texas) said that the paragraph on "clean sheeting" was drafted by Florida and Texas, but she was not satisfied with its placement in the document. She suggested that it needed to be in a section of its own or the parenthetical about "wet paper" should be deleted. Mr. Dunlap said the issue of clean sheeting seems to be of most concern where it involves a newly issued policy rather than one that has been in effect for a number of years. Dalora Schafer (Okla.) suggested adding to the parenthetical a reference to clean sheeting. Mike McNerney (Mutual Benefit Corp.) agreed the problems are not identical but are related. He said a newly issued policy where the application is accurate could still cause concern. Clean sheeting just makes the problem worse. Someone could clean sheet the policy to make the individual appear healthy and wait out the contestability period. He said the market is a lot smaller for policies in the contestability period. Roger Strauss (Iowa) suggested making a separate paragraph with a heading for clean sheeting. Kevin McCarty (Fla.) said that this is one of the most significant issues facing his state and he agreed that it needed to be in a separate section. The working group agreed to that preference.

George Coleman (Prudential) expressed concern with the section on pricing. He said he had prepared a submission that compared the "reasonable" price with the table in the model regulation. He said he thought his language did a better job of highlighting the cost of giving up life insurance than the section drafted by the viatical industry. Syver Vinge (N.D.) said that the pricing of policies to investors is an emerging issue and he would like to see this retained as an issue. Mr. Dunlap suggested that Mr. Coleman work with the viatical industry to include both sides of the issue in that paragraph.

Mr. McNerney opined that it is confusing to talk about the old regulation; the history is not as important as the current status. Mr. Dunlap responded that the majority of regulators want to address issues of concern related to pricing. Mr. McNerney said you have to talk about pricing from both sides of the issue, the price that investors are willing to pay affects the amount that can be paid to the viator. Mr. Vinge said securities regulators recognize that the seller of the policy is under duress and needs to be protected first. A close second is to protect the investor.

The regulators next reviewed the section on privacy. Mr. Dunlap said this issue has received a lot of attention in the media and he has serious concerns about protection of the privacy of the viator weighed against protection for the investor. Mr. Vinge said it would be wise for regulators to look at setting up an organization similar to the Medical Information Bureau (MIB), which was set up to control information about individuals applying for insurance. He suggested an organization could be set up that would monitor the status of the insured, be charged with keeping up with subsequent owners of the contract, and collecting the death benefits. This would avoid privacy issues on both sides of the transaction.

Mr. Dunlap expressed support for the section on advertising, especially in the investor arena. He said advertising is a totally unregulated area and his department receives more calls on this issue than any other. Mr. Vinge said some members of the North American Securities Administrators Association (NASAA) are most concerned about control of advertising. Some also say the brokers need a securities license. Mr. Vinge expressed hope for cooperation between the securities regulators and the viatical trade associations. He said most securities regulators are recognizing that they need not be fearful of the *Life Partners* case (*Securities & Exchange Commission v. Life Partners*, 87 F.3rd 536, (D.C. Cir.1996) (*rehearing denied* 102 F.2d 587)). He predicted securities regulators would jump into the fray with both feet very soon. Mr. Borchert said that most states that have adopted the Viatical Settlements Model Act have a good tool to help the viators. On the other side, there should be a clear voice that these are securities and securities regulators should take a hard line on fraud and misrepresentation to investors. He looks upon the viatical settlement industry as an interesting test case on issues of mutual concern to regulators in the financial marketplace. He said this will be a good exercise in cooperation between insurance and securities regulators. Mr. Vinge said he spent 10 years in business being regulated both by securities and insurance regulators and did not find it a problem. He encouraged the two organizations to continue to work together.

The regulators next reviewed the brochures formatted by the NAIC Communications Department. Mr. Head said the viatical industry thinks this is a wonderful product that will be very helpful to consumers. He said Brenda Cude (University of Georgia) submitted comments for simplification of the language. He said some of them are excellent simplification techniques, but a few are off the mark. Mr. Dunlap suggested that several regulators and interested parties meet after the working group's session is completed to address those concerns. Marlyn Burch (Kan.) suggested changing the title of the brochure on viatical settlements because many people still do not know what that term means. He suggested the title be "Selling Your Life Insurance Policy: What to Know about Viatical Settlements before You Sell Your Policy." Ms. Myron suggested a compromise would be to keep the latter part of the title already on the brochure and add the beginning of Mr. Burch's suggestion so the title would read "Selling Your Life Insurance Policy: Understanding Viatical Settlements." The working group agreed to that compromise. Sonja Alleyne (Massachusetts Affordable Housing Alliance) asked if a visual could be added that would show the fees that would be encountered from the start to the finish of the sale. Mr. Dunlap said that suggestion would be included in the discussion after the meeting.

## 2. Discuss Appendices to Model Regulation

Mr. Dunlap said the original intent of the drafters of the Viatical Settlements Model Regulation was to include a shopper's guide as an appendix. To complete development of the model regulation, that appendix was deleted, but as soon as it is developed the regulation will be amended to add the appendices. A first draft was prepared but still needs more work to make it more user friendly. Mr. Dunlap asked Mr. Burch if he would offer his public relations staff to help in that project. Mr. Burch agreed. He asked that anyone with specific suggestions provide those to him by the middle of July.

Ms. Spiezio noted that the reporting forms that were designed to be Appendices B and C of the model regulation have now been completed and asked that these be adopted. Mr. Dunlap said it is his intent to submit all three appendices to the regulation at one time. Ms. Spiezio said it would be helpful to finalize these documents so that states working on the new regulation would adopt the correct version. Mr. Dunlap explained that Appendices B and C are forms that were developed jointly by the viatical settlement industry and the life insurance industry and these forms are agreeable to both sides. They are designed to be used for a viatical settlement provider to obtain information about a life insurance policy. Mr. McCarty moved and Robert Heisler (Ill.) seconded a motion to adopt the forms that will become Appendices B and C of the model regulation (Attachment One-D). The motion passed. Mr. Dunlap said attachment of these documents to the minutes will allow states to use them as needed, but the working group will not ask the A Committee to adopt these until the Shopper's Guide has been completed.

## 3. Adopt Minutes of April 26-27, 1999, Interim Meeting and May 26, 1999, Conference Call

Ms. Myron moved and Ms. Schafer seconded a motion to adopt the minutes of the April 26-27, 1999, interim meeting (Attachment One-F) and the May 26, 1999, conference call (Attachment One-E). The motion passed.

## 4. Discuss How to Proceed with 1999 Charges

Mr. Dunlap asked the working group to review the charges upon which significant progress has not yet been made. The first of these is the issue related to investments in viatical settlements. A small subgroup consisting of Florida, Texas and Kansas will work on developing suggestions for the working group.

The next charge that needs to be addressed is related to insurable interest and fraud issues. Idaho, Tennessee and Louisiana will work on a subgroup to begin to address these issues. Mr. Dunlap said that at some point there will need to be some discussion and debate on whether sales of insurance policies by those who are not terminally or chronically ill should even be allowed. Mr. McCarty said Florida went through that process already and decided that it was an important issue that needed to be addressed. Mr. Dunlap asked if there was any testimony or other written product that could be shared with the working group. Mr. McCarty responded that it was mostly oral testimony, but he would put together any documentation that he had for the working group's enlightenment. Mr. McNerney reminded Mr. Dunlap that the viatical industry submitted a draft of how a life settlement regulation might look. Mr. Dunlap responded that he has read the document, but before any discussion of it, the working group needs to decide if it wants to go in that direction. If the working group decides to do a life settlement regulation, it will consider the draft provided by the viatical industry.

The remaining charge that has not been addressed is to develop a handbook to assist regulators in interpretation of viatical settlement data to determine reasonableness of payments. Mr. Head suggested that Texas has accumulated the most data and offered to assist Texas in development of a handbook.

Having no further business, the Viatical Settlements Working Group adjourned at 11:40 a.m.

\*\*\*\*\*

ATTACHMENT ONE-A

To:  
From:  
Date:  
Re: NAIC Advisory Package on Viatical Settlements

At our 1998 Winter Meeting, the Life & Annuities Committee, chaired by Commissioner Terri Vaughan (Iowa), conducted a public hearing focusing on the business of viatical settlements, other forms of so called life settlements and related issues emerging in this relatively new financial services industry. Testimony and comments were received from a number of regulators and representatives of the viatical settlement and life insurance industries.

The propriety of these transactions, which also involve the purchase of newly issued life insurance "wet paper sales" and policies owned by the elderly "senior settlements," is being questioned in some circles. Concerns also include whether these practices adversely affect the determination of insurance interest and the tax sheltered status of life insurance products. And, concerns have been raised because the purchaser's profit from these transactions is enhanced when the insured's death occurs sooner rather than later. Media attention has focused on instances where some policy purchasers harassed insured who "lived too long." Concerns exist relating to investor suitability and the advertising practices of solicitors for viatical and life settlements funding.

In the early '90s, the NAIC developed a model act and regulations to govern the business of viatical settlements. At present, roughly 26 states have passed legislation covering viatical settlements, many using the NAIC model. The NAIC is now

beginning a further examination into the business of life settlements and investments in life policy purchases to determine the need for regulation. At this point there appear to be compelling reasons to warrant the development of model regulation to govern these activities.

Based upon recommendations made in the December hearings, the Life Insurance and Annuities Committee gave the Viatical Settlements Working Group a new charge to develop a package of information as a means of advising regulators and interested parties. Our purpose in distributing this information is to heighten public awareness of the growing number of issues and concerns which have been raised in connection with the practice of purchasing life insurance policies and the solicitation of investment funding for these transactions. This material should provide you with a good overview for the issues and a ready means to disseminate basic information on buying and selling of in-force life insurance.

We sincerely hope you find this advisory package informative and helpful in your efforts to better serve the public.

\*\*\*\*\*

#### ATTACHMENT ONE-B

### Advisory: Emerging Issues in the Sale of In-Force Life Insurance Policies

#### Introduction

In the late 1980s companies began to engage in transactions called viatical settlements. A viatical settlement is the sale of a life insurance policy of a terminally ill individual to a third party. The owner of the policy on such an individual with a life-threatening illness receives cash for the policy. In these transactions, the viatical settlement provider becomes the new owner and/or beneficiary of the life insurance policy and pays all future premium payments, collecting the entire death benefit of the policy upon the death of the insured.

People living with a life-threatening illness are often faced with very difficult choices. A viatical settlement is one option that can provide immediate cash to assist with expenses.

As various public policy issues around viatical settlements emerged, regulators have developed ideas dealing with these new transactions. In many states, legislation and regulatory structures have been developed. In 1993 the National Association of Insurance Commissioners (NAIC) adopted a Viatical Settlements Model Act and followed with a model regulation in 1994. A revised Viatical Settlements Model Act was adopted in 1998 and a corresponding revised model regulation was adopted in 1999.

Many policies that were sold in the early part of this decade were sold by persons with then-terminal AIDS. With the development of new drug therapies their life expectancy was dramatically increased. Many investors who purchased these policies were disappointed in their financial returns because the insured individual lived longer than the investor expected at the time of purchase. This conflict of interests in the market has led to increased interest in comprehensive regulation of the viatical market.

#### Status of current regulation

Approximately half of the states have adopted some legislation regulating viatical settlements. Other legislation is being considered. Sales of policies of persons who do not meet the definition of "terminally ill" are not regulated in most states. At least eight states have adopted insurance or securities legislation dealing in some form with the activities of viatical settlement providers dealing with investors. The states that have legislated protection of viators are not necessarily the same states that have done so for purchasers.

The NAIC has identified the following major issues for consideration by its Viatical Settlements Working Group:

- Revision of model rules
- Public information
- Sales of the policies of healthy persons
- Sales of newly issued policies
- Purchaser protections

The NAIC is continuing to review these models and is considering the following emerging issues surrounding viatical settlements, other settlements and the purchasing of either.

#### Sale of newly issued policies (also known as "wet paper")

"Wet paper" is a life insurance policy that is still in its contestable period. "Wet paper" sometimes refers to the purchase of life insurance coverage from a life insurance company with the intent of selling the contract to a third party. Whether these new policies should be sold, assigned or transferred is a subject of intense concern. These sales have been encouraged by some life insurance agents and representatives from some viatical companies in order to profit from the transaction. Questions about misrepresentation or fraud during the application process, insurable interest and strawman transactions are being raised.

### Fraudulent practices ("clean sheeting")

A growing number of regulators have expressed concern over the increased incidence of "clean-sheeting" instigated by the viatical settlements industry. "Clean-sheeting" is the practice whereby an individual, alone or in conjunction with a third party, applies for a life insurance policy and commits fraud in the application process by means of an omission of a material fact or making untrue, false, deceptive or misleading statements in order to obtain a life insurance policy or to obtain lower policy premiums on a life insurance policy.

### Other settlements (non-viatical transactions)

A viatical settlement is the sale of a life insurance policy insuring the life of an individual with a terminal or chronic illness to a third party. The owner, called a "viator," receives cash for the policy. Another type of transaction, often called a "life settlement," is the sale of a life insurance policy to a third party, in which an owner of a life insurance policy insuring the life of an individual who does NOT have a life-threatening or terminal illness or condition, receives cash for the policy. There is a growing market for the purchase and sale of policies that do not meet the traditional definition of a viatical settlement. The viatical industry reports that these transactions usually involve policies of a large face amount, but also include key-person coverage and other policies representing excess coverage that is no longer needed. These transactions are not regulated by traditional viatical laws, therefore the licensing and disclosure requirements of viatical transactions do not apply.

In these transactions, additional consumer questions arise concerning tax treatment, eligibility for government assistance, claims of creditors and many other issues. There is also the question of whether the seller has considered other financial options.

### Investor/purchaser issues

Purchasers have existed in the viatical industry as long as there have been sellers; various methods have been used to raise funds for these purchases. In most states current viatical settlement laws do not address purchaser protections, nor is there a sophisticated network of regulations protecting investors. The suggestion has been made in a number of states that investments in viatical settlements should be treated as securities and some states have enacted laws or regulations to do so. Potential purchasers should check with state insurance or securities regulators to determine if viatical or other settlement transactions are regulated in that state. While some states do regulate these transactions, others remain silent on the subject.

As with any investment, there is risk associated with purchasing a viatical investment. A rate of return cannot be guaranteed. In certain circumstances investors may lose money.

Potential purchasers should be aware that insurance companies do not participate in, and do not guarantee any viatical settlement transaction. Similarly, state life and health insurance guaranty associations do not make any guarantee involving viatical settlement transactions.

Another concern is that viatical settlement contracts may not be suitable investments for some of the investors to whom they are being marketed. As with any investment, the buyer or purchaser must invest wisely, considering such factors as: age, risk tolerance, financial situation, liquidity, investment objectives, investment time horizons and level of sophistication.

There are no national standards that have been adopted to regulate information that is provided to potential investors. Some states have adopted—by legislation or regulation—minimum disclosure requirements to purchasers. Currently, there is no consensus among the insurance, securities or viatical industries as to who is qualified to offer viatical and similar settlements as investment options.

### Pricing

The NAIC is concerned about the price being paid to viators for the sale of their policy. The NAIC Viatical Settlements Model Regulation has, since its adoption, included a table of minimum percentage payments. In 1999 an alternative to the table of minimum payments, a reasonableness standard, was added as an option. The reasonableness standard would be policed and enforced by insurance departments using data supplied annually by viatical settlement providers using reasonableness criteria to be developed by the NAIC. There is an inherent concern regarding the economics of pricing. There is a difference between what a viator wants to sell his or her policy for and what an investor is willing to pay for the same policy.

The viatical industry argues that the table of minimum payments rules out certain viatical settlements that are otherwise appropriate. Others argue that the minimum payment tables are adequate and help assure fair treatment for viators and that the reasonableness standard would be difficult for insurance departments to enforce.

It has become evident that equal concern should be given to the price being paid by a buyer of a policy. A fair return on the investment, that takes into account all of the costs and risks involved in the purchase of a viatical settlement, is of equal concern to the NAIC and the viatical investment and insurance industries. Some of the issues involved in determining a fair price to the seller, the buyer and the companies involved in the transaction include: 1) life expectancy of the insured; 2) effect on life expectancy of a combination of illnesses; 3) likelihood of significant medical developments, including a possible cure; 4) non-medical issues regarding the insured such as health care availability, family circumstances and support systems; 5) rating of the life insurance company; 6) specific provisions of the individual or group policy; and 7) the insured's willingness to cooperate and provide information regarding future maintenance of the policy. All of these factors should be considered by both the buyers and sellers of viatical or life settlements.

## Privacy

Viatical settlement providers and their investors are compensated through the payment of the purchased policy's death benefit. To ensure prompt notification of the death of the insured and submission of claims forms to the insurer, the viatical industry tracks the health status of those insured individuals. Certain states have adopted rules to limit contacts between viatical companies and the insured individuals to reduce complaints about insensitivity.

Greater concerns have developed over the identification of viators to unlicensed secondary market investors in viatical settlements. The viatical industry maintains that these investors need to be assured that the viatical settlement transaction is legitimate and having the identity and address of the viator provides this assurance. Critics argue that there are no standards imposed on persons wishing to become an investor in viatical settlements, which raises the concern that unscrupulous investors may be tempted to treat the insured in an insensitive manner.

## Advertising

Significant regulatory concern has been expressed about advertising that has the potential to mislead both sellers and purchasers of viatical and other settlements. Generally, the NAIC has found that informed consumers on all sides of the transaction are better able to make judgments. Misleading advertising can contain false information or could encourage individuals to be involved in improper transactions.

Examples such as "guaranteed rate of return," "no risk" or references to a guarantee by a life insurance company or government entity have been used in some recent advertising and may constitute fraud. Soliciting people to provide false or misleading information on a life insurance application or to purchase a policy with the intent to resell are inappropriate.

Although misrepresentation can take place in any media, the use of the Internet presents unique problems because it allows users to cross state lines, maintain anonymity, misrepresent identity and claim lack of jurisdiction.

The NAIC model act includes minimum disclosures to viators who are selling their policies. While these disclosures do not directly apply to other types of settlements, similar disclosures should be provided to sellers of other settlements.

\*\*\*\*\*

ATTACHMENT ONE-C

## Buying Viatical Settlements

### Buying Viatical Settlements

Individuals with life-threatening illnesses may be able to sell their life insurance policies for a percentage of the death benefit of the policy. If you're interested in buying or investing in one of these policies, you should consider the enclosed information.

Buying a viatical settlement may or may not be the right choice for you. Your state insurance department, along with the National Association of Insurance Commissioners, is concerned that consumers may not fully understand viatical settlements. Please read on before you make decision.

### Know Your Options

If you're thinking of buying a viatical settlement you should:

- Understand the details and the risks before deciding.
- Consult your own professional financial advisor who knows your personal financial circumstances, investment objectives, age and other considerations. You may want to consider other investment choices.
- Ask your tax advisor about any possible tax consequences of buying a viatical settlement. Find out if it's appropriate to use 401(k), IRA, Keogh, or other qualified retirement plan funds to buy a viatical settlement.

### Other Considerations

- Typically, viatical settlement are offered to buyers at a discount from the death benefit. The discount is for the entire life of the policy and is not an annual rate of return. An annual rate of return can't be guaranteed. It depends on when the insured dies and no one can perfectly predict a person's life expectancy.
- A viatical settlement shouldn't be considered a liquid investment. It doesn't give a return on the investment until the individual dies and the death benefit is paid.
- There are risks specific to a group policy that is owned by an employer or other organization. The primary risk is the possibility that the owner (i.e., the employer) or the insurance company may terminate the group policy. This termination will trigger the need to convert the group coverage to an individual policy. You should ask if there are any limits or caps in the conversion rights. Also, ask who will be responsible for paying any additional premiums once a group policy is converted.

- Insurance companies may contest death claims for policies that haven't been in effect at least two years at the date of death. The death benefit could be denied on various grounds. If the insured commits suicide within two years of taking out the policy, the insurance company may not pay the death benefit.
- You should understand who estimates the life expectancy of the insured. It could be in-house staff, independent physicians or a specialty firm that analyzes medical and actuarial data. The estimated life expectancy is based on the medical information provided by the insured's physician or hospital. It's important to note that developments in medical treatments or unexpected changes in the insured's medical condition could affect the accuracy of the estimated life expectancy.
- It's important to know who will be responsible for future premium payments after the buyer invests in the policy. Ask how these payments are guaranteed. If the premiums are prepaid in escrow for a certain period, know who will pay the premiums if the insured lives beyond his or her life expectancy. In some cases, you (as the buyer) can be responsible for making these payments so that the policy doesn't lapse.
- Find out if there are any trust fees, commissions or other expenses you may be required to pay and how much they will be.
- Find out who would be responsible for monitoring the status of the insurance policy and the insured.

#### Defining the Terms

A viatical settlement is the sale of a life insurance policy to a third party. The owner (viator) of the life insurance policy sells the policy for a percentage of the death benefit. The buyer becomes the new owner and/or beneficiary of the life insurance policy, pays all future premiums, and collects the death benefit of the policy when the insured dies.

A viatical settlement purchaser is the person or company that buys the life insurance policy.

A viatical settlement purchase agreement is the contract or agreement in which the viatical settlement buyer agrees to buy all or part of a life insurance policy.

The viatical settlement provider arranges the transaction between the seller of the life insurance policy and the viatical settlement buyer, typically using a viatical settlement purchase agreement.

#### Questions to Ask

- Is the principal and return on my investment guaranteed?
- How is the return on my investment calculated?
- When is the principal and return on my investment paid?
- Will I ever be asked to pay the premiums of the insurance policy?
- Is the life insurance policy past the contestable period?
- Does my state have regulations about buying viatical settlements?

#### Check with Your State

If you're interested in selling your life insurance policy, we recommend you contact your state insurance office to learn more about the issues that might be involved in such a transaction.

Your state may regulate the purchase of viatical settlements. Contact your state insurance department for a copy of those regulations.

This brochure doesn't include information about all of the risks associated with buying viatical settlements.

To learn more about investments in general, contact your state securities department for a free booklet about investments.

### **Selling Your Life Insurance Policy: Understanding Viatical Settlements**

#### Understanding Viatical Settlements

People living with a terminal illness often face very tough financial choices. A viatical settlement is one option that can give you cash to help with expenses.

A viatical settlement is the sale of a life insurance policy to a third party. The owner of the policy sells it for a percent of the death benefit. The buyer becomes the new owner and/or beneficiary of the life insurance policy, pays all future premiums and collects the entire death benefit when the insured dies.

A viatical settlement may or may not be the right choice for you. Your state insurance department, along with the National Association of Insurance Commissioners, is concerned that many consumers may not fully understand viatical settlements. Please continue reading before you make any decisions.

Know Your Options

- Contact your insurance agent or company for information about viatical settlements.
- Consult your own financial advisor who knows your personal financial needs.
- Contact your state insurance department for information about current laws.

Consider All Your Options

- Find out if you have any cash value in your life insurance policy. You may be able to use some of the cash value to meet your immediate needs and keep your policy in force for your beneficiaries. You may also be able to use the cash value as security for a loan from a financial institution.
- Find out if your life insurance policy has an accelerated death benefits provision. It could pay you a substantial portion of your policy's death benefit and you wouldn't have to sell your policy to a third party.

Other Considerations

- Contact a professional tax advisor. Find out the tax implications. Not all proceeds are tax free.
- Know that the proceeds are subject to the claims of any creditors.
- Find out if you'll lose any public assistance benefits such as food stamps or Medicaid if you get a cash settlement.
- Know that you must provide certain medical and personal information.

Consumer Tips

- Understand how the process works and when the phases will happen.
- Decide whether to sell your policy directly to a viatical settlement provider or go through a viatical settlement broker who will do the comparison shopping for you.
- If you don't use a viatical settlement broker, comparison shop on your own.
- You don't have to accept any viatical settlement offer.
- Check all application forms for accuracy, especially information about your medical history.
- You must be truthful in your answers to application questions.
- Make sure the viatical settlement provider agrees to put your settlement proceeds in escrow with an independent party or financial institution to make sure your funds are safe during the transfer.
- Find out if you have the right to change your mind about the viatical settlement after you get the proceeds. If you have that right, you'll have to return the money you were paid and the premiums the buyer paid. In many states you have the right to change your mind for a certain period of time.
- Understand what information a buyer must know about you to buy your policy, and who else might get that information.

Defining the Terms

The person selling the life insurance policy is the viator. He or she will get money from the settlement. This person gives up ownership of the policy in return for cash now. The viator generally has a terminal illness.

A viatical settlement provider is the person or company that buys the life insurance policy. The buyer becomes the policy owner, and must pay any premiums that are due, and eventually collects the entire death benefit from the insurance company.

The person or company who represents the seller (viator) and can "shop" for viatical offers is a viatical settlement broker. The buyer pays the broker a commission if the sale is completed.

An Accelerated Death Benefit (ADB) is a feature of a life insurance policy that typically pays some or all of the policy's death benefit before the insured dies. It may be another way to get cash from a policy without selling it to a third party.

Questions to Consider

- Do I still need life insurance protection?
- If I sell my policy, how do they decide how much cash I get?
- If I sell my policy, who will be the legal owner?
- Do I need the advice of a tax or estate planning advisor before I decide to sell my policy?
- Will investors have specific information about me, my family or my health status?
- Is the broker or company I plan to sell to allowed to do business in my state?
- After I sell my policy, can it be resold by the buyer?

### Consumer Alert

- If you're asked to invest in or buy a viatical settlement, we recommend you contact your state insurance department. Learn more about the issues and risks.
- If you're interested in selling your life insurance policy, you should contact your state insurance department to get more information.
- If you've been contacted by someone who wants you to buy a policy and then sell it immediately, you should contact your state insurance department. It's possible you're being targeted to participate in fraud.

### Check with Your State

Your state insurance department may regulate viatical settlements transactions. Contact your state insurance department for a copy of those regulations.

## **Selling Your Life Insurance Policy: Understanding Life Settlements**

### Understanding Life Settlements

A life settlement is the sale of a life insurance policy to a third party. The owner of a life insurance policy gets cash for the policy. The buyer becomes the new owner and/or beneficiary of the life insurance policy, pays all future premiums and collects the entire death benefit policy when the insured dies.

People decide to sell their life insurance policies for many reasons. Some common ones are changed needs of dependents, wanting to reduce premiums, and meeting cash for expenses.

A life settlement may or may not be the right choice for you. Your state insurance department, along with the National Association of Insurance Commissioners, is concerned that many consumers may not fully understand life settlements. Please read on before you make any decisions.

### Know Your Options

Before you enter into any life settlement transaction, you should:

- Contact your insurance agent or company for information about life settlements.
- Consult your own financial advisor who knows your personal financial needs.
- Contact your state insurance department for information about current laws.

### Consider All Your Options

- Find out if you have any cash value in your life insurance policy. You may be able to use some of the cash value to meet your immediate needs and keep your policy in force for your beneficiaries. You may also be able to use the cash value as security for a loan from a financial institution.
- Review other sources of cash that may meet your financial needs at a lower cost than a life settlement.

### Other Considerations

- Contact a professional tax advisor. Find out the tax implications. Proceeds are not tax free.
- Know that creditors could claim the proceeds.
- Find out if you'll lose any public assistance benefits such as food stamps or Medicaid if you receive a cash settlement.
- Understand you will be required to provide certain medical and personal information.

### Consumer Tips

- Understand how the process works and when different phases will happen.
- Decide whether to sell your policy directly to a life settlement provider or go through a life settlement broker who will do the comparison shopping for you.
- If you don't use a life settlement broker, comparison shop on your own.
- You don't have to accept any life settlement offer.
- Check all application forms for accuracy, especially information about your medical history.
- You must be truthful in your answers to application questions.

- Make sure the life settlement provider agrees to put your settlement proceeds in escrow with an independent party or financial institution to make sure your funds are safe during the transfer.
- Find out if state law gives you some period of time to undo the sale. You may have the right to change your mind about the life settlement after you get the proceeds. If you have that right, you'll have to return the money you were paid and premiums the buyer paid.
- Understand what information the buyer must know about you to buy your policy, and who else might get that information.

### Defining the Terms

A life settlement is the sale of a life insurance policy to another person or company in return for cash now.

A life settlement provider is the person or company that becomes the new policy owner in return for a payment made to the seller. The buyer becomes the policy owner, must pay any premiums that are due, and eventually collects the entire death benefit from the insurance company.

A life settlement broker is the person or company who represents the seller of the policy and can "comparison shop" for life settlement offers. The broker is paid a commission by the buyer if the sale is completed.

### Questions to Ask

- Do I still need life insurance protection?
- Will I qualify for a new life insurance policy in the future?
- If I sell my policy, how will they decide how much cash I get?
- If I sell my policy, who will be the legal owner?
- Can the policy be resold?
- Will investors have specific information about me, my family or my health status?
- Is the broker or company I plan to sell to allowed to do business in my state?

### Consumer Alert

- If you're asked to invest in or buy a life settlement, we recommend you contact your state insurance department to learn more about the issues and risks.
- If you don't have a life-threatening illness and you're interested in selling your life insurance policy, you should contact your state insurance department for more information.
- If you've been contacted by someone who wants you to buy a policy and then sell it immediately, you should contact your state insurance department. It's possible you're being targeted to participate in fraud.

### Check with Your State

Your state may regulate the purchase of life settlements. Contact your state insurance department for a copy of those regulations.

\*\*\*\*\*

ATTACHMENT ONE-D

## Viatical Settlements Model Regulation Shopper's Guide

### APPENDIX B [All new material]

#### 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

<hr/> Date	<hr/> Signature of a representative of Viatical Settlement Broker or Viatical Settlement Provider
<hr/> 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
  - a) If yes, when: \_\_\_\_\_ / \_\_\_\_\_ / \_\_\_\_\_
- 4) Type of policy: \_\_\_\_\_ (Term/Whole Life/Universal Life/Variable Life)
- 5) Is policy participating? ☐ no ☐ yes
  - a) 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) a) 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.)  
 b) Current surrender value: \$ \_\_\_\_\_
- 8) Terms of policy loans:
  - a) Amount of policy loans: \$ \_\_\_\_\_
  - b) Amount of outstanding interest on policy loan: \$ \_\_\_\_\_
  - c) Current interest rate: \_\_\_\_\_
- 9) Has policy lapsed? ☐ no ☐ yes
  - a) If yes, when did policy lapse? \_\_\_\_\_ / \_\_\_\_\_ / \_\_\_\_\_  
 If policy has lapsed, is coverage continued under non-forfeiture option? ☐ no ☐ yes  
 If yes, indicate which option, amount of coverage, duration, etc.: \_\_\_\_\_
- 10) Is policy in force? ☐ no ☐ yes
  - a) If yes, has policy ever been reinstated? ☐ no ☐ yes  
 If yes, date of reinstatement: \_\_\_\_\_ / \_\_\_\_\_ / \_\_\_\_\_
- 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? \_\_\_\_\_
  - c) Can any remaining death benefit be assigned? ☐ no ☐ yes
- 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:	ST: 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]

## 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 ☐ yes
- e) 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 ☐ yes
- j) Is coverage in force? ☐ no ☐ yes
- k) 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
- i) Is coverage in force? ☐ no ☐ yes
- j) When is next premium due? \_\_\_\_\_
- k) Has employee's coverage under this policy ever been reinstated? ☐ no ☐ yes
- i) 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 What is the waiting period? \_\_\_\_\_
- SUPPLEMENTAL ☐ no ☐ yes What is the waiting period? \_\_\_\_\_
- 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? \$ \_\_\_\_\_
- i) Will a new suicide/contestability clause be in effect for the converted policy? ☐ no ☐ yes
- ii) Will assignee be notified if insured is no longer eligible for waiver? ☐ 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 ☐ yes
- c) 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 \_\_\_\_\_
- iii) Can the remaining death benefit be assigned? ☐ no ☐ yes

## 6) MISCELLANEOUS

- a) Is coverage portable?
- BASIC ☐ no ☐ yes
- SUPPLEMENTAL ☐ no ☐ yes
- b) If insured is no longer eligible for coverage under the group, will Assignee be notified? ☐ no ☐ yes
- c) If master policy discontinues, what amount can be converted to an individual policy? \$ \_\_\_\_\_
- d) 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: ( ) \_\_\_\_\_

\*\*\*\*\*

ATTACHMENT ONE-E

### Viatical Settlements Working Group Conference Call May 26, 1999

The Viatical Settlements Working Group of the Life Insurance and Annuities (A) Committee met by conference call on May 26, 1999, at 1:30 p.m. Lester Dunlap (La.) chaired the conference call. The following working group members participated: Elizabeth Bookwalter for Michael Bownes (Ala.); Kevin McCarty (Fla.); Dale Freeman (Idaho); Robert Heisler (Ill.); Marlyn Burch (Kan.); Tom Jacks (N.C.); Dalora Schafer (Okla.); Greg Martino (Pa.); Malika Essamel Din and Neil Nevins (Tenn.); and Rhonda Myron (Texas).

Lester Dunlap (La.) summarized for those in attendance the interim meeting of the working group in April. He said the working group spent two days developing a package of materials to provide information to regulators, the media, consumer groups and others about emerging issues in viatical settlements. He said the advisory package will include the following components: a cover memo, a background piece on emerging issues, and three brochures, one for viatical settlements, one for life settlements and a third for investors. The emerging issues background paper is based on materials submitted earlier by the technical resource advisors and Mr. Dunlap explained that the technical resource advisors were requested to redraft the issues paper to focus more narrowly and to express more clearly the concerns of the regulators.

Dana Cashin (Accelerated Benefits) said the document before the regulators is a shorter version of the earlier document that focuses on the emerging issues. She said the revised paper begins with a brief introduction. The next section of the paper could contain a description of the status of current regulation and she asked for regulators' input on whether that needed to be included. The third heading describes "wet paper" transactions where newly issued policies are sold. The section on investor issues states that current laws in general do not address protections for investors and points out that this may be a concern. Syver Vinje (N.D. Commissioner of Securities), representing the North American Securities Administrators Association

(NASAA), said that Maine and North Dakota and a few other states have taken action to regulate viatical settlements. He offered to provide further information on what those states are doing. Marlyn Burch (Kan.) said that Kansas is in the process of developing a joint letter between the insurance commissioner and securities regulator to express the position that Kansas will take in calling viatical settlements a security. Julie Spiezio (American Council of Life Insurance—ACLI) noted that the last sentence of the first paragraph says, "while some states do regulate these transactions, others remain silent on the subject." She said this paragraph was designed to raise the issue but not to go into detail about which states do regulate and which states do not. She also pointed out a second paragraph emphasizing the risk in investment in a viatical settlement.

Ms. Cashin said that the next two sections of the paper could speak of pricing and privacy but the technical resource advisors wish to have input from the regulators as to whether these are necessary. Mr. Dunlap pointed out that George Coleman (Prudential) submitted drafts for those two sections. Ms. Cashin responded that those suggestions came from Mr. Coleman and were not reviewed by the other technical resource advisors. The technical resource advisors are meeting prior to the working group's session at the Summer National Meeting and can discuss the language at that time. Mr. Vinje expressed an interest in attending that meeting of the technical resource advisors, as well as the working group's session at the Summer National Meeting. Mr. Dunlap encouraged Mr. Vinje to participate in the drafting and welcomed his participation and that of the NASAA.

Mike McNerney (Mutual Benefits Corp.) said that some sections were included in the longer document provided earlier that are not in the later version. If the working group wants to give guidance on the other issues, the members could look at the longer document and decide whether to include some of it in the shorter document. Mr. Dunlap emphasized that it is his hope to finish this project at the Summer National Meeting because the working group has a host of other charges to address. He asked for comments from the working group on the product before it. Tom Jacks (N.C.) said this document is very carefully written and whether there needs to be more or less information depends on the audience. He opined that the working group should get this finished and move on to its other projects. He said he preferred a brief document that was more readable, even if it did not address every issue. Mr. Vinje asked if it was the working group's intention to leave out reference to accelerated death benefits. He opined that disclosing the existence of an accelerated death benefit is an important piece of information. Mr. Dunlap responded that information about accelerated death benefits is included in the brochure intended to accompany this background paper. He also noted that this document is intended to provide information on emerging issues and concerns and he suggested that accelerated death benefits are not an emerging issue. He also pointed out that the working group still intends to draft a buyer's guide for sellers of viatical settlements.

Mr. Burch said he thought it was important to include a section on pricing because it is a difficult issue with many regulator concerns. Mr. Dunlap said he thought the language drafted by Mr. Coleman would address the issue. Dale Freeman (Idaho) agreed that pricing was important to include and also agreed that Mr. Coleman's language adequately addresses the information. Commissioner Vinje asked if this was pricing at both ends of the transaction. He opined that the document should also address the issue in relation to the investor return. Mr. McNerney said it would take an extensive section to address that adequately. Kevin McCarty (Fla.) opined that pricing is not an emerging issue. He said this is covered in the disclosure document required by the NAIC's model act and is not appropriate in this document. Rhonda Myron (Texas) agreed with Mr. McCarty that this is not an emerging issue. Mr. Burch and Robert Heisler (Ill.) agreed with that opinion.

Mr. McCarty commended the technical resource advisors for the work done on the document. He said the section on investors is particularly important, but he opined that it was better not to deal with state regulations. He said he did not want to leave a false expectation that there was a high level of regulation as with securities or insurance products. John Matthews (Allstate Life) asked if it would be helpful to add to this document the NAIC's chart on state adoptions of viatical settlements. Mr. McCarty agreed that would be appropriate. He said Florida also felt strongly about the "wet paper" issue and thought this was very significant. Mr. McNerney asked if more language should be added. Mr. McCarty agreed to draft a couple of sentences to add to that issue. Ms. Myron asked if this should also include information on "clean sheeting." She said this is an area of great concern in Texas. She defined "clean sheeting" as providing an application that said the individual is in good health, when he or she is not. Mr. McCarty agreed this is a concern that should be mentioned in the background paper. Mr. McNerney asked about the situation where no fraud is found in the application, but the policy is sold soon after being obtained. Mr. McCarty said that ought to raise some concerns on the part of the investor, but it was a much different issue than a fraudulently obtained policy. Mr. Dunlap pointed out that this also had an affect on the issue of insurable interest and asked if this should be further elaborated as an emerging issue. Mr. McCarty opined that, even though this issue is more important since life settlements are being obtained, it is not really an emerging issue. Mr. Dunlap said privacy and pricing issues are regulator concerns and are emerging issues. He said regulator concerns include whether the viator should be identified and whether there should be a limit on the number of times someone checks on the health of the viator. Mr. McNerney pointed out that it is difficult to balance between protecting the privacy of the viator and giving a comfort level to the investor. Mr. Freeman said the viator may want to know who has invested in his policy and asked if the investor has a privacy right. He gave the example of a case in Idaho where the viator was getting many phone calls and wanted to find out whether those were from the investor in his policy.

Mr. Dunlap expressed again that the intent of this advisory package is to draw attention to the concerns of regulators. He also noted there will be people reading this background paper who do not know much about viatical settlements and suggested adding a few sentences to the introduction to better set up the rest of the document.

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

\*\*\*\*\*

## ATTACHMENT ONE-F

Viatical Settlements Working Group  
Kansas City, Mo.  
April 26-27, 1999

The Viatical Settlements Working Group of the Life Insurance and Annuities (A) Committee met in Kansas City, Mo., on April 26-27, 1999. Lester Dunlap (La.) chaired the meeting. The following working group members were in attendance: Elizabeth Bookwalter for Michael Bownes (Ala.); Roger Strauss (Iowa); Marlyn Burch and Tom Foley (Kan.); Dalora Schafer (Okla.); Greg Martino (Pa.); and Malika Essamel Din for Jeanne Bryant (Tenn.).

Lester Dunlap (La.) said the goal of the meeting was to substantially complete an "Alert package." If time remained, the working group could consider the appendices of the regulation and discuss charges related to the sale of life insurance of healthy individuals. He said the concept of the alert package is that it will include background material to introduce the reader to issues related to viatical settlements and then have specifics on viatical settlement transactions, investments and life settlements.

### 1. Viatical Settlements Brochure

Tom Foley (Kan.) said that, when he introduced the concept at the Winter National Meeting in 1998, he had in mind something like the example prepared by the press staff at the Kansas Insurance Department. He said this example was intended to be for the viator. Kansas insurance staff are working with the securities commissioner to put together a comparable document for investors. He suggested this would be in addition to backup material to provide more information to the insurance department or securities commission. Mike McNeerney (Mutual Benefits Corp.) said the document provided by Mr. Foley does not provide a balanced approach. He opined that it should not give just one side of the issues but should be a balanced document. Roger Strauss (Iowa) asked if the emerging issues document provided to the working group is supposed to be the same thing as Mr. Foley's brochure. He also pointed out that there is an Appendix A to an earlier draft of the Viatical Settlements Model Regulation that appears to be a buyer's guide. Doug Head (Medical Escrow Society) explained that the trifold document is to be more narrowly targeted. The "emerging issues" document is intended to be more extensive information that is background for the brochures. He said he envisioned the working group's project to be a folder containing the brochures and the emerging issues background document. He suggested that the working group approach the project by starting with the emerging issues document and then develop the separate brochures. Elizabeth Bookwalter (Ala.) suggested starting with the Kansas brochure. Mr. Dunlap asked if Kansas had documents in progress for investors and healthy people. Marlyn Burch (Kan.) said Kansas is working closely with the securities commissioner to prepare a brochure which will probably be included in a joint press release. He said he saw this document as a way to make people aware of things to consider. He said this is not a document that says "don't do it."

George Coleman (Prudential) said the NAIC has an interest in insurance policyholders. He opined that it is appropriate to encourage them to keep their insurance and to inform them what they are giving up if they sell the policies. He suggested starting with why an individual has insurance coverage in the first place. There is a substantial penalty for giving up the insurance and he pointed out that the Kansas draft does not say anything about contacting your insurer to see what your options are. Mr. Foley said the working group seems to be coming from the perspective that it should encourage the sale of life insurance policies. He said he comes from the perspective that an individual should think about why he has insurance. Mr. Dunlap said he sees this as similar to the way the insurance department would put out information about life insurance purchases and annuities. He opined the message should be, "you bought this life insurance policy for a reason, and you need to think about that before divesting yourself of the policy." Mr. Foley agreed that this was the perspective of the brochure his department drafted: things to think about before you participate in a viatical settlement. He also encouraged the working group to review a draft from the American Council of Life Insurance (ACLI) containing a list of questions viators should ask and a separate list of questions investors should ask. He suggested adding some of these questions to the brochure. Julie Spiezio (ACLI) said the idea came from the Annuities Buyer's Guide which ends with a list of questions. It does not give answers, but the purpose of the questions is to make the person think twice. Ron Panneton (National Association of Life Underwriters—NALU) said this reminded him of the discussion at the Replacements Issues (A) Working Group on the need to have the transaction reviewed with a financial advisor. He said the brochure drafted by the Kansas Department is good because it points out the fact that a person considering such a transaction needs to sit down with his or her advisor. Mr. Strauss agreed that the brochure should be short; it should pique the reader's interest and let him know where to go to find more information. He opined that if the working group tries to include everything in this brochure it will not get done. Mr. Dunlap repeated his conviction that the working group needs to have this package substantially completed by the NAIC Summer National Meeting. Once completed, the documents will be sent to the media, associations like the AARP, state insurance departments, and other agencies that might have an interest. He said the package also needs a cover memo that tells what is included. Mr. Head expressed concern that, if these documents were all included as an appendix to the NAIC model, they would be set and he suggested this needs to be a more flexible document. Mr. Dunlap responded that, however the document is developed, it would still need to go through the NAIC's approval process before being distributed.

The working group spent some time reviewing the document prepared by the Kansas Department and decided on changes to make to the document. The working group discussed whether to include definitions and, if so, whether they should be placed at the beginning of the document or at the end. Mr. Strauss said that he would like to see the definitions at the back of the document. The working group agreed to begin with a brief description of a viatical settlement and to print in bold the terms that were being defined and to put the definitions at the end of the document. Mr. Panneton urged the working group to include a section that describes other options to a viatical settlement and to include a suggestion to discuss the life insurance policy with an agent.

John Matthews (Allstate Life) suggested developing alternative language to address states that have or have not adopted the NAIC's Viatical Settlements Model Act. Mr. Dunlap responded that it is important to keep the language generic in drafting a brochure so that those who receive the letter will be able to distribute it as is. States can change the document for their own use if they want to be more specific to match their own laws. John Ellis (Missouri Department of Securities) suggested including a sentence recommending that the person who might be asked to invest in or purchase a viatical arrangement should contact his securities or insurance regulator and request a brochure that talks about the risks involved. The working group agreed to reference the investor's brochure in the viatical settlement brochure. Ms. Spiezio expressed support for the language in the Kansas draft that alerted the reader to possible dangers. Mr. Coleman also urged regulators to point out that life settlements are not regulated in any way and to warn individuals about this. The working group agreed that the back panel should have three pieces in one box referring to the other brochures. The working group also identified several questions from the ACLI letter to include in the document. They discussed whether to put the questions after each section or at the end and the working group decided to put the questions at the end, but in the same order as the discussion.

When the working group reconvened, the revised brochure was reviewed and more changes were suggested. The working group agreed to ask Carolyn Johnson (NAIC/SSO) to provide the draft of this document to the NAIC public relations staff with a request to put it into a pleasing format for distribution.

## 2. Investment Brochure

The working group members next discussed important information they would like to consider for an investment brochure. Mr. Ellis pointed out that the North American Securities Administrators Association (NASAA) is in the process of forming a working group on the issue of viatical settlements, but he was speaking strictly for the State of Missouri. He said Missouri regulates viatical settlements if the investment is a fractional or pooled interest in an insurance policy, but not if one individual buys a whole life insurance contract. He said the Missouri securities regulator's concern is whether the viatical settlement contract purchase is a suitable investment. He helped the working group identify questions from the ACLI draft that were important to include and also noted that some of the advertising on the Internet and in newspapers has been very close to misleading and deceptive. He pointed out that advertising that talks about a "guarantee" needs full disclosure. He said it is not clear to many that a "42% return" does not mean a 42% rate per year. He said most individuals do not understand the risk of purchasing a policy that is in the contestability period. He said once the NASAA working group is in place, that organization would like to work with the NAIC on this issue. Mr. Ellis said the questions were a good mechanism for shortening the brochure. Full disclosure of risks cannot be included in a brochure; it would look like a prospectus for IBM. He suggested adding a disclaimer that the brochure does not describe all of the risks, and the person considering a purchase should go to a financial advisor with questions.

Mr. Matthews pointed out the problem with using a viatical settlement for an IRA or Keogh plan. He said once an individual reaches the age of 70 ½, he is required to take money from the account, but if there is no money available until the viator dies, there is no money to take out as an IRA distribution. Mr. McNerney suggested writing a question to address that issue. Mr. Strauss suggested including information that this is a non-liquid asset and it is not guaranteed as to the return of principal or the rate of return. Mr. Matthews suggested including information in the viator's brochure that the individual's health would be monitored, and in the investor's brochure saying that monitoring can occur.

## 3. Life Settlements Brochure

Mr. Head agreed to draft a brochure in similar format that describes the sale of policies by healthy individuals. The working group agreed to use the term "life settlements" when describing the sale of a policy by a healthy person.

## 4. Next Steps

Mr. Dunlap asked the working group to schedule a conference call before the Summer National Meeting to discuss the components of the Alert package. He asked that the technical resource advisors' redraft of the emerging issues background piece of the package be prepared before then for discussion. Mr. Head agreed to send a redraft of the emerging issues piece to Ms. Johnson on May 20. Mr. Dunlap said that at the Spring National Meeting, Commissioner Terri Vaughan (Iowa) expressed some concern that individuals might confuse this "Alert" package with the NAIC Accelerated Licensure Evaluation and Review Techniques (ALERT) program on company licensing. He asked the regulators to think about using a different term for this project. The working group decided to term this package of materials a "viatical advisory."

## 5. Life Settlements

Mr. Head described an April 23, 1999, draft of a life settlements regulation drafted by the viatical settlement industry. He said this emerged as a result of a request from the Florida Insurance Department for a proposal to introduce to their legislature. When the NAIC discussed this issue at the December 1998 hearing of the Life Insurance and Annuities (A) Committee, the viatical industry decided to offer this document to the NAIC also. He offered the draft as food for thought as the NAIC considers how to deal with life settlements. Ms. Spiezio said the ACLI has expressed concerns about the terminology "life settlements." She opined that the contract still exists in the secondary market and is not "settled." She also said the ACLI does not think it is appropriate for life insurance agents to solicit investors. She said this is a separate business from being a life insurance agent. Jolene Fullerton (Kelco, Inc.) said that the viatical industry is not wedded to the idea that the solicitors for life settlements be insurance agents. That was the preference of those who were involved in the drafting because the structure already exists. Ms. Spiezio said the draft from the viatical industry does give authority to license investment solicitors, but she thought it important that it should be a separate license. She emphasized that she was not saying an individual could not be both an investment solicitor and a life insurance agent, but the licenses should be separate.

## 6. Buyer's Guide, Appendix A

Mr. Dunlap reminded the working group members that a first draft of a buyer's guide for viatical settlements had been an appendix to the regulation. The regulation was sent forward to the A Committee without the appendix so that drafting could continue on this document. He said he believes the first draft is a good step, but there needs to be more information added in some areas. Ms. Spiezio offered to redraft the section on accelerated death benefits.

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

\*\*\*\*\*

## ATTACHMENT TWO

### Equity Indexed Products Working Group Kansas City, Mo. June 6, 1999

The Equity Indexed Products Working Group of the Life Insurance and Annuities (A) Committee met in Kansas City, Mo., at 11 a.m. on June 6, 1999. Mike Batte (N.M.) chaired the meeting. The following working group members were present: Larry Gorski (Ill.); Roger Strauss (Iowa); Tom Foley (Kan.); Lester Dunlap (La.); and Joan Williams representing Frank Stone (Okla.).

## 1. Discuss Recommendations for Regulators' Checklist for Contract Review

Acting Superintendent Mike Batte (N.M.) said the working group members were asked to review a survey that was compiled a year ago showing what states were doing in contract review of equity-indexed products. Roger Strauss (Iowa) said he reviewed the documents looking for common elements that might be added to a checklist. He came up with 19 separate items and suggested the group working on the checklist could add to these or delete them. He said a key issue to be decided would be whether these items should be submitted as part of the contract review or whether the company should certify that it has complied. Mr. Strauss said Commissioner Terri Vaughan (Iowa) expressed interest in the agents' training issue. She does not think there needs to be a separate test for equity-indexed products but that it is essential that companies show evidence that they are training their agents. He suggested it might be appropriate to submit the training materials to the regulator or to certify that the company trains its agents. Mr. Strauss said the National Association of Indexed Products will create an agent certification process for indexed products. One way to address this issue would be to have the company certify that its agents have taken that training. Acting Superintendent Batte said the working group focused attention at the 1998 Summer National Meeting on the issue of agents' training and heard presentations on possible directions the committee could go. At the 1998 Fall National Meeting the working group discussed alternatives ranging from a specialized examination for agents selling equity-indexed products to a requirement that the company train its agents. Acting Superintendent Batte said no consensus was reached at that time.

Jack Gies (Conn.) opined that the equity-indexed product is closer to a variable annuity than a traditional annuity product. The training for variable annuity agents is quite extensive because of the difficulty in understanding some of the products. He said it is important to treat equity-indexed products different than other life products and the concern of the regulators is well targeted. Tom Foley (Kan.) enforced the comment about the complexity of the products. He opined that equity-indexed products are even more complex than variable products. He suggested that it behooves regulators to require a significant level of training. Mr. Foley said the Life and Health Actuarial (Technical) Task Force has discussed reserves and other issues related to the renewal of equity-indexed products after the initial period. He noted that most of the focus in the past has been on the first period, without consideration of renewals. He opined that there are significant issues related to the renewal of an equity-indexed product, suggesting this is a further indication of the complexity of the product. Larry Gorski (Ill.) suggested that any attempt to standardize the requirements will fail because the products vary so much. Each company has to train its agents on its products. Acting Superintendent Batte noted that as companies developed products, they offered substantial training of their agents, and perhaps regulators do not need to do anything. He suggested that incorporating into the checklist a need to consider this issue could be adequate.

Mr. Gorski expressed concern about combination sales, where an equity-indexed product is being used to fund something else, such as a long-term care product. He explained that the 10% that is allowed to be taken out of the product each year could be used to pay the premium on a long-term care policy. He cautioned that regulators must be mindful about how the products will be used. Mr. Foley said that this is another indication of the importance of considering the renewal issue, because there are not seven-year long-term care products to match the seven years typical in an equity-indexed product.

Mr. Gorski returned to the issue of how to create a checklist. He said it could be either things to consider or things to require. He suggested the best approach was to list items to be considered. He noted that the list must be very dynamic because the product is very dynamic. He said he sees things now in products that he did not see three years ago. Mr. Dunlap said this checklist could be an opportunity to put together information from experts like Mr. Foley and Mr. Gorski so that states without actuaries or similar expertise would know what to look for. Mr. Gorski responded that the state regulator will need some understanding or he or she will not be able to evaluate the response to the questions. It will not be helpful unless the checklist gives correct answers or at least some guidance. Mr. Strauss responded that the purpose of this project is not to create a 40-page document but rather to alert regulators to the issues that they might need to research. Mr. Gorski said that the Equity-Indexed Buyer's Guide does that and would be a value tool for regulators. Mr. Foley agreed that one of the purposes of the Buyer's Guide was education of the insurance department staff. He noted that even though the document was only adopted a year ago it probably needs to be updated. Mr. Gorski suggested using the Buyer's Guide as a foundation for the checklist.

Barbara Lautzenheiser (Lautzenheiser and Associates) called the attention of the working group to a checklist for contract filing that is in a report from the American Academy of Actuaries (AAA) provided to the Life and Health Actuarial Task Force in 1998. She suggested this might be of assistance to the group addressing the charge to this working group. She suggested the first item on the checklist might be: read the Buyer's Guide. Mr. Strauss reviewed the items of commonality that he found in the contract review materials that were available a year ago (Attachment Two-A).

Mr. Gorski opined that several developments had taken place in the past year, such as the Life and Health Actuarial Task Force's Guideline ZZZZ, illustration rules and the Buyer's Guide. He also opined that it is important to review the marketing material.

Mr. Gies asked what this group can contribute to the issue of suitability of sales. He said one question the analysts should consider is whether the material is suitable for the audience to which it is directed. Paul DeAngelo (N.J.), chair of the Suitability (A) Working Group, said that group is developing a white paper on suitability of sales of non-variable products. He opined that there is a growing momentum for some suitability standard for life insurance and annuities, especially for complex products. He suggested that it would be difficult to develop a licensing test because of the rapid changes in the product. His preference is to make the companies disclose what training they do because it is important for regulators to know whether the company is making an effort to educate its agents in its products. Mr. DeAngelo also suggested providing seminars and other training for the analysts to help them better understand equity-indexed products. Mr. Dunlap applauded the suggestion from Mr. DeAngelo and suggested this training could even take place over the Internet to keep regulators up-to-date. Mr. Foley asked Carolyn Johnson (NAIC/SSO) to see whether the NAIC's web site could be expanded to include a chat room where regulators could ask questions about equity-indexed products. Mr. Foley offered an hour a week for himself and for Mr. Gorski to answer those analysts' questions.

Acting Superintendent Batte announced that a subgroup had been formed to develop the checklist with Mr. Dunlap chair, and including Mr. Strauss, Mr. Gorski, Mr. Foley and Acting Superintendent Batte. He invited anyone else with an interest in this topic to join the group developing the checklist. The subgroup agreed to hold a conference call June 24, 1999, to further discuss development of the checklist.

## 2. Adopt Minutes of April 30, 1999, Conference Call

Mr. Dunlap moved and Mr. Strauss seconded a motion to adopt the minutes of the April 30, 1999, conference call (Attachment Two-B).

Having no further business, the Equity Indexed Products Working Group adjourned at 11:55 a.m.

\*\*\*\*\*

## ATTACHMENT TWO-A

### Equity-Indexed Product Checklist

1. Advertising materials
2. Hedging strategy
3. Reserving methods
4. How product will be reported for risk-based capital
5. Copy of annual report to policy owner
6. Initial participation rate must be in policy and minimum and maximum participation rates for future periods in same location
7. Describe investment policy to be followed
8. Limit indices to well-established and published in a recognized journal
9. Describe any right of company to change index
10. Provide an opinion by company's appointed actuary that investments to be made for these contracts are appropriate considering the liabilities
11. Copy of disclosure statement policyholder signs certifying he understands the contract
12. Copy of any illustration material used with hypothetical increases and decrease in index
13. Prior notification to department of changes in any moving parts from those originally filed
14. Describe specific training program for agents for this type of product.
15. Cover page must say "Equity Indexed Product"
16. Actuarial memo
17. Actuarial certification
18. Home state approval
19. Unusual and controversial statement

\*\*\*\*\*

## ATTACHMENT TWO-B

Equity Indexed Products Working Group  
Conference Call  
April 30, 1999

The Equity Indexed Products Working Group of the Life Insurance and Annuities (A) Committee met by conference call at 11 a.m. on April 30, 1999. Acting Superintendent Mike Batte (N.M.) chaired the meeting. The following working group members or their representatives participated: Gene Reed, (Del.); Lester Dunlap (La.); Frank Stone (Okla.); and Sam Myer (S.D.).

Acting Superintendent Mike Batte (N.M.) summarized the activity of the working group during 1998. He reminded the working group that an extensive plan had been developed during 1998 to address the charge to the group. Most of that plan was finished by the Winter National Meeting; one charge was left to complete. The charge to the working group in 1999 is to "develop a list of items that should be addressed by regulators when reviewing contract filings for equity-indexed products, including agent training by the insurer." Acting Superintendent Batte said the purpose of the conference call is to review that charge and decide how to complete it.

Gene Reed (Del.) asked if the reference to agent training materials was simply a monitoring by the state insurance department. Sam Myer (S.D.) asked for clarification that the working group was not considering a recommendation for a continuing education requirement related to equity-indexed products. Acting Superintendent Batte said this issue was discussed by the working group in the fall of 1998 and his recollection was that the working group did not reach consensus on requiring continuing education. Mr. Myer said he thought states should be encouraged to approve courses and encourage agents to take classes. He said he and Mr. Reed were close to finalizing the Single License Procedure Model Act redraft and the focus was on uniformity. He said he did not want to disturb that for every new innovative product that came along. He added that, on the education charge addressed during 1998, his opinion is that all three of the alternates discussed by the working group are overkill. The working group considered whether to require the same education as for sales of variable annuities, to add requirements to the life insurance continuing education or to require company training to be demonstrated as part of the contract review process. He said the insurer is responsible for the actions of its agents, and does not need more administrative burdens.

Acting Superintendent Batte asked if, after addressing this charge, there is anything else the working group may have left out. Lester Dunlap (La.) said the working group has accomplished the charges laid out and expressed the desire to disband the working group. He opined that it could be reconstituted if needed. Acting Superintendent Batte asked for clarification from Mr. Dunlap as to whether he thought the charge for 1999 should be addressed. Mr. Dunlap expressed support for a checklist that would help contract examiners. He said that is just the sort of material he is expected to bring back to the department from NAIC meetings. Acting Superintendent Batte asked if putting together a checklist would be of benefit. Mr. Myer responded that it would be beneficial to his state's analysts, but he did not think the contract review process should include a demonstration of education for agents. He questioned whether contract analysts were qualified to evaluate education requirements.

Mr. Reed asked, if the working group would disband, who would serve as a conduit for any related issues. Acting Superintendent Batte responded that those would come to the Life Insurance and Annuities (A) Committee, which would probably reconstitute the working group to do that task. He said the easiest place to start the checklist would be by reviewing the summary of state contract filing guidelines provided by Carolyn Johnson (NAIC/SSO) last summer. Mr. Dunlap agreed that would be helpful and also suggested requesting states with a higher degree of expertise to help in this project. Acting Superintendent Batte reviewed the states that had submitted guidelines in 1998 and the working group identified Larry Gorski (Ill.) and Tom Foley (Kan.) as very knowledgeable individuals who might be willing to help in this effort. Acting Superintendent Batte asked Mr. Dunlap if he would chair the effort. Mr. Dunlap agreed to do so, and said he would contact Mr. Gorski and Mr. Foley to solicit their participation. Acting Superintendent Batte said he would also like to work on this project.

Mr. Dunlap suggested that the working group prepare this checklist and then disband, reporting to the A Committee that its work is complete. Acting Superintendent Batte agreed that was appropriate and asked Mr. Dunlap to try and have this material prepared for working group review at the Summer National Meeting.

Having no further business, the Equity Indexed Products Working Group adjourned at 11:30 a.m.

\*\*\*\*\*

## ATTACHMENT THREE

Life Disclosure Working Group  
Kansas City, Missouri  
June 8, 1999

The Life Disclosure Working Group of the Life Insurance and Annuities (A) Committee met in Kansas City, Mo., at 8 a.m. on June 8, 1999. Tom Foley (Kan.) chaired the meeting. The following working group members were present: John Shields for John Hartnedy (Ark.); Sheldon Summers (Calif.); Roger Strauss (Iowa); Lester Dunlap (La.); Paul DeAngelo (N.J.); Mike Batte (N.M.); Louis Belo for Tom Jacks (N.C.); and Rhonda Myron (Texas).

### 1. Presentation from American General Life

Sharon Roberson, Craig Clark and Regis George (American General) demonstrated a product developed for their company that contains an electronic illustration system. After the demonstration and questions by working group members, Tom Foley (Kan.) commented that late in the development of the Life Insurance Illustrations Model Regulation the working group recognized the problem with electronic illustrations where no printed document was provided. He said he was concerned at that time over the lack of control over the electronic illustration but said he was impressed with the controls provided in the product demonstrated by American General.

### 2. Discuss Conflicts Between Life Disclosure Model Regulation and Life Insurance Illustrations Model Regulation

Mr. Foley said the main item of business for the working group is to decide what direction to take on resolving conflicts between the Life Disclosure Model Regulation and Life Insurance Illustrations Model Regulation. He said when the illustrations regulation was developed, there was discussion about how this would interface with other NAIC models. The greatest concern was expressed over the Life Disclosure Model Regulation. The illustrations regulation allows a company to choose whether it will illustrate a policy form or not, but the disclosure regulation requires a policy summary for all. If a company is illustrating, this appears to be duplicative. In 1996 former Commissioner Robert E. Wilcox (Utah), at that time chair of the Life Disclosure Working Group, sent a letter to the commissioners to highlight possible conflicts. That letter included a suggestion that the basic illustration should serve as the policy summary. If no illustration was being provided, the policy summary should show guarantees only. Mr. Foley opined that this is somewhat of a misuse of the policy summary and has led to confusion. Mr. Foley asked if most states with the illustrations regulation have followed the Wilcox letter. George Coleman (Prudential) said a few states amended their disclosure regulations but many have not. Since it appears that many states have not addressed this issue, Mr. Foley asked the working group what recommendation it would like to make. He suggested one way would be to delete the requirements in the Life Disclosure Model Regulation or to write a letter to regulators suggesting how they might change their regulations. Paul DeAngelo (N.J.) said his state has adopted the illustrations regulation but did not change the disclosure regulation. He told the life insurance industry that the illustrations regulation would supersede the earlier document. Mr. DeAngelo said he is attempting to draft amendments to the disclosure regulation but had difficulty with the cost indices and needs actuarial assistance.

Mr. Foley said there are two major questions. The first is, if a company chooses not to illustrate, is there a need for a policy summary. He asked what a consumer would gain from a guarantees-only policy summary. Lester Dunlap (La.) said his state adopted the illustrations regulation but does not have a disclosure regulation. Mr. Foley responded that he does not face the problem that needs to be addressed in some other states now. Mr. DeAngelo noted that the Buyer's Guide is an attachment to the Life Disclosure Model Regulation. Mr. Foley said one way to address the issue would be to delete all references to the policy summary but to keep the Buyer's Guide requirement in the Life Disclosure Model Regulation. Acting Superintendent Mike Batte (N.M.) said, if the working group is going to start down this road, it needs to look at other models at the same time, such as the Life Insurance and Annuities Replacement Model Regulation. Mr. Foley responded that, if the working group will give him some sense of where it wants to go, he will work with NAIC staff to put together a draft. A member of the audience noted that the Long-Term Care Insurance Model Regulation also refers to the policy summary in connection with using life insurance to fund long-term care. Mr. DeAngelo said the working group he chaired that amended the replacement model last year addressed the issue of using an illustration rather than a policy summary.

Mr. Foley said the indices are the next important issue in the Life Disclosure Model Regulation. He explained that the net payment index and the cash surrender index are both designed to help a person get a sense of the value of the payments made and to compare different policies. He said this concept was developed during the mid-1970s. Chris Kite (FIPSCO) said the indices were adopted at a time when there were no illustrations. In addition, the indices are supposed to be used to compare similar policies. The market is now so diverse that it is difficult to decide if two policies are comparable. Mr. Foley said it is his sense that the market is now far beyond indices and these are no longer needed. Mr. DeAngelo responded that, before these are deleted from the model, he would like to hear from consumer groups and others who might feel they are needed. Barbara Lautzenheiser (Lautzenheiser and Associates) said she would like to emphasize that the indices only work with similar policies. Another point is that these are to determine value upon surrender. She opined that regulators should not be encouraging an emphasis on surrenders but rather keeping the insurance. Mr. Kite said there are better tools available today, but he suggested it is not necessary for regulators to mandate their use.

### 3. Review Illustrations Examples

Mr. Coleman provided regulators with a number of samples of life insurance illustrations for review. Mr. Foley summarized the types of policies in the packet and the number of pages of illustration. He said the average is 9-11 pages, which is somewhat shorter than he had been led to believe was typical. He said there was some discussion of including some of the narrative summary from the illustration in the Buyer's Guide. Mr. Coleman said the Buyer's Guide is more generic than the narrative summary in an illustration so that might be difficult to do. He suggested another alternative is to design the illustration in two parts with the narrative preprinted. This would not make the document shorter but it would be easier for agents to handle. Mr. Foley said there is some benefit to updating the Buyer's Guide and the discussion could include the possibility of moving some of the narrative to the Buyer's Guide. He said one of the agenda items for the 1999 Fall National Meeting will be to have a more extensive discussion on the Buyer's Guide.

### 4. Update on Variable Life Insurance Illustrations

Julie Spiezio (American Council of Life Insurance—ACLI) said that Carl Wilkerson (ACLI) told her that the Securities and Exchange Commission is expected to release its new provisions on variable life insurance illustrations by August. Mr. Foley

said that, as soon as this material is released, staff will let the working group know. He suggested a special session at the 1999 Fall National Meeting on how the NAIC should respond to this in developing its own Variable Life Insurance and Annuities Illustrations Model Regulation.

#### 5. Discuss Equity-Indexed Products Buyer's Guide

Mr. Foley asked if new concepts being developed in equity-indexed products should be incorporated into the Buyer's Guide. He said not very many companies are writing equity-indexed life insurance, but it may be necessary to update the Equity-Indexed Annuity Buyer's Guide. He said the Equity-Indexed Products Working Group can help ferret out new concepts that can be incorporated in any revision to the Buyer's Guide.

Having no further business, the Life Disclosure Working Group adjourned at 10 a.m.

\*\*\*\*\*

### ATTACHMENT FOUR

#### Suitability Working Group Kansas City, Mo. June 6, 1999

The Suitability Working Group of the Life Insurance and Annuities (A) Committee met in Kansas City, Mo., at 3 p.m. on June 6, 1999. Paul DeAngelo (N.J.) chaired the meeting. The following working group members were present: Rosanne Mead (Iowa); Marlyn Burch (Kan.); Lester Dunlap (La.); Julie Boulter representing Linda Ruthardt (Mass.); Scott Borchert (Minn.); Cindy Amann (Mo.); Louis Belo representing Tom Jacks (N.C.); Joel Ario (Ore.); Rhonda Myron (Texas); and Tom Van Cooper (Vt.).

#### 1. Discuss Advertising of Life Insurance and Annuities Model Regulation

Paul DeAngelo (N.J.) announced that the first draft of the Advertising of Life Insurance and Annuities Model Regulation is available for comment (Attachment Four-A). He asked that comments be submitted to Carolyn Johnson (NAIC/SSO) by July 15, 1999. A conference call to discuss the comments will be scheduled at the end of July. He said the amendments in the document include everything that has been suggested and discussed by the working group so that all the suggestions can be aired, and then changes or deletions will be made as appropriate.

#### 2. Discuss Suitability White Paper

Mr. DeAngelo said the first draft of the white paper (Attachment Four-B) is a compilation of work done by individuals. He noted that there is some overlap that will need to be combined. Other sections are currently under development and some will need to be drafted. After all the sections of the white paper have been drafted, the group will work together on conclusions and recommendations. Mr. DeAngelo asked those who have work under development to complete it by July 15 and then Ms. Johnson will place the document on the NAIC's web site. He asked those interested parties and regulators who wish to comment to provide those comments to Ms. Johnson by Aug. 30, 1999. In early September the working group will have a conference call or an interim meeting to discuss the white paper. Joel Ario (Ore.) drew the attention of the working group to the section he had drafted on state suitability standards. He said it would be helpful if those states that have standards could elaborate on how they have used them and how they work. Representatives from those states are asked to submit the material to Mr. Ario so that he can incorporate it into his section for inclusion in the revised draft. Mr. DeAngelo asked Ms. Johnson to prepare a section summarizing the results of an earlier survey by the NAIC on suitability. Mr. DeAngelo offered to draft introductory material. Cindy Amann (Mo.) offered to draft a section describing the Insurance Marketplace Standards Association (IMSA) and its impact on suitability. Mr. DeAngelo asked members of the working group and interested parties if there are other sections or topics that should be included in the white paper indicating he is desirous of identifying such topics now rather than when the paper is nearing completion.

#### 3. Adopt Minutes of March 30, 1999, Conference Call

Mr. Ario moved and Lester Dunlap (La.) seconded a motion to adopt the minutes of the March 30, 1999, conference call (Attachment Four-C). The motion passed.

#### 4. Any Other Matters Brought Before the Working Group

Mr. Dunlap asked for working group consideration of an article written by Dr. Joseph Belth for the *Insurance Forum* (June 1997). Mr. Dunlap said the article discusses the exclusion for agent training material contained in the current advertising regulation. He noted this is true in most state laws. Dr. Belth argues that it should not be permissible for agents' training materials to be misleading because that is the understanding the agent will have and will convey that misinformation to policyholders. Mr. Dunlap asked the working group to consider whether the model should be amended to delete that exclusion. He said he agreed with Dr. Belth and thought that any information that would find its way to the consumer should come under the advertising regulation. Mr. Dunlap quoted Dr. Belth "...agents may be misled into placing business with a company, and consumers therefore may be victimized indirectly by improper information." Tom Van Cooper (Vt.) concurred that this should be covered by the advertising regulation, but he cautioned regulators to acknowledge that a certain amount of puffery is used to motivate the agent sales force. He said he thought it would be possible to draw a line between puffery and misleading information. Anda Olsen (ING) said that much training material is competitive; describing how one company's product is better

than others, and she cautioned that this might not be allowed if the exclusion was deleted from the advertising model. Mr. DeAngelo asked interested parties to comment on this issue also by July 15. Mr. Van Cooper said the regulators will need to look at the whole model with this in mind to make sure all of the provisions would work without the exclusion.

Mr. Dunlap said a second issue contained in the June 1997 *Insurance Forum* describes possible use of insurance company ratings in a deceptive manner. Mr. Van Cooper agreed that this could be misleading without giving proper context because the consumers context would be his own grade school experience where an A- was a good grade, not recognizing that companies might be rated A+++, A++, A+, and A over the company rated A-. Don Walters (American Council of Life Insurance—ACLI) cautioned the regulators against reacting to the position of one academic. He asked if there is a problem to be addressed. Mr. Van Cooper responded that he was not sure this issue rises to the level of abuse, but it is common sense to recognize possible confusion. Mr. Walters responded that this requirement does not exist in the securities industry. Mr. DeAngelo said he would like to be ahead of the securities industry in this disclosure issue and noted that the intent of the advertising regulation is to prevent someone from being misled rather than to cure abuses.

Mr. DeAngelo asked if there should be a higher standard in regard to suitability where the company has more information, for example, where a bank and a securities firm are related to an insurer. In this case, the agent may have access to a much greater range of information than would otherwise be true. Mr. Van Cooper responded that it makes sense to him but he cautioned that merely because a person chooses to consolidate his investments, that does not make the company a guarantor of future performance or imply a super fiduciary responsibility. Mr. Ario opined that this is already incorporated in the state standards that exist. This is because the standard references information already known to the agent. He opined that if the working group drafts a suitability standard, it will probably include similar language. Scott Borchert (Minn.) said the problem is that in the real world the purchaser thinks the seller is working in his best interest and has some sort of fiduciary duty. Rhonda Myron (Texas) cautioned the working group to keep in mind federal law so that a higher standard is not set for a bank involved in the insurance business. Al Dawson (Citigroup) said it is a misconception that there is a big computer in the sky that knows all the holdings of someone. He said this may be true someday but it is not at this time because the different systems developed by subsidiaries cannot communicate. Mr. DeAngelo indicated he just wanted the working group to consider this issue as the marketplace moves in the direction of financial institutions that offer banking, insurance and investment services under one roof.

Having no further business, the Suitability Working Group adjourned at 4 p.m.

\*\*\*\*\*

#### ATTACHMENT FOUR-A

##### Rules Governing The Advertisements Of Life Insurance and Annuities Model Regulation Draft: May 10, 1999

#### Table of Contents

Section 1.	Purpose
Section 2.	Definitions
Section 3.	Applicability
Section 4.	Form and Contents of Advertisements
Section 5.	Disclosure Requirements
Section 6.	Identity of Insurer
Section 7.	Jurisdictional Licensing and Status of Insurer
Section 8.	Statements About the Insurer
Section 9.	Enforcement Procedures
Section 10.	Penalties
Section 11.	Conflict With Other <del>Rules</del> Regulations
Section 12.	Severability

#### Section 1. Purpose

The purpose of ~~these rules~~ this regulation is to set forth minimum standards and guidelines to assure a full and truthful disclosure to the public of all material and relevant information in the advertising of life insurance policies and annuity contracts.

#### Section 2. Definitions

For the purpose of ~~these rules~~ this regulation:

- A. (1) "Advertisement" means material designed to create public interest in life insurance or annuities or in an insurer, or in an insurance producer; or to induce the public to purchase, increase, modify, reinstate, borrow on, surrender, replace or retain a policy including:

Comment: See drafting note caveat immediately following the definition of "insurance producer" in this section.

- (a) Printed and published material, audiovisual material and descriptive literature of an insurer or insurance producer used in direct mail, newspapers, magazines, radio and television scripts, billboards and similar displays, and the Internet or any other mass communication media.
  - (b) Descriptive literature and sales aids of all kinds, authored by the insurer, its insurance producers, or third parties, issued, distributed or used by the insurer or insurance producer; including but not limited to circulars, leaflets, booklets, web pages, depictions, illustrations and form letters;
  - (c) Material used for the recruitment, training and education of an insurer's insurance producers which is designed to be used or is used to induce the public to purchase, increase, modify, reinstate, borrow on, surrender, replace or retain a policy;
  - (d) Prepared sales talks, presentations and materials for use by insurance producers.
- (2) "Advertisement" for the purpose of ~~these rules~~ this regulation shall not include:
- (a) Communications or materials used within an insurer's own organization and not intended for dissemination to the public;
  - (b) Communications with policyholders other than material urging policyholders to purchase, increase, modify, reinstate or retain a policy;
  - (c) A general announcement from a group or blanket policyholder to eligible individuals on an employment or membership list that a policy or program has been written or arranged; provided the announcement clearly indicates that it is preliminary to the issuance of a booklet explaining the proposed coverage.

~~B. "Insurance producer" means an individual who solicits, negotiates, effects, procures, renews, continues or binds policies of insurance covering risks located in this state; a person required to be licensed under the laws of this state to consult, sell, solicit or negotiate insurance.~~

Drafting Note: Each jurisdiction may wish to revise the definition of "insurance producer" to reference the definition in that jurisdiction's licensing law. This definition is from the NAIC Single License Producer Model Act, which also defines the terms "consult," "sell," "solicit," and "negotiate."

Drafting Note: This term and words related thereto should not be included in life advertising ~~rules or~~ regulations unless "insurance producer" also is statutorily defined and the definitions are identical.

- C. "Insurer" means any individual, corporation, association, partnership, reciprocal exchange, inter-insurer, Lloyd's, fraternal benefit society, and any other legal entity which is defined as an "insurer" in the insurance code of this state or issues life insurance or annuities in this state and is engaged in the advertisement of a policy.
- D. "Nonguaranteed policy element" means any premium, cash value, death benefit, endowment value, dividend or other policy benefit or pricing element or portion thereof whose amount is not guaranteed by the terms of the contract. Any policy element that contractually follows a separate account result or a defined index is not considered a nonguaranteed policy element.
- E. "Policy" means any policy, plan, certificate, including a fraternal benefit certificate, contract, agreement, statement of coverage, rider or endorsement which provides for life insurance or annuity benefits.
- F. "Preneed funeral contract or prearrangement" means an arrangement by or for an individual before the individual's death relating to the purchase or provision of specific funeral or cemetery merchandise or services.

### Section 3. Applicability

- A. ~~These rules~~ This regulation shall apply to any life insurance or annuity advertisement intended for dissemination in this state. In variable contracts where disclosure requirements are established pursuant to federal regulation, this regulation shall be interpreted so as to eliminate conflict with such federal regulation.
- B. All advertisements, regardless of by whom written, created, designed or presented, shall be the responsibility of the insurer, as well as the producer who created or presented the advertisement. Every insurer shall establish and at all times maintain a system of control over the content, form and method of dissemination of all advertisements of its policies. Control shall include regular and routine notification, at least once a year, to agents, brokers and others authorized by the insurer to disseminate advertisements of the requirement to seek company approval prior to the use of any advertisements not furnished by the insurer.

- (1) Notification shall include the name, title and location of an individual or department designated by the insurer for the purpose of submitting advertisements for review and approval.

(2) The notification shall address the insurer's method of monitoring adherence with advertising procedures and guidelines, including the consequences of non-adherence. An insurer shall have six (6) months from the effective date of this provision to establish the system of control required by this section.

#### Section 4. Form and Content of Advertisements

A. Advertisements shall be truthful and not misleading in fact or by implication. The form and content of an advertisement of a policy shall be sufficiently complete and clear so as to avoid deception. It shall not have the capacity or tendency to mislead or deceive. Whether an advertisement has the capacity or tendency to mislead or deceive shall be determined by the Commissioner of Insurance from the overall impression that the advertisement may be reasonably expected to create upon a person of average education or intelligence within the segment of the public to which it is directed.

B. No advertisement shall use the terms "investment," "investment plan," "founder's plan," "charter plan," "deposit," "expansion plan," "profit," "profits," "profit sharing," "interest plan," "savings," "savings plan," "private pension plan," "retirement plan" or other similar terms in connection with a policy in a context or under such circumstances or conditions as to have the capacity or tendency to mislead a purchaser or prospective purchaser of such policy to believe that he will receive, or that it is possible that he will receive, something other than a policy or some benefit not available to other persons of the same class and equal expectation of life.

#### Section 5. Disclosure Requirements

A. The information required to be disclosed by ~~these rules~~ this regulation shall not be minimized, rendered obscure, or presented in an ambiguous fashion or intermingled with the text of the advertisement so as to be confusing or misleading.

B. ~~No~~ An advertisement shall ~~not~~ omit material information or use words, phrases, statements, references or illustrations in such omission or such use has the capacity, tendency or effect of misleading or deceiving purchasers or prospective purchasers as to the nature or extent of any policy benefit payable, loss covered, premium payable, or state or federal tax consequences. The fact that the policy offered is made available to a prospective insured for inspection prior to consummation of the sale, or an offer is made to refund the premium if the purchaser is not satisfied or that the policy or contract includes a "free look" period that satisfies or exceeds regulatory requirements, does not remedy misleading statements.

C. In the event an advertisement uses "non-medical," "no medical examination required," or similar terms where issue is not guaranteed, terms shall be accompanied by a further disclosure of equal prominence and in juxtaposition thereto to the effect that issuance of the policy may depend upon the answers to the health questions set forth in the application.

D. An advertisement shall not use as the name or title of a life insurance policy any phrase which does not include the words "life insurance" unless accompanied by other language clearly indicating it is life insurance. An advertisement shall not use as the name or title of an annuity contract any phrase which does not include the word "annuity" unless accompanied by other language clearly indicating it is an annuity. An annuity advertisement shall not refer to an annuity as a CD annuity, or deceptively compare an annuity to a certificate of deposit.

E. An advertisement shall prominently describe the type of policy advertised.

F. An advertisement of an insurance policy marketed by direct response techniques shall not state or imply that because there is no insurance producer or commission involved there will be a cost saving to prospective purchasers unless such is the fact. No such cost savings may be stated or implied without justification satisfactory to the commissioner prior to use.

G. An advertisement for a policy containing graded or modified benefit shall prominently display any limitation of benefits. If the premium is level and coverage decreases or increases with age or duration, that fact shall be commonly disclosed. An advertisement of or for a life insurance policy under which the death benefit varies with the length of time the policy has been in force shall accurately describe and clearly call attention to the amount of minimum death benefit under the policy.

(1) For television advertisements, an announcement describing the graded or modified benefits to be displayed during the advertisement for a least 10 seconds.

(2) For radio advertisements, an announcement describing the graded or modified benefits.

(3) For pre-printed advertisements intended for general distribution, a written description of the graded or modified benefits printed on the first page of the advertisement and in at least twelve-point type.

H. An advertisement for the types of policies described in Subsections F and G of this section shall not use the words "inexpensive," "low cost," or other phrase or words of similar import when the policies being marketed are guaranteed issue.

#### I. Premiums

(1) An advertisement for a policy with non-level premiums shall prominently describe the premium changes.

(2) An advertisement in which the insurer describes a policy where it reserves the right to change the amount of the premium during the policy term, but which does not prominently describe this feature, is deemed to be deceptive and misleading and is prohibited.

(3) An advertisement shall not contain a statement or representation that premiums paid for a life insurance policy can be withdrawn under the terms of the policy. Reference may be made to amounts paid into an advance premium fund, which are intended to pay premiums at a future time, to the effect that they may be withdrawn under the conditions of the prepayment agreement. Reference may also be made to withdrawal rights under any unconditional premium refund offer.

(4) An advertisement which represents a pure endowment benefit has a "profit" or "return" on the premium paid rather than as a policy benefit for which a specified premium is paid is deemed to be deceptive and misleading and is prohibited.

(5) Represent in any way that premium payments will not be required for each year of the policy in order to maintain the illustrated death benefits, unless that is the fact.

(6) Use the term "vanish" or "vanishing premium," or a similar term that implies the policy becomes paid up, to describe a plan for using nonguaranteed elements to pay a portion of future premiums.

J. Analogies between a life insurance policy's cash values and savings accounts or other investments and between premium payments and contributions to savings accounts or other investments must be complete and accurate. An advertisement shall not emphasize the investment or tax features of a policy to such a degree that the advertisement would mislead the purchaser to believe the policy is an investment or that it is anything other than life insurance.

K. An advertisement shall not state or imply in any way that interest charged on a policy loan or the reduction of death benefits by the amount of outstanding policy loans is unfair, inequitable or in any manner an incorrect or improper practice.

L. If nonforfeiture values are shown in any advertisement, the values must be shown either for the entire amount of the basic life policy death benefit or for each \$1,000 of initial death benefit.

M. The words "free," "no cost," "without cost," "no additional cost," "at no extra cost," or words of similar import shall not be used with respect to any benefit or service being made available with a policy unless true. If there is no charge to the insured, then the identity of the payor must be prominently disclosed. An advertisement may specify the charge for a benefit or a service or may state that a charge is included in the premium or use other appropriate language.

N. No insurance producer may use terms such as "financial planner," investment adviser," "financial consultant," or "financial counseling" in such a way as to imply that he or she is generally engaged in an advisory business in which compensation is unrelated to sales unless that actually is the case.

#### O. Nonguaranteed Policy Elements

(1) An advertisement shall not utilize or describe nonguaranteed policy elements in a manner which is misleading or has the capacity or tendency to mislead.

(2) An advertisement shall not state or imply that the payment or amount of nonguaranteed policy elements is guaranteed. Unless otherwise specified in the Life Illustration Regulation, if nonguaranteed policy elements are illustrated, they must be based on the insurer's current scale and illustrate should must contain a statement to the effect that they are not to be construed as guarantees or estimates amounts to be paid in the future.

(3) Unless otherwise specified in [insert reference to Life Insurance Illustration Regulation], an advertisement that includes any illustrations or statements containing or based upon nonguaranteed elements shall set forth, with equal prominence comparable illustrations or statements containing or based upon the guaranteed elements.

(4) If an advertisement refers to any nonguaranteed policy element, it shall indicate that the insurer reserves the right to change any such element at any time and for any reason. However, if an insurer has agreed to limit this right in any way; such as, for example, if it has agreed to change these elements only at certain intervals or only if there is a change in the insurer's current or anticipated experience, the advertisement may indicate any such limitation on the insurer's right.

(5) An advertisement shall not refer to dividends as "tax-free" or use words of similar import, unless the tax treatment of dividends is fully explained and the nature of the dividend as a return of premium is indicated clearly.

(6) Advertisements of annuities containing a rate to be earned, including but not limited to interest rates or rates of return, are prohibited unless all limitations and conditions which affect the ultimate rate of return earned by the policyholder/annuitant are disclosed prominently and conspicuously with equal emphasis to describe the interest rate or rate of return. The disclosure shall include:

(a) Premium expense charges, if any;

- (b) Administrative charges, if any;
    - (c) The full surrender charge, year by year; and
    - (d) Any policy fee.
  - (7) Advertisement of two-tier annuities or multiple benefit annuities shall disclose:
    - (a) The interest rate on annuity accumulation fund;
    - (b) The interest rate for cash value accumulation fund; and
    - (c) The planned interest rate that will apply on the maturity date of annuitization.
  - (8) An advertisement may not state or imply that illustrated dividends under either or both a participating policy or pure endowment will be or can be sufficient at any future time to assure without the future payment of premiums, the receipt of benefits, such as a paid-up policy, unless the advertisement clearly and precisely explains the benefits or coverage provided at such time and the conditions required for that to occur.
- P. An advertisement shall not state that a purchaser of a policy will share in or receive a stated percentage or portion of the earnings on the general account assets of the company.
- Q. Testimonials, Appraisals, Analysis, or Endorsements by Third Parties
- (1) Testimonials, appraisals or analysis used in advertisements must be genuine; represent the current opinion of the author; be applicable to the policy advertised, if any; and be accurately reproduced with sufficient completeness to avoid misleading or deceiving prospective insureds as to the nature or scope of the testimonial, appraisal, analysis or endorsement. In using testimonials, appraisals or analysis; the insurer or insurance producer makes as its own all the statements contained therein, and such statements are subject to all the provisions of ~~these rules~~ this regulation.
  - (2) If the individual making a testimonial, appraisal, analysis or an endorsement has a financial interest in the insurer or related entity as a stockholder, director, officer, employee or otherwise, or receives any benefit directly or indirectly other than required union scale wages, such fact shall be prominently disclosed in the advertisement.
  - (3) An advertisement shall not state or imply that an insurer or a policy has been approved or endorsed by a group of individuals, society, association or other organization unless such is the fact and unless any proprietary relationship between an organization and the insurer is disclosed. If the entity making the endorsement or testimonial is owned, controlled or managed by the insurer, or receives any payment or other consideration from the insurer for making an endorsement or testimonial, that fact shall be disclosed in the advertisement.
  - (4) When an endorsement refers to benefits received under a policy for a specific claim, the claim date, including claim number, date of loss and other pertinent information shall be retained by the insurer for inspection until the completion by the Commissioner of Insurance of the next market conduct examination of the insurer.
- R. An advertisement shall not contain statistical information relating to any insurer or policy unless it accurately reflects recent and relevant facts. The source of any statistics used in advertisement shall be identified.
- S. Policies Sold to Students
- (1) The envelope in which insurance solicitation material is contained may be addressed to the parents of students. The address may not include any combination of words which imply that the correspondence is from a school, college, university or other education or training institution nor may it imply that the institution has endorsed the material or supplied the insurer with information about the student unless such is a correct and truthful statement.
  - (2) All advertisements including but not limited to informational flyers used in the solicitation of insurance must be identified clearly as coming from an insurer or insurance producer, if such is the case, and these entities must be clearly identified as such.
  - (3) The return address on the envelope may not imply that the soliciting insurer or insurance producer is affiliated with a university, college, school or other educational or training institution, unless true.
- T. Introductory, Initial or Special Offers and Enrollment Periods
- (1) An advertisement of an individual policy or combination of policies shall not state or imply that the policy or combination of policies is an introductory, initial or special offer, or that applicants will receive substantial advantages not available at a later date, or that the offer is available only to a specified group of individuals, unless that is the fact. An advertisement shall not describe an enrollment period as "special" or "limited" or use similar words or phrases in describing it when the insurer uses successive enrollment periods as its usual method of marketing its policies.

(2) An advertisement shall not state or imply that only a specific number of policies will be sold, or that a time is fixed for the discontinuance of the sale of the particular policy advertised because of special advantages available in the policy.

(3) An advertisement shall not offer a policy which utilizes a reduced initial premium rate in a manner which overemphasizes the availability and the amount of the reduced initial premium. A reduced initial or first year premium may not be described as constituting free insurance for a period of time. When insurer charges an initial premium that differs in amount from the amount of the renewal premium payable on the same mode, all references to the reduced initial premium shall be followed by an asterisk or other appropriate symbol which refers the reader to that specific portion of the advertisement which contains the full rate schedule for the policy being advertised.

Drafting Note: Some states prohibit a reduced initial premium. This section does not imply that ~~the a states which that prohibits an initial premium~~ are is not in conformity with the NAIC rules model.

(4) An enrollment period during which a particular insurance policy may be purchased on an individual basis shall not be offered within this state unless there's been a lapse of not less than [insert number] months between the close of the immediately preceding enrollment period for the same policy and the opening of the new enrollment period. The advertisement shall specify the date by which the applicant must mail the application, which shall be not less than ten (10) days and not more than forty (40) days from the date on which such enrollment period is advertised for the first time. This rule-regulation applies to all advertising media—i.e., mail, newspapers, radio, television, magazines and periodicals—by any one insurer or insurance producer. The phrase “any one insurer” includes all the affiliated companies of a group of insurance companies under common management or control. This rule-regulation does not apply to the use of a termination or cutoff date beyond which an individual application for a guaranteed issue policy will not be accepted by an insurer in those instances where the application has been sent to the applicant in response to his or her request. It is also inapplicable to solicitations of employees or members of a particular group or association which otherwise would be eligible under specified provisions of the insurance code for group, blanket or franchise insurance. In cases where insurance product is marketed on a direct mail basis to prospective insurance by reason of some common relationship with a sponsoring organization, this rule-regulation shall be applied separately to each sponsoring organization.

U. An advertisement of a particular policy shall not state or imply that prospective insureds shall be or become members of a special class, group, or quasi-group and as such enjoy special rates, dividends or underwriting privileges, unless that is the fact.

V. An advertisement shall not make unfair or incomplete comparisons of policies, benefits, dividends or rates of other insurers. An advertisement shall not disparage other insurers, insurance producers, policies, services or methods of marketing.

W. For individual deferred annuity products or deposit funds, the following shall apply:

(1) Any illustrations or statements containing or based upon interest rates higher than the guaranteed accumulation interest rates shall likewise set forth with equal prominence comparable illustrations or statements containing or based upon the guaranteed accumulation interest rates. The higher interest rate shall not be greater than those currently being credited by the company unless the higher rates have been publicly declared by the company with an effective date for new issues not more than three (3) months subsequent to the date of declaration.

(2) If an advertisement states and the premium accumulation interest rate, whether guaranteed or not, it shall also disclose in close proximity thereto and with equal prominence, the actual relationship between the gross and the net premiums.

(3) If the contract does not provide a cash surrender benefit prior to commencement of payment of annuity benefits, an illustration or statement concerning such contract shall prominently state that cash surrender benefits are not provided.

X. An advertisement of a life insurance policy or annuity that illustrates nonguaranteed values shall only do so in accordance with current applicable state law relative to illustrating such values for life insurance policies and annuity contracts.

~~X. An advertisement of a life insurance product and annuity as a single policy or life insurance policy with an annuity writer shall include the following disclosure or substantially similar statement at the point of sale before the application is taken; provided, however, if the policy contains an unconditional refund provision of at least ten (10) days, then the disclosure statement shall be delivered with or prior to the delivery of the policy, or upon the applicant's request, whichever occurs sooner. The disclosure shall include the first five (5) policy years, the tenth and twentieth policy years, at least one age from sixty (60) to seventy (70) and the scheduled commencement of annuity payments:~~

Year	Gross Annual Life %	Premium Annuity %	Guaranteed Cash Value of Annuity
1	%	%	\$
2	%	%	\$
3	%	%	\$
4	%	%	\$
5	%	%	\$
10	%	%	\$
20	%	%	\$
etc.	%	%	\$

~~Information in the disclosure statement shall be based on gross premium. The life and annuity percentages of the total gross premium shall equal 100 percent for each required duration. The guaranteed cash value of the annuity shall be the value at the end of the contract year. A copy of the disclosure statement shall be provided to the applicant.~~

Y. An advertisement for the solicitation or sale of a preneed funeral contract or prearrangement as defined in Section 2F ~~above~~ which is funded or to be funded by a life insurance policy or annuity contract shall adequately disclose the following:

- (1) The fact that life insurance policy or annuity contract is involved were being used to fund a prearrangement as defined in Section 2F ~~of these rules~~; and
- (2) The nature of the relationship among the soliciting agent or agents, the provider of the funeral or cemetery merchandise services, the administrator and any other person.

#### Section 6. Identity of Insurer

A. The name of the insurer shall be clearly identified in all advertisements ~~about the insurer or its products, and if any specific individual policy is advertised it shall be identified either by form number or other appropriate description. If an application is a part of the advertisement, the name of the insurer shall be shown on the application. If an advertisement contains a listing of rates or features which is a composite of several different policies or contracts, the advertisement must so state, must indicate whether all insurers are authorized everywhere the advertisement appears, and must provide the rating of the lowest rated insurer, but need not identify each insurer.~~

B. An advertisement shall not use a trade name, an insurance group designation, name of the parent company of the insurer, name of a particular division of the insurer, service mark, slogan, symbol or other device or reference without disclosing the name of the insurer, if the advertisement would have the capacity or tendency to mislead or deceive as to the true identity of the insurer or create the impression that a company other than the insurer would have any responsibility for the financial obligation under a policy.

C. An advertisement shall not use any combination of words, symbols or physical materials which by their content, phraseology, shape, color or other characteristics are so similar to a combination of words, symbols or physical materials used by a governmental program or agency or otherwise appear to be of such a nature that they tend to mislead prospective insureds into believing that the solicitation is in some manner connected with such governmental program or agency.

D. An advertisement shall not refer to a holding company or subsidiary of an insurer unless the advertisement fully discloses that the holding company or subsidiary is a separate entity and not responsible for the insurer's financial condition or contractual obligations. An advertisement shall not refer to a reinsurer or the existence of applicable reinsurance.

#### Section 7. Jurisdictional Licensing and Status of Insurer

A. An advertisement which is intended to be seen or heard beyond the limits of the jurisdiction in which the insurer is licensed shall not imply licensing beyond those limits.

B. An advertisement may state that an insurer or insurance producer is licensed in the state where the advertisement appears, provided it does not exaggerate that fact or suggest or imply that competing insurers or insurance producers may not be so licensed.

C. An advertisement shall not create the impression that the insurer, its financial condition or status, the payment of its claims or the merits, desirability, or advisability of its policy forms or kinds of plans of insurance are recommended or endorsed by any governmental entity. However, where a governmental entity has recommended or endorsed a policy form or plan, that fact may be stated if the entity authorizes its recommendation or endorsement to be used in an advertisement.

#### Section 8. Statements About the Insurer

An advertisement shall not contain statements, pictures or illustrations which are false or misleading, in fact or by implication, with respect to the assets, liabilities, insurance in force, corporate structure, financial condition, age or relative position of the

insurer in the insurance business. An advertisement shall not contain a recommendation by any commercial rating system unless it clearly defines the scope and extent of the recommendation.

#### Section 9. Enforcement Procedures

A. Each insurer shall maintain at its home or principal office a complete file containing a specimen copy of every printed, published or prepared advertisement of its individual policies and specimen copies of typical printed, published or prepared advertisements of its blanket, franchise and group policies, hereafter disseminated in this state, with a notation indicating the manner and extent of distribution and the form number of any policy advertised. The file shall be subject to inspection by the department. All advertisements shall be maintained in the file for a period of either four (4) years after discontinuance of its use or publication or until the filing of the next regular report on the examination of the insurer, whichever is the longer period of time.

B. If the commissioner determines that an advertisement has the capacity or tendency to mislead or deceive the public, the commissioner may require an insurer or insurance producer to submit all or any part of the advertising material for review or approval prior to use.

C. Each insurer subject to the provisions of ~~these rules~~ this regulation shall file with the ~~department~~ commissioner with its annual statement a certificate of compliance executed by an authorized officer of the insurer stating that to the best of his or her knowledge, information and belief the advertisements which were disseminated by or on behalf of the insurer in this state during the preceding statement year, or during the portion of the year when these rules were in effect, complied or were made to comply in all respects with the provisions of these rules and the insurance laws of this state as implemented and interpreted by these rules.

#### Section 10. Penalties

An insurer or its officer, directors, ~~agents~~ (producers) or employees that violate any of the provisions of this regulation, or knowingly participate in or abet such violation, shall be subject to a fine up to \$1,000 for each violation and suspension or revocation of its certificate of authority or license.

#### Section 11. Conflict With Other Laws or Rules Regulations

It is not intended that ~~these rules~~ this regulation conflict with or supersede any ~~rules~~ regulations currently in force or subsequently adopted in this state governing specific aspects of the sale or replacement of life insurance including, but not limited to, laws or rules regulations dealing with life insurance cost comparison indices, deceptive practices in the sale of life insurance, ~~and~~ replacement of life insurance policies, illustration of life insurance policies, and annuity disclosure. Consequently, no disclosure ~~pursuant to or~~ required under ~~any such rules~~ those regulations shall be deemed to be an advertisement within the meaning of ~~these rules~~ this regulation.

#### Section 12. Severability

If any section, term or provision of this ~~rule~~ regulation shall be ~~adjudged~~ invalid for any reason, ~~such that~~ that judgment shall not affect, impair or invalidate any other ~~Section~~ section, term or provision of this ~~rule~~ regulation, and the remaining sections, terms and provisions shall be and remain in full force and effect.

\*\*\*\*\*

ATTACHMENT FOUR-B

[TITLE]

Suitability Working Group White Paper  
Draft: May 21, 1999

#### Introduction

1. Survey Results
2. State Suitability Statutes and Standards
3. There are at least five states (Iowa, Kansas, Minnesota, Vermont and Wisconsin) that have a suitability standard for individual life and annuity products, and in some cases, for additional products as well. For each of these states, the following cites the relevant statute or rule, quotes the key operative language, identifies what products are covered, and highlights any fleshing out of the term "suitability." Also included is a brief discussion of five other states (Arkansas, New Mexico, Ohio, South Dakota and Utah) that have more limited suitability standards.

A. States with Broad Suitability Standards

## 1. Iowa

Iowa has an administrative rule (191-15.8) providing that “a producer shall not recommend” a product “without reasonable grounds to believe that the transaction or recommendation is not unsuitable for the person.” The rule applies to “the purchase, sale, or exchange of any life insurance policy, annuity, or any rider, endorsement, or amendment thereto.” The rule provides some guidance on how to judge suitability, stating that it should be “based upon reasonable inquiry concerning the person’s insurance objectives, financial situation and needs, age and other relevant information known by the producer.” Group products are covered, and the rule specifies that the relevant person in such cases is the group policyowner.

A second rule (191-15.11) provides an exception to a general prohibition on income discrimination when applying suitability standards.

## 2. Kansas

Kansas has an administrative rule (40-2-14) that prohibits “recommending to a prospective purchaser the purchase” of a product “with reasonable grounds to believe that the recommendation is unsuitable for the applicant.” The rule applies to “the purchase or replacement of any life insurance policy or annuity contract.” The rule provides limited guidance on how to judge suitability, stating that it should be “on the basis of information furnished by this person, or otherwise obtained.”

## 3. Minnesota

Minnesota has a statute (60K.14) providing that “an agent must have reasonable grounds for believing the recommendation” to purchase a product “is suitable for the customer.” The statute applies to “any life, endowment, individual accident and sickness, long-term care, annuity, life-endowment, or Medicare supplement insurance.”

The statute is more detailed on how to judge suitability, stating that the agent “must make reasonable inquiries to determine suitability” and prescribing the following suitability standard: “the suitability of a recommended purchase of insurance will be determined by reference to the totality of the particular customer’s circumstances, including, but not limited to, the customer’s income, the customer’s need for insurance, and the values, benefits, and costs of the customer’s existing insurance program, if any, when compared to the values, benefits, and costs of the recommended policy or policies.”

A second statute (72A.20) establishes the same “reasonable grounds for believing that the recommendation is suitable” standard on an insurer “either directly or through its agent.”

In implementing these statutes, the Minnesota Insurance Department has developed a suitability form that can be used to assess compliance. The form is scheduled for revision in 1999.

## 4. Wisconsin

Wisconsin has an administrative rule providing that “no insurer or intermediary may recommend to a prospective buyer” the purchase of a product “without reasonable grounds to believe that the recommendation is not unsuitable to the applicant.” The rule applies to “the purchase or replacement of any individual life insurance policy or annuity contract” (individual policies issued on a group basis are excluded).

The statute provides the following guidance on judging suitability: “the insurer or intermediary shall make all necessary inquiries under the circumstances to determine that the purchase of the insurance is not unsuitable for the prospective buyer.”

## 5. Vermont

Vermont has a statute (8 VSA 4724) that defines as an unfair or deceptive practice “soliciting, selling or issuing an insurance policy when the person soliciting, selling, or issuing the policy has reason to know or should have reason to know that it is unsuitable for the person purchasing it.” The statute appears to apply to all insurance products, and does not provide any guidance on how to judge suitability.

B. Other States with Some Suitability Standards

## 1. Arkansas

Arkansas has an administrative rule (14) that establishes a suitability standard for life insurance sales involving premium financing to college students.

## 2. New Mexico

New Mexico has an administrative rule (13 NMAC 10.8.50) that requires an agent to “make reasonable efforts to determine the appropriateness of a recommended purchase or replacement” of a Medicare supplement policy or certificate.

### 3. Ohio

A 1992 Ohio bulletin (92-1) relies on an unfair trade practices statute (3901.20) to require agents to "determine the status and suitability of any and all products he or she markets."

### 4. South Dakota

South Dakota has a statute (58-17) authorizing rules on the "suitability and appropriateness" of individual health insurance policies, and a second statute (58-18B) authorizing rules on the "suitability and eligibility for coverage of insureds" for stop loss, multiple employer trusts, and multiple employer welfare arrangements (MEWAs). One administrative rule (20:06:13) has been promulgated for Medicare supplement insurance that tracks the Minnesota statute in judging suitability on the basis of the prospective insured's financial condition, need for insurance, and existing insurance in comparison to the recommended insurance.

### 5. Utah

Utah has a statute (31A-123-303) that authorizes the commissioner to find certain products "inherently unsuitable." This power has not been exercised.

## 4. SEC and NASD Suitability Standards and Enforcement Procedures

### A. Introduction

Although variable life and annuity contracts are issued by insurance companies and subject to state insurance regulation, they also contain investment risks and are therefore required to be registered with the Securities and Exchange Commission (SEC). Producers who sell variable life insurance and variable annuities are also regulated both by the state insurance laws and the SEC. The producer must be licensed with the states in which he sells these products as well as affiliated with a member of the National Association of Securities Dealers (NASD) and a registered securities representative with the NASD. Therefore, it appears appropriate to review the requirements the SEC and the NASD have regarding the suitability of sales for securities, which would include these variable products, to determine whether such standards should be considered for all life and annuity products and to see if the existing rules for variable life and annuity products are sufficient to protect the buying public.

### B. Background

The Securities Act of 1933 is a federal law passed to promote truth in securities by requiring disclosure of material information on a security to the investor and by establishing a means to prevent misrepresentation, deceit and other fraudulent activities in the sale of securities. The primary means of accomplishing these goals under the law is through the requirement of registering offers and sales of securities. When the law was first passed, the Federal Trade Commission was responsible for its administration. Later, the Securities Exchange Act of 1934 created the Securities and Exchange Commission as an independent, nonpartisan regulatory agency of the securities industry. The Commission is comprised of five members appointed by the President for five-year terms. The staff of the Commission administers the federal securities laws and creates rules and regulations necessary to protect investors.

The Exchange Act and subsequent amendments to it require registration with the SEC of:

- national securities exchanges
- brokers and dealers who conduct interstate commerce (a broker is defined as one engaged in the business of effecting transactions in securities for the account of others; a dealer is a person engaged in the business of buying and selling securities for his own account)
- transfer agents
- clearing agents
- government and municipal brokers and dealers
- securities information processors

Each registered exchange is considered by the act to be a self-regulatory organization (SRO). Under the requirements of the law, the SRO must have rules and procedures in place for its members that assure fair and honest dealing with the investors. Member broker-dealers are subject to disciplinary action including fines, suspension and expulsion by the SRO if they violate these rules. The SEC must approve the rules and any amendments made to them. If an exchange disciplines a member, the member has the right to appeal the decision to the SEC.

In 1938, an amendment to the Exchange Act, commonly referred to as the Maloney Act, allowed for the creation of a national securities association to be registered with the SEC. Under Section 15A of the Act, the rules of such an association must be designed to "prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade...and in general, to protect investors and the public interest..." *Securities Exchange Act of 1934, Section 15A(b)(6)* Members of the association who violate the rules are subject to disciplinary actions including but not limited to fines, censure, suspension, expulsion or limitation of activities and functions. The National Association of Securities Dealers, Inc. (NASD) is the only registered securities association. Its registration was approved in August 1939.

### C. Securities and Exchange Commission Suitability Rules and Enforcement

Although the SEC does not have a specific rule regarding suitability standards in the sales of securities, their Rule 10b-5 (17 C.F.R. Section 240.10b5) states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

- a) to employ any device, scheme, or artifice to defraud,
- b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
- c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Part of the SEC's responsibilities includes overseeing the self-regulatory organizations (SROs). Any registered representative who contests a decision rendered by the SRO has the right to appeal it to the SEC. The SEC has upheld SRO disciplinary action where the broker/dealer has been found to recommend securities that are not suitable for the client. In one particular case, *In the Matter of the Application of Stephen Thorlief Rangen for Review of Disciplinary Action Taken by the New York Stock Exchange, Inc.*, Rel. No. 38486, Admin. Proc. File No. 3-8994, April 8, 1997, a broker/agent was disciplined for recommending the purchase of speculative securities on margin to three clients of limited financial means who had indicated they were looking for safe investments with steady income. In upholding the New York Stock Exchange's findings and sanctions, the Commission stated:

[W]e find that Rangen's recommendations to these customers were unsuitable and, therefore, inconsistent with just and equitable principles of trade. Rejek, Mr. and Mrs. Stapes, and F. Stapes were all seeking safe, income-producing investments, and did not wish to speculate...Even if we were to accept Rangen's view that these clients wanted to speculate and were aware of the risks, a conclusion not supported on this record, the Commission has held on many occasions that the test is not whether Mr. and Mrs. Stapes considered the transactions in their account suitable, but whether Rangen 'fulfilled the obligation he assumed when he undertook to counsel [them], of making only such recommendations as would be consistent with [their] financial situation and needs.'

It is apparent the SEC places the burden on the broker/dealer to review the information provided by the client regarding income, net worth and investment objectives to determine which securities are suitable.

Because the SEC rules allow for self-regulatory organizations, an important role of the Commission staff is monitoring and oversight of these organizations. The Division of Market Regulation completes inspections of the SROs, reviewing their market surveillance and disciplinary programs and procedures for handling customer complaints as well as other financial and operational procedures. The Division of Investment Management reviews registration statements and recommends rules. Part of their job also involves issuing interpretive letters relating to variable annuity and variable life insurance products registered with the SEC. The Office of Compliance Inspections and Examinations examines SROs to determine if they are acting in accordance with securities laws. As a result of the rapid growth in the variable insurance products market, the office formed a specialized insurance product examination team. The SEC's 1997 Annual Report states this team examined 24 insurance companies representing 20% of the insurance sponsors for variable insurance products. In 20 of these exams, deficiency notices were issued.

### D. NASD Suitability Requirements

The National Association of Securities Dealers, Inc. (NASD) is a self-regulatory organization with over 500,000 registered securities representatives, 5,400 securities firms and 58,000 branch offices as members. In 1996, as part of a restructuring of the organization, NASD Regulation, Inc. was established as an independent subsidiary of NASD responsible for regulating the securities market. All securities professionals associated with a member firm must register with the NASD.

NASD Manual and Notices to Members Conduct Rules, Section 2310 addresses suitability requirements:

- a) In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

In 1990 the rule was amended to add the following requirements for accounts opened and recommendations made after Jan. 1, 1991:

- b) Prior to the execution of a transaction recommended to a non-institutional customer, other than transactions with customers where investments are limited to money market mutual funds, a member shall make reasonable efforts to obtain information concerning:
  - 1) the customer's financial status;
  - 2) the customer's tax status;
  - 3) the customer's investment objectives; and

- 4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

The subject of suitability has been addressed in several notices to its members written by the NASD in the past few years. For example, NASD Notice to Members 95-80 reminds members that "A starting point in a member's recommendation of a mutual fund is to clearly define the investor's objectives and financial situation. The need for current income, liquidity, diversification, and acceptable levels of risk are important considerations."

The NASD has also expressed concern about the suitability of certain sales of variable life insurance products. NASD Notice to Members 96-86 reminded members that Rule 2310 applies to the sale of these variable products since they are registered securities. Members were advised a representative was recently fined \$75,000 and disciplined by NASD Regulation because it was determined based upon facts disclosed to him of financial situation, needs, and investment objectives, he did not have reasonable grounds for recommending the sale of certain variable life insurance products to several customers. The notice listed some factors regarding a recommendation to purchase variable products that could be considered under the suitability rules including:

- i) a representation by the customer that his or her life insurance needs were already adequately met;
- ii) the customer's express preference for an investment other than an insurance product;
- iii) the customer's inability to fully appreciate how much of the purchase payment or premium is allocated to cover insurance or other costs, and a customer's ability to understand the complexity of variable products generally;
- iv) the customer's willingness to invest a set amount on a yearly basis;
- v) the customer's need for liquidity and short-term investment;
- vi) the customer's immediate need for retirement income;
- vii) the customer's investment sophistication and whether he or she is able to monitor the investment experience of the separate account.

The NASD views suitability requirements as part of the overall requirement of fair dealing with customers. NASD Conduct Rule IM 2310.2 requires members and registered representatives to observe sales practices which are within the ethical standards of the association and which deal fairly with the public. Replacement of existing securities primarily to generate new commissions, excessive trading and selling products beyond the customer's financial ability to pay are all actions which would be considered in violation of the Rules of Conduct.

#### E. NASD Enforcement Activity

The two major means NASD Regulation uses to discover violations of suitability rules are field examinations and investigations of complaints. Member firms are examined anywhere from once a year to once every four years, with sales practices a major part of a routine exam. In addition, the association investigates individual complaints filed against member firms and registered representatives. Disciplinary action is primarily used to promote industry compliance with the Rules of Conduct, rather than as a source of relief or recovery to the complainant.

Once an investigation is complete, the staff must determine if formal disciplinary action is warranted. Cases where formal action is recommended must be reviewed and authorized by the Office of Disciplinary Affairs. (Prior to Jan. 1, 1999, the Case Authorization Unit and Office of Disciplinary Policy reviewed and commented on these cases. NASD Notice to Members 99-01 placed the functions performed by both these units into the Office of Disciplinary Affairs.) The Office of Disciplinary Affairs reviews the "legal, policy and consistency issues presented by each case." *NASD Notice to Members 99-01* If formal action is warranted, NASD issues a complaint and the respondent must respond or request an extension within 25 days. Hearings are conducted through the Office of Hearing Officers with a decision rendered in writing by the assigned hearing officer. Both the respondent and the Enforcement Department have the right to appeal the decision to the National Adjudicatory Council (NAC).

To understand how the NASD interprets suitability guidelines, it would be helpful to look at findings from hearings. In the *Matter of District Business Conduct Committee for District No. 8 v. Miguel Angel Cruz* was decided by the National Business Conduct Committee of NASD Regulation, Inc. on Oct. 31, 1997. A major portion of the decision centered around an examination of the evidence presented in the sale of variable life insurance products to nine customers. In each case, the committee reviewed the stated investment objectives and goals of the customers to determine whether the product was suitable to meet these objectives. In one case the customer told Mr. Cruz she wanted to invest money and she also needed more insurance. She was interested in products with tax-deferred features. While this customer was not happy with the performance of the product and believed she was going to get less insurance and more investment for the premiums, there was no evidence that information was not disclosed to her and the committee determined the variable life product was not unsuitable for her stated investment goals. Another customer specifically told Mr. Cruz he has no interest in life insurance since he already had sufficient coverage. He was looking for an investment vehicle to save money for his retirement. In this case, given the stated investment objectives, the committee found the policy to be unsuitable. Each of the nine sales was reviewed in this manner and the representative was fined, received a censure and was required to requalify as an investment company and variable contracts representative.

Although misrepresentation is a separate violation of the Rules of Conduct, it is not uncommon for a representative to misrepresent a product that is not suitable for the stated investment objectives. In the *Cruz* case, when the customers indicated their objectives were to invest money for short time periods and that they had no interest in insurance, Mr. Cruz represented the variable life policy as primarily an investment product with incidental life insurance. He failed to disclose substantial penalty charges for early surrender of the product. In reviewing the investment objectives and the true nature of the product, it is apparent the customers would have concluded on their own that the product was unsuitable if all features were truly represented.

## F. Court Cases

When reviewing cases where the plaintiff pursues a cause of action against a firm or securities representative for recommending unsuitable securities, the courts generally look at whether there is liability because of a violation of Section 10 of the Securities Exchange Act, specifically Rule 10b-5. The courts have required a plaintiff seeking recovery on a private cause of action to demonstrate two things: "[F]irst, that the rule has been violated, and second, that it was violated with scienter, that is, with intent to deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L. Ed.2d 668 (1976).

The U.S. Court of Appeals, Second Circuit in *Clark v. John LaMula Investors, Inc.*, 583 F.2d 594 (1978) ruled that the appellants, registered members of the NASD, acted with intent to deceive when they sold the plaintiff certain securities without advising her of the extent of the risk involved, of other investments which would meet her needs, and of how leading rating organizations rated the debentures sold. Although the court concluded the appellants did not make any untrue statements about the securities, they failed to inform her of all information, and had the plaintiff been informed, she would not have purchased these securities. In addition, the court found Mr. LaMula purchased the securities with the specific intent of selling them to the plaintiff at an excess mark-up, further indicating his intention to deceive. The court noted the trial judge instructed the jury to determine whether Mr. LaMula understood or should have understood the plaintiff's investment objectives, and whether the debentures sold were in fact suitable given these objectives. While the court did not address whether violations of the NASD suitability requirements create a separate cause of action, they noted the jury findings of these violations also supported a judgment of violation of the Securities Exchange Act.

Court cases often link findings in an unsuitability claim with the requirement that the plaintiff prove material misstatements or omissions that would indicate an intent to deceive or defraud in connection with the sale of securities. *Brown v. E.F. Hutton Group, Inc.*, 991 F. 2d 1020 (2d Cir. 1993). The courts have also ruled the investor can not rely on a misrepresentation if, "through minimal diligence, the investor should have discovered the truth." *Royal American Managers, Inc. v. IRC Holding Corp.*, 885 F. 2d 1011, 1015-16 (2d Cir. 1989). Although the Second Circuit Court has not established a list of relevant factors to consider whether the investor acted recklessly in relying on the misrepresentation, other courts have been guided by such factors as:

1. the sophistication and expertise of the plaintiff in financial and securities matters;
2. the existence of a long standing business or personal relationship;
3. access to the relevant information;
4. the existence of a fiduciary relationship;
5. concealment of the fraud;
6. the opportunity to detect the fraud;
7. whether the plaintiff initiated the stock transaction or sought to expedite the transactions; and
8. the generality or specificity of the misrepresentations.

See *Davidson v. Wilson*, 973 F. 2d 1391, 1400 (8th Cir. 1992); *Myers v. Finkle*, 950 F.2d 165, 167 (4th Cir. 1991); *Molecular Technology Corp. v. Valentine*, 925 F. 2d 910, 918 (6th Cir. 1991); *Bruschi v. Brown*, 876 F. 2d at 1529 (11th Cir.); *Kennedy v. Josephthal & Co.*, 814 F. 2d 798, 804 (1st Cir. 1987); *Zobrist v. Coal-X, Inc.* 708 F.2d at 1516 (10th Cir.).

Suitable investments to meet an investor's objectives do not guarantee positive financial growth. A broker may recommend or purchase securities that are suitable, but for reasons beyond his control, do not yield positive results. The broker is required not to knowingly make an untrue statement of material fact or knowingly fail to state a material fact that would be relied on by the investor *Farlow v. Peat, Marwick, Mitchell & Co.*, 956 F.2d 982, 986 (10th Cir. 1992).

## G. Summary

The NASD and other self-regulatory organizations that are regulated by the SEC have specific rules that address the suitability requirements for investments. Knowledge of the investor's financial status, tax status and investment objectives are important factors that must be considered prior to recommending a product. Representatives are expected to make reasonable efforts to obtain this knowledge and only make recommendations that are consistent with the investor's tax status, financial status, investment objectives and other characteristics of the investor as expressed or apparent to the representative. The SEC addresses suitability under its fraud and misrepresentation rules. Suitability concerns are seen as part of the overall requirements of fair dealings expected of a representative. Registered firms and representatives who violate SRO or SEC rules are subject to disciplinary action including fines and suspensions of their registration and/or civil or criminal action.

### 5. NASD Enforcement Procedures

### 6. Applicable Caselaw

This chapter provides an overview of how suitability standards have been applied by courts and regulatory bodies, generally in relation to cases involving the suitability of securities transactions.

Most discussion by courts of what "suitability" means arises out of cases interpreting what commonly is called the "suitability" or "know your customer" rule, enacted by the National Association of Securities Dealers (NASD) in approximately 1938. That rule states:

In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts,

if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

Article III, Section 2, NASD Rules of Fair Practice (NASD Manual D-5).

The suitability rule is just a part of the NASD Rules of Fair Practice. The NASD Rules of Fair Practice essentially are rules of ethics. For example, the NASD Rules of Fair Practice also require NASD members to "observe high standards of commercial honor and just and equitable principles of trade." Article III Section 1 of NASD Rules of Fair Practice (NASD Manual).

The NASD Rules of Fair Practice are closely related to and often applied at the same time as federal securities laws. Section 10(b)5 of the Securities Exchange Act of 1935 ("Section 10(b)5") states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

- a) to employ any device, scheme, or artifice to defraud,
  - b) to make any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, or
  - c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
- in connection with the purchase or sale of any security.

Securities Exchange Act of 1935, § 10(b)5, 17 C.F.R. §240.10b5.

Although the NASD suitability rule is ethically-based and the federal securities laws are geared toward fraudulent activity, one court explained the close relationship between the federal laws and NASD rules as follows: "Analytically, an unsuitability claim is a subset of the ordinary § 10(b) fraud claim in which a plaintiff must allege, *inter alia*, (1) material misstatements or omissions, 2) indicating an intent to deceive or defraud, 3) in connection with the purchase or sale of a security." *Brown v. E.F. Hutton Group, Inc.*, 991 F.2d 1020, 1031 (2d Cir. 1993) (citations omitted).

If an unsuitability claim is a subset of a Section 10(b)5 fraud claim, it would be helpful to know something about such a fraud claim. The elements necessary for a plaintiff to succeed in a Section 10b claim are well determined.

A plaintiff must prove: (1) that the securities purchased were unsuited to the buyer's needs; (2) that the defendant knew or reasonably believed the securities were unsuited to the buyer's needs; (3) that the defendant recommended or purchased the unsuitable securities for the buyer anyway; (4) that, with scienter, the defendant made material misrepresentations (or, owing a duty to the buyer, failed to disclose material information) relating to the suitability of the securities; and (5) that the buyer justifiably relied to its detriment on the defendant's fraudulent conduct.

*Brown, supra*, at 1031. (citations omitted).

The 'scienter', or intent, element required to succeed in a Section 10(b) claim "may be inferred by finding that the defendant knew or reasonably believed that the securities were unsuited to the investor's needs, misrepresented or failed to disclose the unsuitability of the securities, and proceeded to recommend or purchase the securities anyway." *Id.*

The *Brown* court set forth a list of relevant factors to consider when deciding whether liability should be imposed under rule 10b:

- (1) The sophistication and expertise of plaintiff in financial and securities matters; (2) the existence of longstanding business or personal relationships; (3) access to relevant information; (4) the existence of a fiduciary relationship; (5) concealment of the fraud; (6) the opportunity to detect the fraud; (7) whether the plaintiff initiated the stock transaction or sought to expedite the transaction; and (8) the generality or specificity of the misrepresentations.

*Brown*, at 1032. (citations omitted).

As part of understanding the reasons the courts have interpreted "suitability" as they have, it is helpful to know the background for the duties imposed upon persons selling securities.<sup>1</sup>

A theory that is often discussed in securities sales practice cases is the "shingle" theory. The theory comes from a 1939 Commission administrative proceeding and, therefore, predates Section 10(b)5. Under the "shingle" theory, the act of "hanging out a shingle" is an implied representation that a person will be fair with customers. 5C A. Jacobs, *Litigation and Practice Under Rule 10b-5*, § 211.03 at 9-12, 9-13 (1994).

Inherent in the relationship between a dealer and his customer is the vital representation that the customer will be dealt with fairly and in accordance with the standards of the profession. It is [not] fair dealing ... to exploit trust and ignorance for profit far higher than might be realized from an informed customer.

*Id.* (quoting 6 SEC at 388-89 (footnote omitted)).

The courts have routinely held that a securities agent occupies a special status with a customer. "A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicitly represents he has an adequate basis for the opinions he renders." *Hanly v. Securities & Exch. Comm'n*, 415 F.2d 589, 596 (2d Cir.1969).

This special status imposes certain duties on securities dealers:

In summary, the standards by which the activities of each petitioner must be judged are strict. He cannot recommend a security unless there is an adequate and reasonable basis for such recommendation. He must disclose facts which he knows and those which are reasonably ascertainable. By his recommendation he implies that a reasonable investigation has been made and that his recommendation rests on the conclusions based on such investigation.

*Hanly, supra*, at 597.

One author has stated:

The theory on which any doctrine of suitability must rest...is that the customers tend to rely on their broker-dealer. [T]he broker-dealer community has made the investing public aware that it has the special skills needed to deal with such intricate merchandise as securities, and the public has been encouraged to—and has—relied on the superior skill of the broker-dealer community in its securities transactions.

Mundheim, *Professional Responsibilities of Broker-Dealers: The Suitability Doctrine*, 1965 Duke L.J. 445, 450.

The purpose of the suitability rule is not to make a broker-dealer an insurer of favorable investment performance or to review a broker-dealer's investment judgment. *Id.* at 448. Imposing a suitability standard "shifts the responsibility for making inappropriate investment decisions from the customer to the broker-dealer." *Id.*, at 449. "A suitability doctrine imposes a responsibility on the broker-dealer to take the risk threshold of his customers into account when he recommends or sells securities to them." *Id.*

The term "suitability" has been defined in case law as follows:

- "adapted, appropriate, apt, fit, proper" (40A Words and Phrases 189).
- "[f]or purposes of licensing requirements for insurance brokers, 'suitability' constitutes a combination of trustworthiness and competence." (40A Words and Phrases at Supp. 95 (citing *Deluty v. Commissioner of Insurance*, 386 N.E.2d 730, 732, 7 Mass App 88 (\_\_\_))).
- "'Suitable' is defined as appropriate and fitting." (*Id.*, at 96, citing *Morgan v. Morgan*, 366 NYS2d 977, 981, 81 Misc.2d 616 (\_\_\_)).

---

<sup>1</sup> Several terms will be relevant to this discussion.

A "broker-dealer," commonly called a "BD," is a firm that sells securities.

Individuals that sell securities are called "registered representatives."

"Licensing" of broker-dealers and registered representatives is a process whereby the firm or individual first is approved by the NASD and then by each state in which the firm or individual intends to conduct business.

Under federal law, direct regulation of securities laws is delegated to the NASD as a self-regulatory organization. The NASD has authority to discipline its members. Disciplinary action can be appealed to the SEC and further appealed to the courts.

How does one determine whether a recommendation was suitable? An analysis often applied by the courts in sales practice cases is whether a reasonable basis existed for the transaction. Under a reasonable basis rule, "[a] brokerage firm's recommendation to purchase or sell a security carries with it the implied representations that there is a reasonable basis for the recommendation and that the security is suitable for the customer." 5C Jacobs, *Litigation and Practice Under Rule 10b-5*, *supra*, at Section 211.01, p. 9-23.

Under the 'reasonable basis' rule, a broker-dealer has a burden and has certain duties. The burden has been stated as follows: "The SEC rules on reasonable basis place a burden on the broker-dealer to disclose all relevant facts, to make a reasonable investigation into the product recommended and, if the agent lacks knowledge, to disclose the lack of knowledge and caution customers as to the risk." A. Jacobs, *supra*, § 211.01[a], at 9-26. The duties have been defined as follows:

[t]he law implies there are separate duties under the reasonable basis rules: (1) to make a reasonable investigation of the facts, which in turn mandates gathering and evaluating the facts in a reasonable manner; (2) to disclose a lack of knowledge regarding the matter; and (3) to reveal known data which show that a statement is wrong.

A. Jacobs, *supra*, § 211.01[a], at p. 9-55.

A reasonable basis is not always required. "[A] broker has no reasonable basis duties when a customer places an unsolicited order." A. Jacobs, *supra*, § 211.01[a], at p.9-35 (citing *Pachter v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 444 F. Supp 417, 421-22 (E.D.N.Y. 1978)).

But it is rare that a suitability requirement is not imposed, even with mitigating circumstances. For example, the *Hanly* court stated that the suitability requirements must also be met when an investor has investment experience. "The fact that his customers may be sophisticated and knowledgeable does not warrant a less stringent standard." *Hanly, supra*, at 596 (citations omitted)

The duties and burdens placed on the seller of securities seem high. A seller may not rely on others very much. The *Hanly* court imposed a requirement that agents must not accept at face value information provided by an issuer of a security. "A salesman may not rely blindly upon the issuer for information concerning a company, although the degree of independent investigation which must be made by a securities dealer will vary in each case." *Hanly, supra*, at 597.

Several states have gone so far as to impose a *fiduciary duty* on stockbrokers.

- **California:** California imposes a fiduciary duty on stockbrokers and has rejected arguments that sophisticated investors are owed a lesser standard. See *Duffy v. Cavalier*, 264 Cal. Rptr. 740 (1989) citing *Twomey v. Mitchum Jones & Templeton, Inc.*, 262 Cal. App. 2d 690 (1968).
- **Missouri:** "Missouri courts have uniformly held or stated that a stockbroker owes a fiduciary duty to his customer." *Vogel v. A.G. Edwards & Sons, Inc.*, 801 S.W.2d 746, 751 (Mo App 1990).
- **Michigan:** *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 461 F. Supp 951 (E.D. Mich 1978).

Indeed, there are only a minimal number of duties imposed on the investor. For example, an investor does have an obligation to learn about securities products. "An investor may not justifiably rely on a misrepresentation if, through minimal diligence, the investor should have discovered the truth." *Brown, supra*, at 1032 (citations omitted).

However, the suitability standard is not wholly unreasonable. It is important to note that the imposition of suitability standard is not a guarantee of future results. In evaluating whether a transaction was suitable it is improper to evaluate it in light of current events, changes in the economy or a customer's personal financial situation. A broker is required to simply compare the customer with the security before making a recommendation. See A. Jacobs, *supra*, § 211.01[b], at 9-63, 64.

In fact, in the opinion of one author, the existence of the suitability requirement can also work to the broker-dealer's advantage.

Moreover, insofar as it [the suitability doctrine] encourages the broker-dealer to discuss transactions with his customers – particularly to point out the risks of an investment and relate those risks to the customer's ability to bear them – the suitability doctrine prepares a customer to accept some of the disappointments which inevitably occur in connection with investments in securities.

Mundheim, *supra*, at 459.

To better understand what suitability is, it is helpful to look at occasions when courts find that a seller is liable because suitability did not exist.

Courts have found a sale of securities to be unsuitable when a broker failed to tell a customer the rating on the debentures sold and the extent of the risk faced. See, e.g., *Clark v. John LaMula Investors, Inc.*, 583 F.2d 594, 598 (2d Cir. 1978). In the *Clark* case, the sale was found to be unsuitable even though no untrue statements were made. The jury found that the salesman acted with intent to deceive when he failed to inform the buyer of other investment opportunities and charged an excessive price. *Id.*

The SEC has also commented on suitability. In one case an agent was sanctioned by the NASD for making unsuitable recommendations. The agent appealed to the SEC and argued that the customer had refused to supply complete information on financial holdings and he was thus forced to estimate her net worth. The Commission held that the agent "had a duty to proceed with caution; to make recommendations only on the basis of the concrete information that [the customer] *did* supply and not on the basis of guesswork as to the value of other possible assets." *In re Application of Eugene J. Erdos*, 47 S.E.C. 985, 988 (1983)(*emphasis original*), *aff'd*. Federal Securities Law Reports, ¶ 91,652 (9th Cir. 1984). The Commission stated that the test of whether the sales representative's conduct was proper was not whether the customer thought the transactions were suitable, but rather "whether [the agent] 'fulfilled the obligation he assumed when he undertook to counsel [the customer], of making only such recommendations as would be consistent with [her] financial situation and needs.' " *Id.*, at 989 (*quoting Philips & Company*, 37 S.E.C. 66,70 (1956)).

Although most cases dealing with the issue of suitability have been securities cases, at least one court imposed a suitability standard on a sale of life insurance as early as 1958. On appeal the court upheld a verdict against the insurance agent and stated:

any insurance agent who would sell a man with ... limited income and prospects an insurance program that involved saddling him with a bank indebtedness of \$125,000, an essentially term insurance type of protection, and dissipation of the accumulated cash values of his old insurance, must have known that he was not acting honestly in making the sale.

*Anderson v. Knox*, 297 F.2d 702, 727-28 (9th Cir 1961) *cert. denied*, 370 U.S. 915 (1962)

In conclusion, this is not an exhaustive study of the concept of suitability as used in the securities industry. It is meant to serve as an overview and a summary of the key concepts.

## 7. Voluntary Suitability Standards

### A. IMSA

### B. Other

## 8. Current Consumer Protection Tools

### A. Standards for Informing and Educating Consumers

#### *1998 NAIC Model Life Insurance and Annuities Replacement Model Regulation*

In September 1998 the NAIC adopted the Life Insurance and Annuities Replacement Model Regulation. This is a comprehensive regulation that imposes significant new duties upon insurers and their agents. The NAIC developed this new rule in response to concerns over past market conduct abuses in replacement sales. Forty-six states had adopted the 1984 version of this model. I would anticipate that many of these same states will be revising their current regulation to comport with the 1998 version.

#### *NAIC Life Insurance Illustrations Model Regulation*

During 1996 and 1997 the NAIC Life Disclosure Working Group developed the Life Insurance Illustrations Model Regulation. The goals of the regulation are to ensure that illustrations do not mislead purchasers of life insurance as well as to make life illustrations more understandable. Thirty-three states have adopted the model. The Working Group continues to develop a model illustration regulation for fixed annuities and variable life products, with the goal of each being to provide consumers accurate and comprehensive information prior to and during the insurance sales process.

#### *Model Advertising Rules*

The NAIC adopted Model Rules Governing the Advertising of Life Insurance to address appropriate disclosures in the sale of life insurance. The model rules set forth standards and guidelines to achieve full and truthful disclosure of all material and relevant information in the advertising of life insurance and annuities. The advertising rules also prohibit the use of certain words and/or phrases that may be considered misleading or deceptive. The requirement in the model rules that guaranteed and non-guaranteed elements be fully explained and distinguished attempts to inform the consumer of important financial features. The majority of states have adopted this rule, or one of similar design.

#### *Life Insurance Disclosure Model Regulation*

The NAIC's Life Insurance Disclosure Model Regulation requires insurers to provide information to the consumer in order to allow him/her to make an informed purchase of life insurance. The purpose of the model regulation is to require insurers to deliver information in a timely manner so as to improve the buyer's ability to select an appropriate plan of insurance for his/her needs. The model regulation also seeks to educate the buyer about the different features of a policy being considered and to improve the buyer's overall capability to evaluate different insurance policies. To date, 34 states have adopted this model.

*Annuity Disclosure Model Regulation*

At the 1998 Winter National Meeting, the NAIC's Life Insurance and Annuities (A) Committee adopted a model regulation for disclosures during the sale of annuities. This new model regulation specifies the type of information that must be disclosed as well as the method for doing so. This regulation will assist in informing and educating the consumer about certain basic features of annuity contracts. This regulation focuses on the sale of annuities to vulnerable populations; however, it is applicable to all annuity sales.

*Buyer's Guides*

The NAIC Life Insurance Buyer's Guide is included as Appendix A to the Life Insurance Disclosure Model Regulation. The Buyer's Guide provides information to the consumer to assist them in making an informed decision when purchasing an insurance policy.

*Unfair Trade Practices Act*

The NAIC's Model Unfair Trade Practices Act is designed to prevent deceptive and/or misleading practices during the sale of insurance. The model act also provides an enforcement mechanism and a framework for regulatory action in this area. This act prohibits deceptive, dishonest, or unfair sales practices, as well as unfair methods of competition. To date, 47 states have adopted some form of this model.

*NAIC's Market Conduct Examiners Handbook*

During 1995 and 1996 the handbook has undergone major revisions. During the course of this review numerous new models were incorporated into the handbook to serve as a guide for states when developing their own state-specific handbook.

*Long-Term Care Insurance Model Act*

This model act specifies disclosure standards, renewability and eligibility terms and conditions, and other performance requirements for this specific line of business. This act also requires the delivery of an outline of coverage during the initial solicitation and again with the delivery of the policy.

*Life Insurance and Annuities Replacement Model Regulation*

The purpose of this regulation is to not only regulate the practices surrounding the replacement of an existing life insurance policy, but also to protect the interests of the insured by establishing minimum standards of conduct that will: assure that purchasers receive adequate information to allow them to make an informed decision; and, reduce the opportunity for misrepresentation and incomplete disclosure. This regulation also requires companies to develop a method for determining the suitability and appropriateness of the replacement.

## 9. Industry Viewpoint

## 10. Conclusions and Recommendations

A. Life ProductsB. Annuity Contracts

\*\*\*\*\*

ATTACHMENT FOUR-C

Suitability Working Group  
Conference Call  
March 30, 1999

The Suitability Working Group of the Life Insurance and Annuities (A) Committee met by conference call at 1 p.m. on March 30, 1999. Paul DeAngelo (N.J.) chaired the meeting. The following working group members or their representatives participated: Bill McAndrew and Chuck Budinger for Richard Rogers (Ill.); Marlyn Burch (Kan.); Lester Dunlap (La.); Craig Spratt and Eleanor Perry for Linda Ruthardt (Mass.); Scott Borchert and Paul Hanson (Minn.); Cindy Amann (Mo.); David Sky (N.H.); Randy Ward (Ohio); Joel Ario (Ore.); and Greg Martino (Pa.).

1. White Paper on Suitability

Paul DeAngelo (N.J.) asked the working group for comments on a letter from the American Council of Life Insurance (ACLI), which suggested adding sections to address 1) the distinct characteristics of the securities industry and the life insurance industry; and 2) the current NAIC standards that address some of the goals of consumer protection a suitability standard would address. Joel Ario (Ore.) agreed that these are valuable sections to add to the paper but noted that regulators might draw different conclusions from those contained in the ACLI letter. He did not, however, have a problem with the ACLI preparing the first draft of that section. Mr. DeAngelo responded that he would prefer to see regulators do the first draft. He said that it

seemed logical to him that an agency that regulates both securities and insurance be asked to prepare the initial draft. Scott Borchert (Minn.) offered to prepare the draft on the first issue. Cindy Amann (Mo.) volunteered to prepare the first draft of the consumer protection section.

## 2. Life Insurance Advertising Regulation

Mr. DeAngelo explained to the participants that the working group went through part of the regulation prior to the Spring National Meeting and intended to complete an initial review of the model regulation during the conference call. After initial review of the model, Mr. DeAngelo said he would prepare a draft including the issues discussed by the working group. He expressed his intent to complete that draft early in May. He suggested the working group could solicit comments on that draft and then discuss the draft and the comments. Mr. DeAngelo asked the working group to turn its attention to Section 5I, where discussion left off at the previous conference call. Mr. DeAngelo proposed including prohibitions from the Life Insurance Illustrations Model Regulation within Section 5I. He said he did not see anything wrong with having similar material in two different regulations, as long as they were consistent. The working group agreed to the suggestion.

Mr. DeAngelo next asked the working group to consider a suggestion from the Massachusetts Insurance Department to add information to Section 5J. The language from Massachusetts discusses the possibility of misleading a purchaser as to the investment aspect of insurance. Mr. DeAngelo pointed out that an issue in many lawsuits is that the life insurance policy is being sold as an investment. The ACLI suggests not including the language from Massachusetts, opining that what is already in the model regulation is adequate. Mr. Ario said that the language drafted by Massachusetts is not tight enough because it talks about the person who "possibly will receive" or to "the degree it will mislead." Mr. DeAngelo agreed that the language needs some work but said he favors the concept. Julie Spiezio (ACLI) said the ACLI does not disagree with the concept, but believes that the language already in Subsection J accomplishes that goal. Mr. DeAngelo said Massachusetts is attempting to be more specific. He suggested including language in the first draft and then the working group could tighten the language or move it or whatever seems appropriate.

The ACLI comment letter suggested deletion of Subsection N because the Unfair Trade Practices Act and the Life Insurance Illustrations Model Regulation address this issue. Mr. DeAngelo said that he did not think it was necessary for the Suitability Working Group to re-examine issues of agent identification but he did not see a problem in having information in more than one place. Ms. Spiezio requested that the language be evaluated in all three places to be sure it was consistent. Mr. DeAngelo agreed that was an appropriate request.

The working group next turned its attention to Subsection O. Mr. DeAngelo said that Paragraph (2) as currently written is inconsistent with the Life Insurance Illustrations Model Regulation. The ACLI asked that this be changed to apply only in states where the illustrations regulation was not adopted. The working group reviewed the suggestion from the ACLI and from Massachusetts and Mr. DeAngelo agreed to reconcile the comments in his first draft. The working group also discussed a proposal from Massachusetts to add new Paragraphs (6), (7) and (8). Anda Olsen (ING) asked the working group to keep in mind that, if it gets too specific in the drafting, it will not take into account new technology that might be developed after the draft is written. Mr. DeAngelo responded that the draft does need to address the issue of abbreviated payments. Mr. Dunlap suggested that Paragraph (5) referring to dividends is in the wrong place.

Discussion next turned to Subsection Q. Scott Cipinko (National Alliance of Life Companies—NALC) asked if there had been any discussion of this issue in the Agent Licensing (EX3) Working Group. He said the suggestion from Massachusetts would imply that anyone who makes a testimonial is a producer. Mr. Ario said that is probably inconsistent with what is in the agents model. Mr. DeAngelo said this suggested language comes from New Jersey law and says that anyone who provides advice for a fee must be licensed. Mr. Cipinko asked for clarification as to whether everyone who gives a testimonial must be licensed as an insurance agent. He asked if Ed McMann was licensed as an agent in New Jersey and he asked where this provision was in New Jersey law. Mr. DeAngelo responded that it is in the New Jersey advertising rule, but that a provision in the agent's licensing law says that anyone who holds himself out to be an agent must be licensed. He opined that the provision in the advertising regulation was worthless without that provision. He questioned whether this is appropriate in an NAIC model. Eleanor Perry (Mass.) suggested that the phrase "acts as" is too vague and suggested "holds oneself out to be" as more to the point. Mr. Ario agreed that he would like to include language that says holding oneself out to be an agent is a violation of the advertising regulation. The working group next reviewed a new Paragraph (4) suggested by Massachusetts to address situations where the person making a testimonial or endorsement is someone who has had a claim resolved. The paragraph specifies that the claim information must be available so that a regulator can identify the claim that is the subject of the endorsement. Mr. Dunlap suggested deleting Subsection X and referring instead to the Life Insurance Illustrations Model Regulation. The working group agreed to that suggestion.

The working group next discussed a suggestion from Massachusetts regarding a reference to long-term care when discussing an accelerated death benefit in life insurance. Riva Kinslick (Prudential) offered to provide material to the working group to help in determining the appropriateness of marketing life insurance for the purpose of long-term care. The working group agreed to include this provision and discuss it more fully after the receipt of Ms. Kinslick's information.

Mr. DeAngelo outlined two additional areas where he intended to offer amendments to address an issue that arose in New Jersey in the identification of insurer and record retention requirement provisions.

The working group also reviewed suggestions from the ACLI for changes to Section 11 and agreed to include those suggestions in the draft.

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

\*\*\*\*\*

# ATTACHMENT FIVE

## Life Insurance and Annuities (A) Committee and Property and Casualty Insurance (C) Committee Joint Hearing on Factoring of Structured Settlements Kansas City, Missouri June 5, 1999

The Life Insurance and Annuities (A) Committee and the Property and Casualty Insurance (C) Committee held a joint hearing on June 5, 1999, on the issue of factoring of structured settlement arrangements. Testimony was taken from:

- Julie Spiezio (American Council of Life Insurance—ACLI)
- Randy Dyer (National Structured Settlements Trade Association—NSSTA)
- Craig Ulman (Hogan & Hartson)
- John Lobert (Alliance of American Insurers—AAI)
- Earl Nesbitt (National Association of Settlement Purchasers—NASP)
- Patricia Holden (American Insurance Association—AIA)
- Laura Murry (Barnert Associates)
- Michele Whitmore (Settlement Strategies International)
- Charles Burhan (Liberty Mutual)

Ms. Spiezio said that structured settlements have long been used as a method for compensating victims of accidents that resulted in serious, disabling injuries. Structured settlements are voluntary arrangements recognized by Congress and encouraged through use of favorable tax treatment. They provide, in lieu of a lump sum settlement, an income stream that provides for long-term security. Congress encourages the use of structured settlements to meet a basic public policy goal. When individuals received lump sum settlements, they often were unable to manage the assets received. Once the money ran out, many individuals were forced to rely on government assistance to survive. These costs are passed on to taxpayers. It is not clear whether the tax benefit is lost when the structured settlement is sold to a factoring company. The ACLI suggests that a court should find imminent financial hardship before the payment is accelerated.

Mr. Dyer said only an annuity or a trust funded by government securities is given the tax preferred treatment. Mr. Uhlman said the factoring transactions offend the federal public policy. The owner of the contract is usually a property and casualty insurer. The transaction is tax neutral if set up properly, but the tax benefit is linked to the tax treatment for the person getting the payment. The insurer faces the risk that, if the courts hold that the factoring transaction wipes out the tax benefits, the insurer will face a huge liability. Right now, property and casualty companies have \$6 billion in structured settlements on their books that could potentially be taxed. In addition, the insurer often does not know the settlement has been transferred to a factoring company and may be required to make double payments. Some state laws prohibit transfer of workers' compensation payments to any other party.

Mr. Uhlman distributed a chart compiled from court records showing typical discounts. He said the typical discount was about 25%, but some were much more. The worst example was a discount equivalent to a loan at 83% per year interest paid by the recipient of the settlement. Mr. Uhlman said the solution to this problem is a model act proposed by NSSTA and already adopted by eight states.

Mr. Lobert said his organization does not think this is an insurance regulatory matter and the NAIC does not need to address it.

Mr. Nesbitt said the factoring transaction provides a liquidity option that gives flexibility where it is desirable. There are two basic types of factoring transactions. First is the direct purchase of the income stream for a lump sum. In this transaction, the individual transfers the income stream to the factoring company in exchange for the lump sum payment. The second type is a form of a loan. The factoring company "loans" the lump sum to the individual and the loan is repaid by the structured settlement payment stream.

Mr. Nesbitt opined that the NSSTA model is very restrictive and said the laws in place in the states do not follow that model. Some only contain a disclosure requirement. He said NASP would support full disclosure and a court review where the original settlement was approved by the court, but suggested it is overkill to require court approval in every case. He encourages those considering such a transaction to have legal counsel. He said he does not support the NSSTA model because it gives the insurance company veto power over the transaction and contains a vague and onerous standard for the "imminent harm" that allows the sale of the settlement. Mr. Nesbitt characterized the issue as a dispute between the people who set up structured settlements and those who factor them.

Mr. Nesbitt acknowledged that his company often does not tell the insurer that it has purchased an interest in the settlement, instead requesting a change of address for the payments. If the annuitant changes the instructions to the insurer to redirect the payments back to himself, the factoring company will sue him.

Ms. Holden would support legislation like the NSSTA model. She provided regulators with written testimony from a state legislator and a copy of the bill he supported. She expressed concern about the subterfuge of hiding the factoring agreement from the insurer. She said the insurer could help the annuitant understand the consequences of his or her action.

Ms. Murry said she represents a factoring company that is not a member of NASP. She said the reason for the factoring transaction is that the structured settlement annuity is used in many cases where a monthly income for an extended period is not needed, rather than for the catastrophic losses it was originally intended to address. She opined that the NSSTA model is really designed to eliminate the factoring companies rather than regulate them. She said limiting the factoring transactions is only appropriate if it is likely to result in a person's dependence on welfare.

Ms. Whitmore said she is a structured settlements broker and expressed the opinion that the factoring transaction gives the client more options.

Mr. Burhan asked regulators to weigh the evidence carefully, opining that they received much clouded information and half truths during the hearing.