

## LIFE INSURANCE AND ANNUITIES (A) COMMITTEE

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Terri Vaughan, Chair—IA  
Diane Koken, Vice Chair—PA

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### MINUTES

The Life Insurance and Annuities (A) Committee met in Atlanta, GA, on Oct. 6, 1999. A quorum was present and Terri Vaughan (IA) chaired the meeting. The following committee members were present: Diane Koken, Vice Chair (PA); Tom Foley for Kathleen Sebelius (KS); Lester Dunlap for James H. Brown (LA); Dan Judson for Linda Ruthardt (MA); and Dalora Schafer for Carroll Fisher (OK).

#### 1. Review Information on Structured Settlements and Discuss How to Proceed

Commissioner Vaughan noted that the NAIC legal staff summarized laws on structured settlements for the Life Insurance and Annuities (A) Committee. She suggested that a conference call be scheduled for late October or early November after the regulators have had time to review the chart.

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

Mr. Dunlap reported that the working group adopted three appendices to the Viatical Settlements Model Regulation and held extensive discussion regarding the appropriate approach to life settlements. The working group recommends to the A Committee that it be allowed to create a model to provide for regulation of life settlements and for solicitation of investors. Mr. Dunlap said these are very important issues and the most expeditious manner to proceed would be to amend the existing Viatical Settlements Model Act. The working group did not discuss at its meeting the strengthening of the informational brochures in the Viatical Advisory Package adopted by the Plenary, as promised to the A Committee in the July conference call. The chair will solicit suggestions and ask staff to put those together by Nov. 1. On Nov. 9, a conference call of the Viatical Settlements Working Group will

be held to discuss this issue. In that way, the working group will be able to fulfill its promise to bring stronger brochures to the December meeting.

Commissioner Vaughan said that in Iowa the Insurance Department also regulates securities, and it was her sense that most securities regulators are headed in the direction of some regulation of viatical settlements. Mr. Dunlap said that the intent of the working group is to develop model language that could be applied in insurance regulation where the securities division does not wish to take on this responsibility. He said it is a fallback position for that situation. Commissioner Vaughan said that the securities issues are critical but the working group needs to consider how to prioritize its work. She offered to talk to the Iowa Department securities staff to see what their sense is.

Commissioner Vaughan asked if the working group's consideration of life settlement issues might include the prohibition of certain types of life settlements. Mr. Dunlap agreed that might be the case. Commissioner Vaughan asked what the time frame would be for the completion of this activity. Mr. Dunlap said the working group will start in earnest at the Winter National Meeting and he hoped the project would be final by the summer of 2000. He noted that this charge was on the list for 1999 but the working group had a large number of charges and had postponed consideration of this one. Mr. Foley asked what was included in the definition of life settlements. He asked if this is large amount policies on healthy lives or "wet ink" transactions, or both. Mr. Dunlap said that, for the purpose of their discussion, the working group is using the term life settlements to include all sales of life insurance policies by individuals who are not terminally or chronically ill. This definition may be refined as a result of discussion between now and next June. The working group will sort through the list of different types of transactions and decide which are appropriate and which are not. He opined that there must be at least some adverse health factors that limit life expectancy in order for a life settlement transaction to work.

Commissioner Koken moved and Mr. Dunlap seconded a motion to adopt the report of the Viatical Settlements Working Group (Attachment One). The motion passed.

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

Mr. Dunlap reported for Michael Batte (NM). He said that the working group prepared a checklist for contract analysts to use in reviewing equity indexed product filings. He asked that the A Committee continue to revise this checklist as the market evolves. The working group recommended that it be disbanded because its charges are complete. Commissioner Vaughan said that any future revision of the checklist could be handled by the Life Disclosure Working Group, which has also considered some issues related to equity indexed products. She said it would be helpful for the A Committee to have time to review this document, and asked that its consideration be deferred until the conference call.

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

### 4. Report of Life Disclosure Working Group

Mr. Foley reported that the Life Disclosure Working Group discussed three items. The Life Disclosure Model Regulation, which has been in place since the early 1970s, is being considered for revision. The working group sent a letter in early 1996 to say that changes were needed in some states when the Life Insurance Illustrations Model Regulation was adopted. Now the working group is making changes to the NAIC's model and plans to finalizing them by the Winter National Meeting. The second issue discussed at the working group meeting was whether changes are needed to the Equity Indexed Annuities Buyer's Guide. Mr. Foley said product designs continue to change and participation rates have been lowered significantly because of market volatility. The working group intends to make some change to the Buyer's Guide to reflect the changed marketplace. The third item discussed at the working group meeting was Securities and Exchange Commission (SEC) developments regarding disclosure and illustrations for variable products. The working group met with the SEC several years ago when it began work on this project, but the project was delayed for several years and now seems

to be close to completion. The working group may visit with the SEC on this issue because it is important that there be consistency in life insurance products and a level playing field.

Commissioner Vaughan asked if the variable life issue will be discussed at the Winter National Meeting and Mr. Foley responded in the affirmative. He said this will be the working group's greatest challenge. Commissioner Vaughan said that, if the public is given an opportunity to comment on the SEC document, that will be a very short period of time and the working group needs to be prepared to act quickly. George Coleman (Prudential) said the sense of the American Council of Life Insurance (ACLI) is that a large number of industry recommendations have been incorporated in the SEC document and there may not be another opportunity for comment. He said the SEC has not yet released a draft, and the only way to determine the SEC's direction is from the questions they ask.

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

#### 5. Report of Suitability Working Group

Mr. Dunlap reported for Paul DeAngelo (NJ) that the working group has nearly completed its work on the amendments to the Advertisements of Life Insurance and Annuities Model Regulation and anticipates adopting the amended model at the Winter National Meeting. The working group's second charge is to consider suitability of sales of life insurance and annuities. The working group considers this issue to be very important and is making a concentrated effort to prepare a comprehensive and fair study of the issue. Mr. DeAngelo asks that the charge be extended to next year to allow the working group to complete its project properly. Commissioner Vaughan said it is not a problem to extend the charge and this request can be considered with the other charges at the Winter National Meeting.

Mr. Foley moved and Commissioner Koken seconded a motion to receive the report of the Suitability Working Group (Attachment Four). The motion passed.

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

Mr. Foley reported that the task force adopted amendments to the Standard Valuation Law on the confidentiality issue being considered by many committees at the NAIC. In addition, the task force is considering public policy concerns related to guaranteed investment contracts (GICs) with bailout provisions as authorized in a new charge from the Executive Committee. The task force anticipates being able to finalize that activity by the Winter National Meeting. Mr. Foley reported that the Society of Actuaries is working on a new Commissioners Standard Ordinary (CSO) table and expects to have that completed by the end of 2000.

Mr. Foley said a significant issue has arisen as states are adopting the Valuation of Life Insurance Model Regulation (commonly known as "XXX") to be effective Jan. 1, 2000. New products with "shadow accounts" that provide a universal life secondary guarantee have recently surfaced. Mr. Foley said there is some question as to whether these shadow accounts are covered by XXX. The task force has concluded that shadow accounts are covered and debated how to communicate this to all regulators. He noted that it would be included in the minutes of the A Committee and in the Actuarial Task Force minutes, but said that it may be useful to make a presentation at the Commissioners Roundtable at the Winter National Meeting. Commissioner Vaughan agreed that it would be helpful to have a presentation at the Roundtable. She said the issue came up at a public hearing at the Indiana Insurance Department and said that preparing an Alert, as the task force did with the GIC bailout issue, might not be a bad idea. Commissioner Vaughan asked Mr. Foley to consider whether a clear statement of the issue is necessary, and, if so, it can be added to the agenda of the Executive Committee at the next meeting. Mr. Foley noted that most companies agree with this position, but a small number of companies are using the concept as a way to avoid the proscriptions of XXX.

Commissioner Vaughan discussed the Standard Valuation Law amendments. She said there will be another conference call and a public hearing on this issue before the work is complete and suggested

that it makes sense for the A Committee to hold this document and make any other changes that might be necessary. The members of the A Committee agreed with that assessment.

Ms. Schafer moved and Commissioner Koken seconded a motion to receive the report of the Life and Health Actuarial Task Force. The motion passed.

#### 7. Adopt Minutes of Joint Conference Call of Aug. 17, 1999

Commissioner Vaughan noted that the Life Insurance and Annuities (A) Committee and the Life and Health Actuarial Task Force held a conference call on Aug. 17, 1999, to consider the Alert prepared by the task force on the issue of GICs with bailout provisions. The minutes were adopted by the task force and now are subject to adoption by the A Committee. Commissioner Koken moved and Ms. Schafer seconded a motion to adopt the minutes of the joint conference call of Aug. 17, 1999 (Attachment Twenty of the Life and Health Actuarial Task Force minutes). The motion passed.

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

Mr. Foley moved and Ms. Schafer seconded a motion to adopt the market share reports. The motion passed.

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

*[Editor's Note: Minutes of the Life Insurance and Annuities (A) Committee and its Viatical Settlements Working Group joint conference call of July 14, 1999, are published here as Attachment Five. The NAIC adopted these minutes at the Oct. 4, 1999, Executive Committee meeting and Plenary Session.]*

#### ATTACHMENT ONE

##### Viatical Settlements Working Group Atlanta, Georgia October 4, 1999

The Viatical Settlements Working Group of the Life Insurance and Annuities (A) Committee met in Atlanta, GA, on Oct. 4, 1999. Lester Dunlap (LA) chaired the meeting. The following working group members were present: Elizabeth Bookwalter for Michael Bownes (AL); Kevin McCarty (FL); Dale Freeman (ID); Robert Heisler (IL); Roger Strauss (IA); Marlyn Burch (KS); Tom Jacks (NC); Sue Anderson for Glenn Pomeroy (ND); Dalora Schafer (OK); Greg Martino (PA); Maliaka EssameIDin for Jeanne Bryant (TN); and Linda Bayless (TX).

#### 1. Discuss Appendices to Model Regulation

Mr. Dunlap reported that during an interim conference call the working group nearly completed work on three appendices to the Viatical Settlements Model Regulation. Appendix A is a consumers informational guide. Mr. Dunlap asked the group to go through the guide section by section for any final comments before adoption. Brenda Cude (University of Georgia) questioned an entry under the heading "Comparison Shop." She asked if there is any disadvantage for viatical settlement providers to know that the policyholder is shopping the policy. Mr. Dunlap responded that that was not a disadvantage and the group decided to leave the language as written. Bill McAndrew (IL) pointed out that the document does not consistently use the same term for viatical settlement providers. In some cases they are called providers or viatical providers. The working group agreed that the guide should say viatical settlement providers in every case.

Ms. Cude asked about the provision under Step 3, How the Process Works, Phase 1—Qualifying to sell your policy (underwriting). The language says the viatical settlement provider will gather information, and she asked if sometimes the broker gathers that information. The working group decided it did not really matter to the seller who gathered the information so the language was changed to say, "The viatical settlement provider will need information ... ."

Ms. Cude noted that Phase 2 describes the calculation of the offer and Phase 3 describes closing the agreement without any step in between to talk about how the offer is made. Doug Head (Medical Escrow Society) said that this is generally a simple phone call, but could be done in many different ways. Mr. Dunlap said this document is intended to introduce the process and that specifics about how the offer will be made can be answered by the broker or provider. Kevin Hennosy (Spread the Risk) said the provisions under Step 4, Know Your Rights, were unclear. Many people would not understand that the protections listed in the bullet points apply only in some states. He suggested redrafting them as questions or beginning with a statement

that the viator should find out whether the sentences are true. Mr. Freeman suggested ending the introductory paragraph with "Determine if:" and then following with the bullet points. The working group agreed this would clarify this section.

Under the section headed Federal Tax Laws, Mr. Hennosy pointed out that the term "tax-free advantage" sounds like marketing language and the working group decided to change that phrase to "tax-free treatment." Michael McNerney (Mutual Benefits) said this section is somewhat unclear because, in order to qualify, the individual must meet one of the two standards in the bullets plus the paragraph underneath. The working group changed some of the wording to clarify this section.

Ms. Bookwalter moved and Mr. Strauss seconded a motion to adopt the informational brochure with the changes agreed upon by the working group. The motion passed.

Mr. Dunlap asked if there were any comments on Appendices B and C, the forms for transferring information between the viatical settlement provider and the insurer. George Coleman (Prudential) said that he reviewed the document and felt comfortable that the changes made reflected the discussion during the conference call. He pointed out that one change was made to the individual form (Appendix B) to refer to the two-year incontestability period when asking whether the policy had been reinstated. He asked that the same change be made in Appendix C and the working group agreed to that change.

Mr. Strauss moved and Ms. Bookwalter seconded a motion to adopt Appendices B and C. The motion passed. The three appendices, as appended to the Viatical Settlements Model Regulation, are Attachment One-A. The motion passed.

## 2. Discuss How to Proceed with Charge Regarding Life Settlements

Mr. Dunlap asked regulators to express their opinions as to whether the sales of insurance policies of healthy individuals, commonly called life settlements, should be regulated. Mr. Jacks said that there is a great deal more activity in this area now and more sophisticated marketing techniques than regulators saw when providers were soliciting individuals with HIV. He opined that this problem cries out for regulator intervention. Mr. Dunlap asked if Mr. Jacks is saying this is a legitimate market and Mr. Jacks responded in the affirmative. Mr. McCarty said that, if a state chooses to regulate the investment side, then protection is only offered for investors who buy a viatical settlement, rather than a life settlement, unless both transactions are regulated. He said Florida tried a life settlement bill that mirrored the viatical settlement law but it did not pass. Mr. Strauss said that he would prefer not to allow life settlement transactions. If they are allowed, he opined that parallel regulation to viatical settlements is needed. Mr. Heisler agreed. He said he would just as soon see the transactions banned. Mr. McCarty said a state could prohibit the transactions, but he would like to see people have the ability to sell a policy after full disclosure of the effect. Ms. Schafer noted that this protection is needed for seniors and also in the case of key-man insurance.

Mr. Head said the Viatical Association of America has drafted a proposal to help regulators address these issues. He opined that simply trying to change the definition of a viatical settlement creates new problems. He did agree that key-man insurance has some similar concerns and said it should also be covered in a life settlement act. Julie Spiezio (American Council of Life Insurance—ACLI) said her organization would like to see the NAIC take some action to address these issues. She said that for a start, changing the definitions would be helpful. She said creating an entire new model might not be the way to go; perhaps pieces could just be added to the existing model. Ms. Spiezio noted that disclosure is very important. An individual with a policy that has been sold may be considered over-insured and could not get additional insurance coverage even if he or she was healthy. Rob Shear (Enhanced Life Benefits) said that life settlements are attracting institutional capital, so many of the investor issues the regulators have been discussing will not occur.

Mr. McNerney spoke in favor of two separate bills so that if a state wanted to regulate only viatical settlements or life settlements, it would not have to take the bill apart. He noted that the draft prepared by the viatical settlement industry puts in some purchaser protections and also suggests some edits to the NAIC Viatical Settlements Model Act. Mr. Dunlap said that it appeared that, as a result of the working group discussion, there is agreement that it is good public policy to permit life settlements, but they should be regulated. Ms. EssameiDin said Tennessee has strong concerns about whether this is good public policy. She said if the legislature decides it is a good public policy, it definitely needs to be regulated. Mr. Jacks moved and Ms. Bookwalter seconded a motion that the working group proceed with development of a model act on life settlements.

## 3. Consider Recommendations on Charge Relating to Investments

Mr. Burch asked the working group to consider a document that he prepared that outlines where states have the authority to determine whether a viatical settlement is a security. He noted that this document is a first draft for working group consideration and asked that it be attached to the minutes for further exposure (Attachment One-B). He said this document recommends that regulators pursue creation of a regulatory framework relative to investments in viatical settlements. Mr. Strauss noted that Iowa recently passed a law that says viatical settlements are securities and regulations have been developed.

Mr. McCarty said that it is up to the state securities regulators to decide whether a viatical settlement is a security. If they decide it is, regulation will be done through that agency. If the securities regulators do not call it a security, this working group can develop alternative language so the insurance department could protect investors. Mr. McCarty presented draft language that he had prepared that would allow the insurance department to provide those protections (Attachment One-C). He said that insurance regulators are not in a position to decide if this is a security in most states. In Florida the securities regulators decided that their rules do not apply to individually transacted contracts. In that vacuum, the Florida insurance law now contains some provisions to protect investors. Mr. Dunlap asked if it behooves this working group to develop a model to cover that type of situation and Mr. McCarty replied that he thought it would be helpful. Mr. Jacks expressed concern that the insurance department would not be able to regulate this if there is an independent agency to regulate securities. Mr. McCarty responded that it is definitely not the business of insurance, but insurance regulators can regulate the transaction by

prohibiting false and misleading advertising, etc. Mr. McCarty moved and Ms. Bookwalter seconded a motion that the working group develop a model regulation to protect investors in the situation where securities regulators do not consider the investment transaction a security. The motion passed.

4. Adopt Minutes of Sept. 8, 1999, Conference Call

Mr. Strauss moved and Mr. Burch seconded a motion to adopt the minutes of the Sept. 8, 1999, conference call (Attachment One-D). The motion passed.

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

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ATTACHMENT ONE-A

Viatical Settlements Model Regulation  
Draft: October 11, 1999  
Adopted by the Life Insurance and Annuities (A) Committee

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\* \* \* \*

Section 10. Insurance Company Practices

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

- (1) A current authorization consistent with applicable law, signed by the policyowner or certificateholder, accompanies the request;
- (2) In the case of an individual policy, submission of a form substantially similar to Appendix B, which has been completed by the viatical settlement provider or the viatical settlement broker in accordance with the instructions on the form.

~~Drafting Note: The appendices referenced in this subsection are being drafted.~~

- (3) In the case of group insurance coverage:
  - (a) Submission of a form substantially similar to Appendix C, which has been completed by the viatical settlement provider or viatical settlement broker in accordance with the instructions on the form, and
  - (b) Which has previously been referred to the group policyholder and completed to the extent the information is available to the group policyholder.

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

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

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

\* \* \*

## APPENDIX A [All new material]

### Selling Your Life Insurance Policy

Today it's possible for you to sell your life insurance policy to someone else (a viatical settlement provider) for an immediate cash payment. This financial arrangement, known as a viatical settlement, is best suited for people who are living with an immediate life-threatening illness and facing tough financial choices.

It may not always be in your best interest to sell your life insurance policy. Before you take action, you want to be sure you understand:

- What future benefits you may lose
- What other options may be available

Selling your life insurance policy is a complex financial arrangement. This guide will help you make an informed decision.

We recommend that you:

1. Evaluate your needs
2. Check all your options
3. Understand how the process works
4. Know your rights
5. Check with your state insurance department.

#### Step 1, Evaluate your needs

Before you sell your policy and give up valuable insurance protection, think about whether your need for life insurance has changed since you bought the policy. If it hasn't, selling your policy may not be the right choice. If you sell your policy now, your beneficiaries will not be paid a benefit at your death.

If you sell your policy now, remember premiums go up a lot as you grow older. You may not want to pay the higher cost to replace your coverage later.

#### Step 2, Check all of your options

You may be able to get the cash you need now without selling your policy.

#### Policy Cash Values

Contact your current life insurance agent or company to see if you have any cash value in your policy. Ask if you can:

- (1) borrow from the cash value and still keep the insurance in force,
- (2) cancel the policy for its current cash value,
- (3) use the cash value as collateral to get a loan from a financial institution.

Your insurance company must tell you about your options if you ask.

#### Accelerated Death Benefits

Find out if your policy has an "accelerated death benefit." It may be your best option.

Many life insurance policies do have an accelerated death benefit. With that benefit, policyholders who are terminally ill, affected with certain diseases or permanently confined in a nursing home can access 50% or more of a policy's death benefit while still living. An accelerated death benefit could pay you a large part of your policy's death benefit and you could keep your policy.

A very important feature of the accelerated benefit is that when the policyholder dies, the beneficiaries get the remaining death benefit. This means that eventually 100% of the policy benefits will be paid out either to the insured or the beneficiary.

#### Other considerations

Think about what it will mean if you do sell your policy. Check out the tax implications. Not all proceeds from a viatical settlement are tax-free.

Find out if creditors could claim any of the money you would get from a viatical settlement.

Find out if you will lose any public assistance benefits such as Medicaid or other government benefits if you accept a cash settlement for your life policy.

#### Comparison Shop

To learn the market value of your policy, it's a good idea to contact three to five viatical settlement providers. Or you could use a viatical settlement broker who would contact several viatical settlement providers for you. Your financial advisor can help you decide whether to work with a viatical settlement provider or through a viatical settlement broker.

#### Summary

Everyone's financial situation is different. A viatical settlement may or may not be the best approach for you. Check it out for yourself. We recommend that you ask an advisor who is qualified to review your finances to help you review your options.

#### Step 3, How the process works

If you decide to sell your life insurance policy to a viatical settlement provider, you will enter into a viatical settlement agreement with the provider. You, the seller, agree to accept a cash payment for your policy. The amount will be less than the face amount the policy would pay upon your death. (For example, you might agree to accept a \$75,000 cash payment for a \$100,000 policy.)

The viatical settlement provider buying your policy:

- becomes the new owner of your policy,
- names the beneficiary,
- collects the full death benefit when you die,
- begins paying premiums on the policy, and
- may sell your policy again.

There are four basic phases required to complete a viatical transaction.

#### Phase 1—Qualifying to sell your policy (underwriting)

The viatical settlement provider will need information about you before making an offer. Usually it will take some preliminary information from you over the phone and send you this paperwork to sign:

- a medical release form so the viatical settlement provider can get and review your medical records
- an authorization form to contact your insurance company to confirm benefit, premium, and ownership of your policy.

To avoid delays, it's important that you give complete and accurate information about your medical history.

If you apply with more than one viatical settlement provider, each will contact your doctor for medical records and your insurance company for policy information.

#### Phase 2—Calculating the offer

The viatical settlement provider uses the information it gets in the underwriting phase to make an offer. To develop an offer, a viatical settlement provider takes into account various factors including:

- Estimated life expectancy and medical condition of the insured. Generally, the shorter the life expectancy of the insured, the more the viatical settlement provider will offer for the policy.
- The amount of life insurance coverage.
- Loans or advances, if any, previously taken against the policy.
- Amount of premiums necessary to keep the life insurance policy in force.
- The rating of the issuing insurance company.
- Prevailing interest rates.
- State laws, if any, that require a minimum payment.

#### Phase 3—Closing the agreement

• If you accept an offer, a closing package is forwarded to you, the seller, for approval and signature. Closing documents typically include an offer letter, a viatical settlement contract, and the forms the insurance company needs to transfer ownership of the policy to the viatical settlement provider.

- The closing documents are then returned to the viatical settlement provider for its signature.
- The viatical settlement provider will put the cash payment owed to you in escrow, if required, and send the signed insurance change forms to the insurance company to record the change.



#### Phase 4—Receiving the Payment:

Once the insurance company notifies the viatical settlement provider that the changes on the life insurance policy have been recorded, the payment is released to you, the seller, usually the next business day.

In many states, you may have the right to change your mind about the settlement AFTER you receive the money, provided you return all the money. Typically the law allows 15 days to review your settlement arrangement.

#### Step 4, Know your rights

##### State laws

Many states have laws that provide important consumer protections. You'll want to contact your state insurance department to see which of the following consumer protections your state requires. Determine if:

- A viatical settlement broker or viatical settlement provider arranging viatical settlements must be licensed with your insurance department.
- The viatical settlement provider buying your policy must keep your identity and medical history confidential unless you give written consent to tell others.
- To protect your proceeds, the viatical settlement provider buying your policy must put your money into an escrow account with an independent party during the transfer process.
- You have the right to change your mind about the settlement AFTER you receive the money, provided you return all the money. You have 15 days to review your settlement arrangement.
- The new owners of your policy are limited in how often they may contact you about your health status.

##### Federal tax laws

Two groups of people may receive benefits from a viatical settlement without owing federal income tax:

- persons who have been diagnosed with a terminal illness and with a life expectancy of 24 months or less and
- certain chronically ill individuals.

If you qualify for this federal tax-free treatment, you also must use a viatical settlement provider that is licensed in the state where you live, or, in states where licensing is not required, that complies with the standards of the National Association of Insurance Commissioners' Viatical Settlements Model Act.

Remember that, as when interpreting any tax laws, it's always best to check with your own financial advisor.

##### Avoiding Consumer Fraud

- ◆ If you're in good health and someone asks you to sell your life insurance policy, proceed with caution. Remember that viatical settlements are intended for people living with life-threatening or chronic illnesses. 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. You may be a target for fraud.
- ◆ If you're asked to buy a life insurance policy for the sole purpose of selling it, you may be participating in fraud.
- ◆ If you're asked to invest in a viatical settlement, we recommend you contact your state insurance department to learn more about the issues and risks that might be involved in such an investment.

#### Step 5, Check with your state insurance regulator

##### State licensing

Find out if your state licenses viatical settlement providers and brokers. For a complete list of authorized viatical settlement providers, brokers, and their representatives, call the Department of Insurance.

##### Seller Checklist

Before you sell your policy be sure you know the answers to these questions.

##### Evaluating your needs

- Do you still need life insurance?

- Do you have dependents who might rely on your life insurance benefits should anything happen to you?
- If you don't need life insurance protection now, what are the chances you'll need it in the future?

#### Current policy benefits

- Can you borrow from the cash value?
- Can you cancel the policy for its current cash value?
- Can you use the cash value as collateral to get a loan from a financial institution?
- Do you have an accelerated death benefit feature?

#### Taxes and other financial considerations

- Is the money you get from selling the policy taxable?
- Will the money you get from selling the policy affect your eligibility for government benefits?
- Do you need the advice of a tax or estate planning specialist before you decide to sell your policy?
- If you sell your policy, can any of your creditors claim the money?

#### Understanding the process

- If you sell your policy, who will be the legal owner?
- Is the viatical settlement provider buying your policy licensed?
- If you sell your policy, how will the value you get be calculated? What interest rate will be used?
- If you sell your policy but then change your mind, can you get your money back?
- Will investors have specific information about you, your family or your health status?
- How are fees or commissions paid to the viatical settlement broker or provider?

#### Protections in your state

Contact your state insurance department to find out if there are any laws governing viatical settlements.

#### 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

\_\_\_\_\_  
Date

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

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

## Section Two:

(To be completed by the life insurance company)

- 1) Face amount of policy: \$ \_\_\_\_\_
- 2) Original date of issue: \_\_\_\_\_ / \_\_\_\_\_ / \_\_\_\_\_ (Month/Date/Year)
- 3) Was face amount increased after original issue date? ☐ no ☐ yes
  - 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 the policy been reinstated within the last two years? ☐ 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: \_\_\_\_\_ State: \_\_\_\_\_ ZIP: \_\_\_\_\_  
 Telephone No: \_\_\_\_\_ FAX: \_\_\_\_\_  
 The answers provided reflect information contained in the company's records as of: \_\_\_\_\_ (date)  
 Signature: \_\_\_\_\_ Name: (Printed) \_\_\_\_\_  
 Title: \_\_\_\_\_  
 Company: \_\_\_\_\_  
 Direct Telephone No: \_\_\_\_\_ Direct FAX No: \_\_\_\_\_

## APPENDIX C [All new material]

## 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 and the insurer. Both should indicate the parts they completed.)

## 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? \_\_\_\_\_  
 l) 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 been reinstated within the last two years? ☐ 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) The following parties (as applicable) should indicate whether they will provide notice to the assignee if the master policy is terminated.  
 Group policyholder ☐ no ☐ yes  
 Third party administrator (if any) ☐ no ☐ yes  
 Insurance company ☐ 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  
 If master policy discontinues, what amount can be converted to an individual policy? \$ \_\_\_\_\_  
 Is this plan administered by a third party? ☐ no ☐ yes  
 If yes, please provide the name, address and telephone number of administrator:  
 Name: \_\_\_\_\_ Title: \_\_\_\_\_  
 Company name: \_\_\_\_\_ Department: \_\_\_\_\_  
 Street Address (No P.O. Box please): \_\_\_\_\_  
 City: \_\_\_\_\_ State: \_\_\_\_\_ Zip: \_\_\_\_\_  
 Telephone number: ( ) \_\_\_\_\_ Fax: ( ) \_\_\_\_\_

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

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

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

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

City: \_\_\_\_\_ State: \_\_\_\_\_ Zip: \_\_\_\_\_

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

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

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

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

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

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

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

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

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

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

City: \_\_\_\_\_ State: \_\_\_\_\_ Zip: \_\_\_\_\_

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

### Section Three:

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

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

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

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

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

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

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### ATTACHMENT ONE-B

#### Viatical Investments as Securities (Suggested Guidelines for Determining Licensing Requirements)

Various states have now taken the position that investments in viatical settlement agreements are investment contracts and, therefore, constitute securities in most circumstances.

The guidelines being used by the various states basically follow similar determinations. The first basis for building a case for licensing is the definition of "security" under the securities statutes of those states. Kansas, as an example, sets forth the definition in K.S.A. 171252 as follows: "Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral trust certificate; reorganization certificate of subscription; transferable share; investment contract; voting-trust certificates; thrift certificates or investment certificates; or thrift notes issued by investment companies; leases or mineral deeds; or, in general any investment or instrument commonly known as a "security," or any certificate of interest or participation in; temporary or interim certificate for; guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. "Security" does not include any insurance

or endowment policy or annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or some other specified period.

Alabama has similar language in Ala. Code par.8-6-2(10)(1975). The language is; in fact, identical to that contained in most state statutes and the Securities Act of 1933.

From that point, an analysis must be made of individual contracts for a determination first stated in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). The *Howey* test holds that an investment contract has four principal elements or criteria:

- I. the investment of money;
- II. in a common enterprise;
- III. with an expectation of profits;
- IV. to be earned through the efforts of others.

The decision in *SEC v. Life Partners, Inc.* 87 F.3d 536 (D.C. Cir. 1996) was that, although the Court of Appeals found the first three elements of *Howey* to be satisfied, it disagreed with the SEC's position regarding the fourth element. The court concluded that the investor's return depended, not from the effort of the viatical company, but rather from the length of time the insured remained alive. It further concluded that the fourth prong in *Howey* was concerned only with the promoter's activities after the investor parted with his money, and that the company's post-purchase activities in that case had no effect on the investor's return, consisting merely administrative or ministerial functions.

Various states have taken exception with the rationale in the *Life Partner's* decision. The state views are that both federal and state case law support the conclusion that the fourth element of the *Howey* definition is met when, upon a review of all of the efforts of the promoter as a whole, a court may conclude that the investor's realization of a profit depends substantially upon the essential management efforts of the promoter, regardless of the time at which such services are performed. The investors are, as a rule, completely passive and do not have the skill, knowledge or access to information to perform the tasks which are necessary for their investment to be successful.

The actions that may be, and usually are, performed by the viatical company in connection with the settlement transaction include, but are not limited to:

1. identification of insured parties with short life expectancies
2. evaluation of the medical condition of the insured
3. analysis of the life expectancy of the insured
4. determination of the discount at which to purchase the policy
5. evaluation of the terms and conditions of the policies
6. effectuation of the legal transfer
7. effectuation of changes in beneficiaries
8. determination of whether an insured party has died to ensure timely submission of claims
9. submission of claims
10. pooling of policies for investors
11. computation and distribution of pro rata shares of benefits.

These functions are the type of entrepreneurial efforts which are sufficient to satisfy the fourth prong of the *Howey* test.

Another critical point is that premiums must be paid on the insurance contract to prevent lapse and the entire investment collapse. Rarely is it left to the investor to ensure the premiums are paid.

For the foregoing reasons, the various states' positions are that investments in viatical settlement agreements are investment contracts, and therefore constitute securities, requiring every security offered and sold to be registered unless exempt. Further, persons engaged in the business of effecting transactions in securities must be registered as dealers, and individuals who represent dealers must be registered agents, unless qualified for exemption.

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ATTACHMENT ONE-C

Viatical Settlements Model Act  
Draft: September 24, 1999  
Submission from Florida regarding investments in viatical settlements

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Section 15.	<u>Effective Date</u>

Section 1. Short Title

This Act may be cited as the Viatical Settlements Act.

Section 2. Definitions

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

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

C. "Person" means a legal entity, including but not limited to, an individual, partnership, limited liability company, association, trust, corporation or other legal entity.

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

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

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

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

E. "Viatical settlement broker" means a person that on behalf of a viator and for a fee, commission or other valuable consideration offers or attempts to negotiate viatical settlements between a viator and one or more viatical settlement providers. Irrespective of the manner in which the viatical settlement broker is compensated, a viatical settlement broker is deemed to represent only the viator and owes a fiduciary duty to the viator to act according to the viator's instructions and in the best interest of the viator. The term does not include an attorney, accountant or financial planner retained to represent the viator whose compensation is paid directly by or at the direction of the viator.

F. "Viatical settlement contract" means a written agreement entered into between a viatical settlement provider and a viator. The agreement shall establish the terms under which the viatical settlement provider will pay compensation or anything of value, which compensation or value is less than the expected death benefit of the insurance policy or certificate, in return for the viator's assignment, transfer, sale, devise or bequest of the death benefit or ownership of all or a portion of the insurance policy or certificate of insurance to the viatical settlement provider. A viatical settlement contract also includes a contract for a loan or other financial transaction secured primarily by an individual or group life insurance policy, other than a loan by a life insurance company pursuant to the terms of the life insurance contract, or a loan secured by the cash value of a policy.

G. "Viatical settlement provider" means a person, other than a viator, that enters into a viatical settlement contract. Viatical settlement provider also means a person that obtains financing from a financing entity for the purchase, acquisition, transfer or other assignment of one or more viatical settlement contracts, viaticated policies or interests therein, or otherwise sells, assigns, transfers, pledges, hypothecates or otherwise disposes of one or more viatical settlement contracts, viaticated policies or interests therein. Viatical settlement provider does not include:

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

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



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

H. "Viator" means the owner of a life insurance policy or a certificate holder under a group policy insuring the life of an individual with a catastrophic, life-threatening or chronic illness or condition who enters or seeks to enter into a viatical settlement contract.

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

J. "Viatical settlement purchase agreement" means a contract or agreement, entered into by a viatical settlement purchaser, to which the viator is not a party, to purchase a life insurance policy or an interest in a life insurance policy, which is entered into for the purpose of deriving an economic benefit.

K. "Viatical settlement purchaser" means a person, other than a licensee under this part, who gives a sum of money as consideration for a life insurance policy or an interest in the death benefits of a life insurance policy which has been or will be the subject of a viatical settlement contract, for the purpose of deriving an economic benefit.

L. "Viatical settlement sales agent" means a person other than a licensed viatical settlement provider, who has met the reporting requirements of this state and who arranges the purchase through a viatical settlement purchase agreement of a life insurance policy or an interest in a life insurance policy and is licensed as a life agent in good standing.

### Section 3. License Requirements

A. A person shall not operate as a viatical settlement provider, viatical settlement representative or viatical settlement broker without first having obtained a license from the commissioner.

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

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

C. Licenses may be renewed from year to year on the anniversary date upon payment of the annual renewal fees specified in Section [insert appropriate section]. Failure to pay the fees by the renewal date results in expiration of the license.

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

E. A license issued to a legal entity authorizes all members, officers and designated employees to act as viatical settlement providers, viatical settlement brokers or viatical settlement representatives, as applicable, under the license, and all those persons shall be named in the application and any supplements to the application.

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

- (1) Has provided a detailed plan of operation;
- (2) Is competent and trustworthy and intends to act in good faith in the capacity involved by the license applied for;
- (3) Has a good business reputation and has had experience, training or education so as to be qualified in the business for which the license is applied for; and
- (4) If a legal entity, provides a certificate of good standing from the state of its domicile.

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

### Section 4. License Revocation and Denial

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

- (1) There was any material misrepresentation in the application for the license;
- (2) The licensee or any officer, partner, member or key management personnel has been convicted of fraudulent or dishonest practices, is subject to a final administrative action or is otherwise shown to be untrustworthy or incompetent;
- (3) The viatical settlement provider demonstrates a pattern of unreasonable payments to viators;
- (4) The licensee has been found guilty of, or has pleaded guilty or *nolo contendere* to, any felony, or to a misdemeanor involving fraud or moral turpitude, regardless of whether a judgment of conviction has been entered by the court;
- (5) The viatical settlement provider has entered into any viatical settlement contract that has not been approved pursuant to this Act;
- (6) The viatical settlement provider has failed to honor contractual obligations set out in a viatical settlement contract;
- (7) The licensee no longer meets the requirements for initial licensure;
- (8) The viatical settlement provider has assigned, transferred or pledged a viaticated policy to a person other than a viatical settlement provider licensed in this state or a financing entity; or
- (9) The licensee has violated any provision of this Act.

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

#### Section 5. Approval of Viatical Settlements Contracts and Disclosure Statements

A person shall not use a viatical settlement contract or provide to a viator a disclosure statement form in this state unless filed with and approved by the commissioner. The commissioner shall disapprove a viatical settlement contract or disclosure statement form if, in the commissioner's opinion, the contract or provisions contained therein are unreasonable, contrary to the interests of the public, or otherwise misleading or unfair to the viator.

#### Section 6. Reporting Requirements and Confidentiality

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

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

- (1) Is necessary to effect a viatical settlement between the viator and a viatical settlement provider and the viator has provided prior written consent to the disclosure;
- (2) Is provided in response to an investigation by the commissioner or any other governmental officer or agency; or
- (3) Is a term of or condition to the transfer of a viaticated policy by one viatical settlement provider to another viatical settlement provider.

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

#### Section 7. Examination

A. The commissioner may, when the commissioner deems it reasonably necessary to protect the interests of the public, examine the business and affairs of any licensee or applicant for a license. The commissioner shall have the authority to order any licensee or applicant to produce any records, books, files or other information reasonably necessary to ascertain whether or not the licensee or applicant is acting or has acted in violation of the law or otherwise contrary to the interests of the public. The expenses incurred in conducting any examination shall be paid by the licensee or applicant.

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

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

#### Section 8. Disclosure

A. A viatical settlement provider, viatical settlement representative or viatical settlement broker shall disclose the following information to the viator no later than the time of application:

- (1) Possible alternatives to viatical settlement contracts for individuals with catastrophic, life threatening or chronic illnesses, including, any accelerated death benefits offered under the viator's life insurance policy;
- (2) Some or all of the proceeds of the viatical settlement may be free from federal income tax and from state franchise and income taxes, and that assistance should be sought from a professional tax advisor;
- (3) Proceeds of the viatical settlement could be subject to the claims of creditors;
- (4) Receipt of the proceeds of a viatical settlement may adversely effect the viator's eligibility for Medicaid or other government benefits or entitlements, and that advice should be obtained from the appropriate government agencies;
- (5) The viator's right to rescind a viatical settlement contract fifteen (15) calendar days after the receipt of the viatical settlement proceeds by the viator, as provided in Section 9C;
- (6) Funds will be sent to the viator within two (2) business days after the viatical settlement provider has received the insurer or group administrator's acknowledgment that ownership of the policy or interest in the certificate has been transferred and the beneficiary has been designated pursuant to the viatical settlement contract; and
- (7) Entering into a viatical settlement contract may cause other rights or benefits, including conversion rights and waiver of premium benefits that may exist under the policy or certificate, to be forfeited by the viator and that assistance should be sought from a financial adviser.
- (8) A viatical settlement transaction may be construed to be a commercial transaction and as such any confidentiality statutes that may have applied and any promises of confidentiality made, may be lost or non-applicable.

Drafting Note: This disclosure in and of its self does not effect the confidentiality of any information.

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

- (1) The affiliation, if any, between the viatical settlement provider and the issuer of an insurance policy to be viaticated;
- (2) If an insurance policy to be viaticated has been issued as a joint policy or involves family riders or any coverage of a life other than the insured under the policy to be viaticated, the viator shall be informed of the possible loss of coverage on the other lives and be advised to consult with his or her insurance producer or the company issuing the policy for advice on the proposed viatication; and
- (3) The dollar amount of the current death benefit payable to the viatical settlement provider under the policy or certificate. The viatical settlement provider shall also disclose the availability of any additional guaranteed insurance benefits, the dollar amount of any accidental death and dismemberment benefits under the policy or certificate and the viatical settlement provider's interest in those benefits.

C. No person shall misrepresent the nature of the return or the duration of time to obtain the return of any investment related to one or more viatical settlements sold by a viatical settlement provider.

D. The viatical settlement provider and the viatical settlement sales agent, themselves or through another person, shall provide in writing the following disclosures to any viatical settlement purchaser or viatical settlement purchaser prospect:

- (1) That the return represented as being available under the viatical settlement purchase agreement is directly tied to the projected life span of one or more insureds.
- (2) If a return is represented, the disclosure shall indicate the projected life span of the insured or insureds whose life or lives are tied to the return.
- (3) If required by the terms of the viatical settlement purchase agreement, that the viatical settlement purchaser shall be responsible for the payment of insurance premiums on the life of the insured, late or surrender fees, or other costs related to the life insurance policy on the life of the insured or insureds which may reduce the return.

- (4) The amount of any trust fees, commissions, deductions, or other expenses, if any, to be charged to the viatical settlement purchaser.
- (5) The name and address of the person responsible for tracking the insured.
- (6) That group policies may contain limitations or caps in the conversion rights, that additional premiums may have to be paid if the policy is converted, and that the party responsible for the payment of such additional premiums shall be identified.
- (7) That the life expectancy and rate of return are only estimates and cannot be guaranteed.
- (8) That the purchase of a viatical settlement contract should not be considered a liquid purchase, since it is impossible to predict the exact timing of its maturity and the funds may not be available until the death of the insured.
- (9) The name and address of the person with the responsibility for paying the premium until the death of the insured.
- (10) The life expectancy used by the provider in determining the price paid to the viator.
- (11) The name and address of the insurance company, the policy number and the date of issuance of the viaticated policy.
- (12) The name, address, experience and qualifications of the person issuing the life expectancy certification.
- (13) The name and address of any person providing escrow services.
- (14) The type of life insurance policy offered or sold, i.e. whole life, term life, universal life or a group policy certificate and the current status or condition of such policy, together with any additional benefits contained within the policy.
- (15) The frequency in which the provider will provide the status of the health condition of the insured to a purchaser.

E. The written disclosure required in Subsection D shall be conspicuously displayed in any viatical settlement purchase agreement, and in any solicitation material furnished to the viatical settlement purchaser by such viatical settlement provider, viatical settlement sales agent, or person, and shall be in bold print or contrasting color and in not less than 10-point type or no smaller than the largest type on the page if larger than 10-point type. The department is authorized to adopt by rule the disclosure form to be used. The disclosures need not be furnished in an invitation to inquire, the objective of which is to create a desire to inquire further about entering into a viatical settlement purchase agreement. The invitation to inquire may not quote rates of return, may not include material attendant to the execution of any specific viatical settlement purchase agreement, and may not relate to any specific viator.

#### Section 9. General Rules

##### A. A viatical settlement provider entering into a viatical settlement contract shall first obtain:

- (1) If the viator is the insured, a written statement from a licensed attending physician that the viator is of sound mind and under no constraint or undue influence to enter into a viatical settlement contract;
- (2) A witnessed document in which the viator consents to the viatical settlement contract, acknowledges that the insured has a catastrophic, life threatening or chronic illness or condition, represents that the viator has a full and complete understanding of the viatical settlement contract, that he or she has a full and complete understanding of the benefits of the life insurance policy and acknowledges that he or she has entered into the viatical settlement contract freely and voluntarily; and
- (3) A document in which the insured consents to the release of his or her medical records to a viatical settlement provider or viatical settlement broker.

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

C. All viatical settlement contracts entered into in this state shall provide the viator with an unconditional right to rescind the contract for at least fifteen (15) calendar days from the receipt of the viatical settlement proceeds. If the insured dies during the rescission period, the viatical settlement contract shall be deemed to have been rescinded, subject to repayment to the viatical settlement provider of all viatical settlement proceeds.

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

escrow agent shall transfer the proceeds to the viator immediately upon the viatical settlement provider's receipt of acknowledgment of the transfer of the insurance policy.

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

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

#### Section 10. Authority to Promulgate Regulations

The commissioner shall have the authority to:

- A. Promulgate regulations implementing this Act;
- B. Establish standards for evaluating reasonableness of payments under viatical settlement contracts. This authority includes, but is not limited to, regulation of discount rates used to determine the amount paid in exchange for assignment, transfer, sale, devise or bequest of a benefit under a life insurance policy;
- C. Establish appropriate licensing requirements, fees and standards for continued licensure for viatical settlement providers, representatives and brokers;

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

- D. Require a bond or other mechanism for financial accountability for viatical settlement providers; and
- E. Adopt rules governing the relationship and responsibilities of both insurers and viatical settlement providers, brokers and representatives during the viatication of a life insurance policy or certificate.

#### Section 11. Unfair Trade Practices

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

#### Section 12. Prohibited Practices

It is unlawful for any person:

- A. To knowingly enter into a viatical settlement contract the subject of which is a life insurance policy that was obtained by means of a false, deceptive, or misleading application for the life insurance policy.
- B. In the solicitation or sale of a viatical settlement purchase agreement:
  - (1) To employ any device, scheme, or artifice to defraud;
  - (2) To obtain money or property by means of an untrue statement of a material fact or by any omission 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
  - (3) To engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon a person.

#### Section 13. False representations; deceptive words

- A. It is unlawful for a person in the advertisement, offer, or sale of a viatical settlement purchase agreement to misrepresent that such an agreement has been guaranteed, sponsored, recommended, or approved by the state, or any agency or officer of the state or by the United States or any agency or officer of the United States.
- B. It is unlawful for a person in conjunction with the sale of a viatical settlement purchase agreement to directly or indirectly misrepresent that the person has been sponsored, recommended, or approved, or that his or her abilities or qualifications have in any respect been passed upon, by this state or any other state, or any agency or officer thereof, or by the United States or any agency or officer thereof.

C. It is unlawful for a person in the offer or sale of a viatical settlement purchase agreement to obtain money or property by:

(1) A misrepresentation that the viatical settlement purchase agreement purchased, offered, or sold is guaranteed, sponsored, recommended, or approved by this state or any other state, or any agency or officer thereof, or by the United States or any agency or officer thereof.

(2) A misrepresentation that the person is sponsored, recommended, or approved, or that the person's abilities or qualifications have in any respect been passed upon, by this state or any other state, or any agency or officer thereof, or by the United States or any agency or officer thereof.

D. Neither paragraph A nor paragraph B may be construed to prohibit a statement that the person is licensed or appointed under this part if such a statement is required by this part or rules adopted under this part, if the statement is true in fact, and if the effect of the statement is not misrepresented.

E. A person may not represent that a viatical settlement purchase agreement is guaranteed by any insurance guaranty fund.

F. A person may not represent that the investment in a viatical settlement purchase agreement is "guaranteed," that the principal is "safe," or that the investment is free of risk.

#### Section 14. Injunctions; Civil Remedies; Cease and Desist

A. In addition to the penalties and other enforcement provisions of this act, if any person violates this act or any rule implementing this act, the department may seek an injunction in the circuit court of the county where the person resides or has a principal place of business and may apply for temporary and permanent orders that the department determines necessary to restrain the person from committing the violation.

B. Any person damaged by the acts of a person in violation of this act may bring a civil action against the person committing the violation in the circuit court of the county in which the alleged violator resides or has a principal place of business or in the county wherein the alleged violation occurred. Upon an adverse adjudication, the defendant is liable for damages, together with court costs and reasonable attorney's fees incurred by the plaintiff. When so awarded, court costs and attorney's fees must be included in the judgment or decree rendered in the case. If it appears to the court that the suit brought by the plaintiff is frivolous or brought for purposes of harassment, the plaintiff is liable for court costs and reasonable attorney's fees incurred by the defendant.

C. A violation of this act attendant to the execution of a viatical settlement purchase agreement renders such viatical settlement purchase agreement voidable and subject to rescission by the viatical settlement purchaser. Suit for rescission may be brought in the circuit court of the county in which the alleged violator resides or has a principal place of business or in the county wherein the alleged violation occurred.

D. The department may issue a cease and desist order upon a person that violates any provision of this part, any rule or order adopted by the department, or any written agreement entered into with the department.

E. When the department finds that such an action presents an immediate danger to the public which requires an immediate final order, it may issue an emergency cease and desist order reciting with particularity the facts underlying such findings. The emergency cease and desist order is effective immediately upon service of a copy of the order on the respondent and remains effective for 90 days. If the department begins nonemergency cease and desist proceedings under paragraph D., the emergency cease and desist order remains effective, absent an order by an appellate court of competent jurisdiction pursuant to [cite the state's administrative procedure act].

#### Section 15. Effective Date

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

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ATTACHMENT ONE-D

Viatical Settlements Working Group  
Conference Call  
September 8, 1999

The Viatical Settlements Working Group of the Life Insurance and Annuities (A) Committee met by conference call on Sept. 8, 1999. Lester Dunlap (LA) chaired. The following working group members participated: Ren Norman representing Michael Bownes (AL); Kevin McCarty (FL); Dale Freeman (ID); Betty Jo Tear representing Robert Heisler (IL); Roger Strauss (IA); Marilyn Burch and Vickie Buening (KS); Tom Jacks and Rebecca Hill (NC); Susan Anderson representing Glenn Pomeroy (ND);

Dan Arlidge representing Sue Stead (OH); Dalora Schafer (OK); Lewis Littlehales representing Joel Ario (OR); Neil Nevins and Maliaka EssamelDin (TN); and Rhonda Myron (TX).

#### 1. Consider Comments on Appendices B and C to the Viatical Settlement Model Regulation

Mr. Dunlap said the working group agreed to consider further comments on Appendices B and C, even though the working group has already approved these at the Summer National Meeting. Joan Marcoc (CIGNA) wrote a letter with some suggestions for changes to the forms. Ms. Marcoc commented first that the directions in Section 2 of Appendix C are unclear. She said the instructions say the employer should complete that section but some of the portions need to be completed by the insurance company. If that happens, it will be unclear which party has completed which sections of the form. Mr. Dunlap asked how to address that issue. George Coleman (Prudential) suggested that both parties indicate the parts of the form they filled out. The working group agreed to change the instruction under Section 2 to indicate that each party should identify the parts each had completed. Ms. Marcoc said that Question 3 on disability waiver of premium did not lend itself to a yes or no answer. Doug Head (Medical Escrow Society) said the viatical settlement providers need a yes or no answer. Mr. Straus said that, if the insurer thinks it needs to provide more information, it could attach an additional piece of paper. Ms. Marcoc responded that her company did not give policy interpretations, just the facts, so attaching a copy of the policy would work well. Julie Spiezio (American Council of Life Insurance—ACLI) opined that nothing in these forms would prevent a company from attaching any information it thought necessary. She asked regulators not to mandate attaching items to the forms.

Ms. Marcoc asked the regulators to consider changing “(4) Beneficiaries, Assignments and Limitations.” She suggested this is not relevant. Mr. Head said that in Florida the law currently requires consideration of minor children. Mr. Dunlap asked if the information is readily available and Ms. Marcoc responded in the affirmative. Mr. Coleman suggested there may be a privacy issue, but in some states the interests of revocable beneficiaries must be considered. The working group decided not to make any changes to Paragraph (4).

Ms. Marcoc asked the regulators to consider changing Item (b) under Paragraph (4) also. She said the question does not tell who will notify the viatical provider if the master policy is cancelled. Mr. Coleman suggested changing the question to ask who will notify, and the working group agreed to accept the change.

Mr. Coleman asked the working group to consider changing Appendix B, Paragraph (2)(10). He said asking if the policy has ever been reinstated places an unnecessary burden on the insurer. The only relevant issue is whether the form has been reinstated within the past two years. The working group agreed to ask if the policy has been reinstated within the past two years.

#### 2. Consider Viatical Settlement Buyer's Guide

Mr. Dunlap said the working group would discuss the draft section by section to respond to comments. Stacey Braverman (Viaticus) said that most of the issues in the buyer's guide are also contained in the brochures. She suggested using the brochures rather than creating another document. Mr. Dunlap responded that the NAIC often produces buyer's guides to attach to regulations and the working group had agreed to create this more extensive buyer's guide. The working group members agreed that the buyer's guide would serve a useful purpose for the state. Ms. Buening said the draft before the regulators had already received some level of review and was redrafted to make it easier to understand.

In the first section, “Selling Your Life Insurance Policy,” Ms. Myron suggested adding a number six, “Consider Seeking Professional Help.” Mr. McCarty said this is discussed more extensively later on, and suggested the working group review the rest of the document and then decide if this is an appropriate addition. Mr. Littlehales suggested that, under “Step 1. Evaluate Your Needs,” the first clarification should be to evaluate whether to give up coverage. He suggested rewording the first paragraph to clarify that making the decision whether to sell your policy is the first step. The working group agreed to rewrite Step 1, as suggested by Mr. Littlehales. Mr. Head suggested adding a sentence that says, “Compare these amounts with what you would get in a viatical settlement.” Mr. Coleman responded that it was not an appropriate comparison because in one case the individual is maintaining the insurance policy in force, but in a sale he is not. Mr. Jacks added that inserting such a sentence at this point would also move the viatical settlement option up too soon in the discussion.

Discussion turned to “Step 2, Check All of Your Options.” Mr. Coleman said the paragraph after the three options was not worded appropriately. He said using the phrase, “Your insurance company is required to disclose current policy information to you,” makes it sound as if the insurance company does not want to disclose that information. The phrasing suggests that, if it were not required, the insurer would not do so. The working group agreed to Mr. Coleman's suggestion for redrafting that paragraph.

The discussion next turned to the paragraphs headed “Accelerated Death Benefits.” The working group discussed whether it is appropriate to include a 50% citation of the typical accelerated death benefit. Mr. Burch said this was based on statistical information provided by Ms. Spiezio. Ms. Spiezio responded that 89% of the insurers do provide more than 50% as an accelerated death benefit. After further discussion, the working group agreed to leave the 50% number in the document.

The working group next discussed “Step 3, How The Process Works.” The draft gave as an example accepting a \$75,000 cash payment for a \$100,000 policy. The working group discussed whether that number should be lower because many times the payment is not that much. Mr. Burch suggested retaining the \$75,000 figure because it will encourage the viator to shop more, otherwise he will have lower expectations. The working group agreed to leave the \$75,000 in the draft. Mr. Littlehales pointed out that throughout the draft the terms “provider,” “company,” and “buyer” are used interchangeably. The working group agreed to be consistent and use the term “provider.”

Discussion next turned to the phases of a sale transaction as described in the guide. Discussion focused on the last bullet point under Phase 2, "State laws, if any, that may affect the policy or transaction." Mr. Head said state law would not affect the amount the viatical settlement provider would offer. If their calculation showed that the policy was not worth the amount required under state law, no offer would be made. Mr. Coleman then responded that this would be a factor taken into consideration. The working group decided to clarify the last bullet point to say, "State laws, if any, that require a minimum payment."

Discussion next turned to the entry under "Step 4, Know Your Rights" entitled, "Avoiding Consumer Fraud." Ms. Myron suggested that the sentence in the draft that said, "Remember that viaticals are best suited for people living with life-threatening illness," was too subjective. The working group agreed to reword that sentence to say, "Remember that viaticals are intended for people living with life-threatening or chronic illness." Mr. McCarty suggested adding another bullet point after the second bullet that says, "If you are asked to purchase a life insurance policy for the sole purpose of selling it, you may be participating in a fraud." The working group agreed to that change.

Ms. Marcoe asked if it is important for consumers to understand that their policy can be further assigned. Mr. Dunlap agreed that it was important. Ms. Buening said she thought it would be confusing and asked why the insured would care. Mr. Coleman also expressed his opinion that the insured should understand that. The working group agreed to add that concept as a bullet point under Step 3.

The draft before the working group contained a section on buying viatical settlements and the working group agreed that was not an appropriate section to a buyer's guide attached to the Viatical Settlements Model Regulation. Mr. McCarty agreed, noting that Florida is already in the process of preparing buyer's guides and intends to make the investment portion a separate document.

Mr. Dunlap said the revised draft will be forwarded to Brenda Cude (University of Georgia) for review for consumer understanding. He expressed hope that the working group would be able to adopt the buyer's guide at the Fall National Meeting.

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

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## ATTACHMENT TWO

### Equity Indexed Products Working Group Atlanta, Georgia October 3, 1999

The Equity Indexed Products Working Group of the Life Insurance and Annuities (A) Committee met in Atlanta, GA, on Oct. 3, 1999. Mike Batte (NM) chaired the meeting. The following working group members were present: Roger Strauss (IA); Bill McAndrews for Larry Gorski (IL); Lester Dunlap (LA); Frank Stone (OK); and Sam Myer (SD).

#### 1. Consider Recommendations for Regulators Checklist for Contract Review

Mr. Dunlap reported that a small group he chaired drafted a checklist that will be useful for contract analysts who are reviewing equity indexed products. He said that this is a product that he personally requested because he thought it would be helpful to many regulators. He noted that attached to the checklist is a bibliography of materials to help educate regulators. Mr. Dunlap moved to adopt the checklist and to recommend that this be distributed to regulators across the country. Mr. Strauss seconded the motion. Anda Olson (ING) asked that the checklist reflect the fact that independent distribution channels do not lend themselves to agent training materials. Mr. Strauss responded that this may be true and suggested that information could be provided to regulators if the question is asked. The motion to adopt the checklist (Attachment Two-A) passed.

Paul DeAngelo (NJ) applauded the group for the materials it prepared. He said he had encouraged the group to move with speed because the need for this material is immediate and he appreciated the fast response. He suggested that, when the materials are distributed to the states, the contract analysts be offered an opportunity to provide suggestions so that the material can be revised as new issues come up. Mr. Dunlap responded that this is an excellent idea. Mr. Strauss said that, in the past, questions had arisen when groups wanted to distribute materials that were attached to their minutes. He said he would like to see this distributed as a separate document rather than being buried in the entire set of minutes from the meeting. Mr. DeAngelo suggested that, if this is sent out with an opportunity for comment, it would not give the appearance that this had been adopted by the NAIC hierarchy. Blaine Shepherd (MN) said his understanding of NAIC policy was that, as long as the communication to the department was not characterized as a statement of NAIC policy, but rather an informational piece, this procedure was satisfactory. Bruce Ferguson (American Council of Life Insurance—ACLI) said he was concerned about how contract analysts would address questions that might differ from their states' laws. He suggested adding an introductory sentence that said, "This document is not intended to alter state filing laws." Mr. Strauss moved that the document be left as is, a statement be made in the cover letter that this is not intended to change any state's law or regulation, and that the letter include a request for feedback, and moved that the group be disbanded. Mr. McAndrews asked what would happen with the recommendations if the group is disbanded. Mr. Batte responded that, if the Life Insurance and Annuities (A) Committee feels the need to form a working group, it can do so. If this group is disbanded, it can be reconstituted at any time. Mr. McAndrews seconded the motion made by Mr. Strauss. The motion passed.



## 2. Adopt Minutes of June 29, 1999, Conference Call

Mr. Strauss moved and Mr. McAndrews seconded a motion to adopt the minutes of the June 29, 1999, conference call (Attachment Two-B). The motion passed.

Having no further business, the Equity Indexed Products Working Group adjourned.

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## ATTACHMENT TWO-A

### Equity Indexed Product Checklist

The purpose of this document is to give contract analysts some guidance on issues to consider during the review of equity indexed products.

1. Does the advertising material discuss and give a clear description of all the key features?
2. Does the filing comply with the standards of Actuarial Guideline 35?
  - Hedging strategy
  - Reserving methodology
  - Provide an opinion by company's appointed actuary that investments to be made for these contracts are appropriate considering the liabilities
  - Actuarial certification may be desirable
3. Does the annual report to the policy owner fairly represent the contract terms?
4. Is the initial participation rate in the policy and minimum and maximum participation rates for future periods in the same location?
5. Is the index well-established and published in a recognized journal?
6. Does the contract describe any right of the company to change the index?
7. Is a copy of any illustration material used with hypothetical increases and decreases in the index included for department review?
8. Does the company have a specific training program for agents for this type of product?
  - Department may want to request a statement that training is provided or ask for detail about the training or see copies of the training materials.
  - Do the training materials discuss the types of indices and contract features?
  - Do the training materials emphasize the volatile nature of equity indexed products?
  - Is the product so complex that the chance for misunderstanding is higher without adequate agent training?
9. Does the cover page say "Equity Indexed Product"?
10. Is an actuarial memorandum included?
  - Does it describe the mechanics of the form?
  - Does the form comply with the nonforfeiture law?
11. Has the product been approved by the home state of the insurer?
12. Does the company disclose any unusual or controversial provisions of this filing?

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ATTACHMENT TWO-B

Equity Indexed Products Working Group  
Conference Call  
June 29, 1999

The Equity Indexed Products Working Group of the Life Insurance and Annuities (A) Committee met by conference call at 1 p.m. on June 29, 1999. Lester Dunlap (LA) chaired the meeting. The following working group members participated: Gene Reed (DE); Roger Strauss (IA); Larry Gorski (IL); Tom Foley (KS); and Joan Williams for Frank Stone (OK).

Mr. Dunlap asked four questions about the equity indexed products checklist drafted by Mr. Strauss. Mr. Dunlap asked if this list is intended to be exclusive, whether the items on the list should be expanded upon, whether the list should include a bibliography of reading material, and what type of NAIC product this will be. Mr. Strauss commented that his list was prepared as a summary of the positions in the states at this time. He included in his list common elements in the states reviewed or issues that seem to be worthwhile. Mr. Strauss said that it seemed to him that this should not be a model law or regulation, but rather an informal list of suggestions for policy analysts. Mr. Foley said that at the Summer National Meeting he had commented that the Equity Indexed Buyer's Guide needs to be updated and noted that most of these issues are discussed in the buyer's guide. Another alternative to the list would be to add a table of contents to the Equity Indexed Buyer's Guide and to suggest analysts review that. Mr. Gorski said a related issue is the NAIC process. He asked if this document would have to go through the exposure process. Mr. Strauss responded that the purpose of this document is just to jog the memory of the policy analysts; it is not intended to be a definitive list. Mr. Gorski said he was not advocating a formal comment period. Carolyn Johnson (NAIC/SSO) noted that the checklist was attached to the minutes of the Summer National Meeting; therefore, it is available for discussion and comment by interested parties.

The members of the working group discussed the list point by point. Number 1 on the checklist is "Advertising materials." Mr. Dunlap asked if these should be reviewed. Mr. Strauss responded that Iowa does not review advertising materials as part of the policy approval process, but they could be reviewed in a market conduct examination. Mr. Gorski said that Illinois does review advertising materials and suggested the analysts should have a checklist of important contract features. The advertising should discuss those important features and give a clear description of all of them.

Discussion next turned to number 2 on the checklist "Hedging strategy." Mr. Strauss said that numbers 2, 3, 10, 17 and 18 on his list are all actuarial issues. He opined that policy analysts may know very little about these issues and suggested that an actuarial certification might be desirable in this area. He suggested combining numbers 2 and 3. Mr. Gorski said that compliance with NAIC Actuarial Guideline XXXV would cover these issues and requires a quarterly certification. Mr. Dunlap suggested moving numbers 10 and 17 up to be included as part of the subpoints related to Actuarial Guideline XXXV. The working group agreed to this suggestion.

The working group discussed number 4 "How policy will be report for risk-based capital." Mr. Gorski said this item is no longer needed because the risk-based capital rules now cover this issue. The working group agreed to delete this item from the checklist.

Mr. Dunlap asked the working group to consider number 5 on the list "Copy of annual report to policyowner." He asked if the list should add anything about the content of the annual report. Mr. Gorski said that when Illinois receives a copy of the annual report, staff makes sure the values in the report do not overstate what the contract actually offers. For example, if it is a point-to-point contract and the policyholder cancels the policy before the term is over, he will not receive any of the equity indexed interest. The Illinois analysts look to be sure the report does not imply they will get that interim value.

Mr. Gorski said item number 6, "Initial participation rate must be in policy and minimum and maximum participation rates for future periods in same location" was self-explanatory. He said the analysts should make sure that there is a balanced treatment and it is in one location.

Discussion next turned to item number 7, "Describe investment policy to be followed." Mr. Gorski recommended that this section be dropped because it is wrapped into Actuarial Guideline XXXV compliance. The working group agreed to that suggestion.

Mr. Gorski asked if number 8, "Limit indices to well-established and published in a recognized journal," belongs in a checklist. He opined that it is prescriptive. Mr. Strauss suggested rewording the entry to reflect the purpose of the chart, which is to jog the memory of the analyst. He suggested instead that number 8 say, "Is the index used well-established and published in a recognized journal?" Mr. Gorski agreed that would serve the purpose of giving the analysts something to think about.

Mr. Dunlap said that item number 9, "Describe any right of the company to change the index," should be in the contract. Mr. Strauss agreed that if the company can do this it should say so in the contract.

Discussion next turned to number 11, "Copy of disclosure statement policyholder signs certifying he understands the contract." Mr. Strauss said this discussion item came from the North Dakota checklist written by Mr. Foley. Mr. Foley suggested that this item be deleted from the equity indexed products checklist because very few policyholders understand the contract. The working group agreed.

Mr. Strauss said that number 12, "Copy of any illustration material used with hypothetical increases and decreases in index," may also be prescriptive. Mr. Gorski opined that it is not, because it says copy of "any" illustration material. The list is not saying they should have illustration material, but it is worthwhile to review the material if the company provides it.

Mr. Gorski said that many of the contracts today have a minimum and maximum period so that number 13, "Prior notification to department of changes in any moving parts from those originally filed," would require many reports to the department. Mr. Strauss said that he thought this was meant to require notification of any changes to the contract itself, rather than changes in its moving parts. Mr. Strauss said that if the company changes its contract, it has to refile anyhow and he suggested deleting number 13 from the list. The working group agreed.

Discussion next turned to item number 14, "Describe specific training program for agents for this type of product." Mr. Dunlap said the working group earlier agreed that the training program would be the company's responsibility. He asked if this item would require that the insurer file its training program and require the analysts to evaluate the value of that training program. Mr. Dunlap said the item could require a statement that the company trains, detail about what that training includes, or a copy of the training materials. He noted that this requirement is in lieu of a requirement for a separate license or test for equity indexed products agents. Mr. Foley said that the attitude of the North Dakota Insurance Department was that the equity indexed product is 500% more complicated than a variable annuity, but here we don't even ask for a training program or assurance that the agent has a level of comprehension. He predicted that companies will be sued for lack of disclosure when individuals are dissatisfied with the equity indexed products they have purchased. Mr. Strauss suggested adding to the phrase a suggestion that the policy analysts may want to see the training materials. Mr. Dunlap said that the NAIC may need further discussion on whether this product needs a higher level of training than other agent sales. He noted, however, that this working group is not the proper place for that discussion. He suggested that the Agents Licensing Working Group should discuss this issue. For purposes of this checklist, a decision does not need to be made. Mr. Gorski said this raises a good point. If a company says "we don't train our agents," what would the department do? He opined that there is not much point in going into detail without any authority to require agent training. Mr. Strauss suggested leaving the check point in the list because it would be helpful to the analysts to know if the company trains its agent. Mr. Gorski suggested pointing out three or four different items that the training materials should include, such as whether the training material discusses the type of index and the contract features, and emphasizes the volatile nature of this product. He said that if the policy analysts came across a particularly complex product and the company responded that it provided no training, the analysts might disapprove it on the basis that the policy could be easily misinterpreted. Mr. Strauss added that, if a complaint occurs later, the information may be helpful to market conduct examiners.

Number 15 on the checklist is "Cover page must say 'Equity Indexed Product'." Mr. Strauss said this is probably not necessary because it is routinely done. Mr. Foley disagreed with that statement. Mr. Dunlap said he also had seen forms that did not identify the product on the cover page. Mr. Dunlap suggested changing the check point to say, "Does the cover page say this is an 'Equity Indexed Product'?" Mr. Foley said that some products were approved by insurance departments without them even being aware that this was an equity indexed product.

Mr. Strauss asked if number 16 "Actuarial memorandum" should be moved to the other issues dealing with Actuarial Guideline XXXV. Mr. Gorski responded that it should not, because the memorandum would deal with nonforfeiture issues. He suggested leaving it as is and perhaps adding two bullet points "describe the mechanics of the form" and "compliance with nonforfeiture rules." The working group agreed with that suggestion.

Discussion next turned to number 18, "Home state approval." Mr. Dunlap asked about the significance of whether the home state has approved the product. Mr. Strauss opined that if the home state has not approved the product, it might cause the analyst to question the filing. Mr. Gorski said that some states do less review if the home state has approved the product. He suggested rephrasing the point to say, "Has the home state approved it?"

Mr. Strauss explained that number 19, "Unusual and controversial statement," is a requirement in Iowa. If the product contains unusual or controversial features, the filing company must disclose that to the insurance department. Mr. Gorski said his state has the same requirement, but he does not recall anyone answering in the affirmative. Mr. Strauss gave an example: if the industry standard is to use the S&P 500, but this insurer wanted to use the Nikkei Index, the insurer should say so. Mr. Gorski suggested rewording number 19 to say, "Did the company disclose any unusual or controversial policy provisions?" Mr. Strauss asked if a state would review the policy filing any differently if a statement was filed. He suggested this may be of little value. Mr. Dunlap suggested leaving the item as part of the list so that a state can decide whether it wants to consider it.

Mr. Dunlap asked if there were any items that have not been included on this checklist but should be added. Charlotte Liptak (American General) said she would like an opportunity to review the revised list. She applauded the working group for changing these to questions to jog the memory of the contract analyst so that they can be used in light of the state's own filing requirements. She suggested beginning the checklist with a summary of its purpose stating that it is to provide guidance to the contract analyst.

Mr. Dunlap next asked the working group to consider the development of a bibliography of reading materials to give the analyst background material. Ms. Johnson offered the assistance of the NAIC Research Library to put together such a bibliography, and reminded the working group that the Life Disclosure Working Group sponsored a seminar at the NAIC meeting in June 1997, and a video of that seminar was provided to all insurance departments. Ms. Liptak also suggested that the article she prepared for the *Journal of Insurance Regulation* be included in the bibliography.

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

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#### ATTACHMENT THREE

##### Life Disclosure Working Group Atlanta, Georgia October 4, 1999

The Life Disclosure Working Group of the Life Insurance and Annuities (A) Committee met in Atlanta, GA, on Oct. 4, 1999. Tom Foley (KS) chaired the meeting. The following working group members were present: John Hartnedy (AR); Sheldon Summers (CA); Roger Strauss (IA); Lester Dunlap (LA); Linda Ruthardt (MA); Paul DeAngelo (NJ); Mike Batte (NM); and Frank Stone (OK).

#### 1. Review Draft of Life Disclosure Model Regulation Amendments

Mr. Foley said that in early 1996 the working group sent a letter to commissioners with suggestions about how to handle the potential conflict between the Life Disclosure Model Regulation and the Life Insurance Illustrations Model Regulation. The Life Disclosure Model Regulation requires a policy summary and a buyer's guide. The letter suggested that the states alter their regulation to indicate that the basic illustration can serve as a policy summary, but if no illustration is used, the policy summary shown must use guaranteed elements only. In the spirit of that letter, Mr. Foley said he and Carolyn Johnson (NAIC) took the current version of the model regulation and reflected that concept, as well as making other amendments to coordinate with the Life Insurance Illustrations Model Regulation. He said numerous comments were received on that draft and they represented a number of important issues.

Many comments focused on whether group life should be included in the scope of this regulation, as it is in the Life Insurance Illustrations Model Regulation. George Coleman (Prudential) said the concerns addressed in the Life Insurance Illustrations Model Regulation were the result of some abuses in the illustration process. There was no suggestion at that time that abuses existed in the disclosure process. He opined that the buyer's guide and summary document are not appropriate for group activity and are very expensive to produce. Mr. Foley said the life disclosure model was developed in the 1970s when most group insurance was term life. By the time the illustrations model was developed, the market changed so that more permanent insurance was being sold in the group market. He said the question before the working group today was whether the Life Disclosure Model Regulation now should be made applicable to group products. Commissioner Ruthardt said that in the early 1970s when the Life Disclosure Model Regulation was developed the employer did not have fiduciary responsibility in a group setting. After the adoption of the Employee Retirement Income Security Act (ERISA) in 1976, the employer had many responsibilities. A summary plan description was required and the protection provided to employees motivated employers to be very careful not to misrepresent benefits. She suggested that making this model applicable to group policies might add confusion because of the Department of Labor fiduciary responsibility rules. Mr. Hartnedy said he had no reports of problems in the group market, but still sees some individual problems. Mr. Foley asked if any members of the working group felt if it was important to include group policies in the model regulation and no one spoke in favor of that requirement. The working group decided to return the model to its original status of excluding group policies under Section 3B(3). Mr. Coleman asked whether the group's decision to reinstate the provision in Section 3B(3) included reinstating paragraph (4). The working group agreed that it did.

Mr. Foley noted that the next comment was in regard to life insurance policies for the preneed funeral plan market. The working group discussed the provision in the Life Insurance Illustrations Model Regulation that exempts life insurance policies with a death benefit on one individual that does not exceed \$10,000. Mr. Foley noted that those individuals would not receive a Life Insurance Buyer's Guide. Mr. Hartnedy said that the preneed funeral contract business is very extensive in Arkansas and, if the working group decides to include those policies, that part would not be adopted in Arkansas. Mr. DeAngelo said the purpose of the buyer's guide is to educate and inform. He said many people who fund a preneed insurance contract with life insurance do not understand that fact and are in need of education. He thought delivery of the buyer's guide to them would be helpful. Mr. Hartnedy said he also liked the idea of requiring a buyer's guide for that situation. The working group agreed not to exempt preneed funeral contracts from this model regulation.

Julie Spiezio (American Council of Life Insurance—ACLI) asked the working group to consider changing the definition in Section 4A so that it refers to the most current guide prepared by the NAIC. She said a problem arises in states that have adopted this language and attached one of the earlier guides. She opined that it is in everyone's best interest to use the most current version. She said it is appropriate to keep the language that said "a guide approved by the commissioner" because some states have specific requirements. The working group agreed to that suggestion.

The ACLI also suggested that the definition of non-guaranteed elements in Section 4B be replaced with language identical to the definition of non-guaranteed elements found in the Life Insurance Illustrations Model Regulation. Barbara Lautzenheiser (Lautzenheiser and Associates) suggested it would be better to use the definition in the Annuity Disclosure Model Regulation. The working group agreed with that suggestion.

It was suggested that the definition of policy data in Section 5F prohibits the use of an in-force illustration with older policies. Mr. Foley said that was not intended and he would review the draft to be sure that was not the result.

Mr. Coleman expressed confusion at the provision in Section 5B(2) because of the deletion of the words "investment generation method." Mr. DeAngelo said he supports this change because it is in the best interest of the policyholder to have this information, no matter why the method of determining the dividend scale has changed. He suggested that this information was much of the basis for misunderstanding about vanishing premiums and this change will help alert policyholders that their dividends will be calculated differently. The working group agreed to hear further comments on this issue and consider it further at the Winter National Meeting.

Mr. DeAngelo said that he discussed at the Suitability Working Group the preneed funeral contract issue and the fact that insurance regulators generally do not regulate all preneed funeral contracts, but only ones funded by life insurance policies. He suggested that the definition may need to be tweaked to reflect this more clearly.

The working group next discussed Section 7F and its requirement for a disclosure for applicants age 60 and older. Mr. Coleman said the Life Insurance Illustrations Model Regulation serves the purpose of illustrating the values of the policy and also opined that making a comparison to a bank account is inappropriate. Mr. Batte said that it would be worthwhile to revisit this issue and decide if this appendix provides value. Mr. Strauss noted that Iowa was the only state to adopt this provision and it has now been deleted from Iowa's regulation. Commissioner Ruthardt suggested that this requirement gives the message, "you are old, you are stupid." The working group decided to delete Subsections E and F and the accompanying appendices.

Mr. Foley asked the working group to consider the issue of cost indices. He noted that the current draft deletes the requirement for a cost index and the sample indices in Appendix B. Mr. DeAngelo said he would feel more comfortable if regulators heard from consumer groups that this information is not needed. Mr. Foley responded that, if consumers want to compare policies, they have the illustrations to do so. He opined that is better than an index. Mr. Coleman reminded the group that when the illustrations regulation was prepared, the participants agreed in general that cost indexes were no longer necessary.

Mr. Foley said a new draft will be prepared included revisions discussed by the working group (Attachment Three-A). He said the working group should be able to finish this project by the Winter National Meeting.

## 2. Consider Necessity of Revising Equity Indexed Products Buyer's Guide

Mr. Foley said the working group discussed at the last meeting whether it is necessary to update the Equity Indexed Annuities Buyer's Guide to reflect changes in the marketplace. Charlotte Liptak (American General Life) said several technical resource advisers held a conference call on this issue. They agreed that some changes could be made to the document. She suggested that the most useful change would be to simplify the document to be less specific so that it would have a longer shelf life. Mr. Foley asked Ms. Liptak and the technical resource advisers to prepare a suggestion for the working group's consideration.

## 3. Report of Activity of Securities and Exchange Commission (SEC) in Regard to Variable Life Insurance Illustrations

Ms. Spiezio reported for Carl Wilkerson (ACLI) that the SEC has received final comments on its update of variable life insurance. Mr. Wilkerson expects the documents to be finalized by the SEC by Dec. 1. The document will reflect substantial portions of the NAIC's Life Insurance Illustrations Model Regulation and Mr. Wilkerson thinks regulators will be happy with the resulting product. Mr. Foley said that in 1995 a small subgroup consisting of then-Commissioner Robert Wilcox of Utah, Rick Morris, then of the New York Insurance Department, and Mr. Foley went to Washington, DC, to talk to the SEC. They had an excellent discussion and he suggest that insurance regulators go back to visit with the SEC again. He asked for regulators who are interested in doing so to speak with him.

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

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ATTACHMENT THREE-A

Life Insurance Disclosure Model Regulation  
Draft: October 4, 1999

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Section 1. Authority

This rule is adopted and promulgated by the commissioner of insurance pursuant to insert state equivalent to Section 4A(1) of the Unfair Trade Practices Act] of the Insurance Code.

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

Section 2. Purpose

A. The purpose of this regulation is to require insurers to deliver to purchasers of life insurance information ~~which that~~ will improve the buyer's ability to select the most appropriate plan of life insurance for the buyer's needs; ~~and~~ improve the buyer's understanding of the basic features of the policy ~~which that~~ has been purchased or ~~which~~ is under consideration ~~and improve the ability of the buyer to evaluate the relative costs of similar plans of life insurance.~~

B. This regulation does not prohibit the use of additional material ~~which that~~ is not a violation of this regulation or any other [state] statute or regulation.

Section 3. Scope

A. Except for the exemptions specified in Section 3B, this regulation shall apply to any solicitation, negotiation or procurement of life insurance occurring within this state. Section 5C ~~only~~ shall apply only to any existing nonexempt policy held by a policyowner residing in this state. This regulation shall apply to any issuer of life insurance contracts including fraternal benefit societies.

B. ~~Unless specifically included, t~~This regulation shall not apply to:

- (1) Individual and group annuity contracts ~~Annuities~~;
- (2) Credit life insurance;
- (3) Group life insurance (except for disclosures relating to preneed funeral contracts or prearrangements; as ~~provided herein~~. These disclosure requirements shall extend to the issuance or delivery of certificates as well as to the master policy);
- (4) Life insurance policies issued in connection with pension and welfare plans as defined by and which are subject to the federal Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. Section 1001 *et seq.* as amended; or
- (5) Variable life insurance under which the amount or duration of the life insurance varies according to the investment experience of a separate account.

## Section 4. Definitions

For the purposes of this regulation, the following definitions shall apply:

A. "Buyer's Guide". ~~A Buyer's Guide is means the current Life Insurance Buyer's Guide adopted by the National Association of Insurance Commissioners (NAIC) a document that contains, and is limited to, the language contained in Appendix A to this regulation or language approved by the commissioner.~~

B. "Cash Dividend". ~~A cash dividend is means the current illustrated dividend which that can be applied toward payment of the gross premium.~~

C. ~~Contribution Principle. The contribution principle is a basic principle of dividend determination adopted by the American Academy of Actuaries with respect to individual life insurance policies. The Academy report, *Dividend Recommendations and Interpretations* (November 1985), describes this principle as the distribution of the aggregate divisible surplus among policies in the same proportion as the policies are considered to have contributed to divisible surplus. In a broad sense, the contribution principle underlies the essential equity implied by participating business.~~

D. ~~Cost Comparison Indexes.~~

(1) ~~Surrender Cost Comparison Index—Illustrated Basis. The Surrender Cost Comparison Index—Illustrated Basis is calculated by applying the following steps:~~

(a) ~~Determine the cash surrender value, if any, available at the end of the tenth and twentieth policy years, based on the company's current rate schedule.~~

(b) ~~For participating policies, add the terminal dividend payable upon surrender, if any, to the accumulation of the annual cash dividends at five percent (5%) interest compounded annually to the end of the period selected and add this sum to the amount determined in Step (a).~~

(c) ~~Divide the result of Step (b) (Step (a) for nonparticipating policies) by an interest factor that converts it into an equivalent level annual amount that, if paid at the beginning of each year, would accrue to the value in Step (b) (Step (a) for nonparticipating policies) over the respective periods stipulated in Step (a). If the period is ten (10) years, the factor is 13.207 and if the period is twenty (20) years, the factor is 34.719.~~

(d) ~~Determine the equivalent level premium by accumulating each annual premium payable for the basic policy or rider, based on the company's current rate schedule, at five percent (5%) interest compounded annually to the end of the period stipulated in Step (a) and dividing the result by the respective factors stated in Step (c). (This amount is the annual premium payable for a level premium plan.)~~

(e) ~~Subtract the result of Step (c) from Step (d).~~

(f) ~~Divide the result of Step (e) by the number of thousands of the equivalent level death benefit, using the company's current rate schedule to determine the amount payable upon death for purposes of Section 4H(1), to arrive at the Surrender Cost Comparison Index—Illustrated Basis.~~

(2) ~~Surrender Cost Comparison Index—Guaranteed Basis. The Surrender Cost Comparison Index—Guaranteed Basis is calculated by applying the steps indicated in (1) above but assuming that the company charges the maximum premiums and provides the minimum cash values and, for purposes of Section 4H(1), provides the minimum death benefits allowed by the policy, and, if the policy is participating, pays no dividends.~~

(3) ~~Net Payment Cost Comparison Index—Illustrated Basis. The Net Payment Cost Comparison Index—Illustrated Basis is calculated in the same manner as the comparable Surrender Cost Comparison Index—Illustrated Basis except that the cash surrender value and any terminal dividend are set at zero.~~

(4) ~~Net Payment Cost Comparison Index—Guaranteed Basis. The Net Payment Cost Comparison Index—Guaranteed Basis is calculated in the same manner as the comparable Surrender Cost Comparison Index—Guaranteed Basis except that the cash surrender value is set at zero.~~

EC. ~~Disciplined Current Dividend Scale means the scale described in [insert section of state law or regulation corresponding to Section 4D of the Life Insurance Illustrations Model Regulation]. The current dividend scale is a schedule that exhibits dividends to be distributed if there is no change in the basis of these dividends after the time of illustration.~~

F. ~~Current Rate Schedule. The current rate schedule is a schedule showing the premiums that will be charged or the cash values or death or other benefits that will be available if there is no change in the basis of these items after the time of illustration.~~

G. ~~Discontinuity Index. The discontinuity index is the sum of the backward second differences squared in the yearly prices of death benefits (per 1,000) for policy years through twenty-three (23). Examples of calculations appear in Appendix B of this regulation.~~



~~H. Equivalent Level Death Benefit. The equivalent level death benefit of a policy or term life insurance rider is an amount calculated as follows:~~

~~(1) Accumulate the amount payable upon death, regardless of the cause of death, at the beginning of each policy year for ten (10) and twenty (20) years at five percent (5%) interest compounded annually to the end of the tenth and twentieth policy years respectively.~~

~~(2) Divide each accumulation of Step (1) by an interest factor that converts into one equivalent level annual amount that, if paid at the beginning of each year, would accrue to the value in Step (1) over the respective periods stipulated in Step (1). If the period is ten (10) years, the factor is 13.207 and if the period is twenty (20) years, the factor is 34.719.~~

~~ID. "Generic nName" means. A generic name is a short title that is descriptive of the premium and benefit patterns of a policy or a rider.~~

~~J. Investment Generation Method. The investment generation method is the method of determining dividends so that dividends for policies issued in specified years or groups of years reflect investment earnings on funds attributable to those policies.~~

~~KE. "Nonguaranteed elements" Factor. A nonguaranteed factor is any premium, benefit, or other item entering into the calculation of the Surrender Cost Comparison Index. Illustrated Basis means that can be changed by the company without the consent of the policy owner. the premiums, credited interest rates (including any bonus), benefits, values, non-interest based credits, charges or elements of formulas used to determine any of these, that are subject to company discretion and are not guaranteed at issue. An element is considered non-guaranteed if any of the underlying non-guaranteed elements are used in its calculation.~~

~~LF. "Policy Ddata" means. The policy data is a display or schedule of numerical values on a ,both guaranteed basis and nonguaranteed for each policy year or a series of designated policy years of the following information: illustrated annual, or other periodic, and terminal dividends; premiums; death benefits; cash surrender values and endowment benefits.~~

~~MG. "Policy Ssummary". The policy summary is means a written statement describing the elements of the policy, including, but not limited to:~~

- ~~(1) A prominently placed title as follows: STATEMENT OF POLICY COST AND BENEFIT INFORMATION.~~
- ~~(2) The name and address of the insurance agent or, if no agent is involved, a statement of the procedure to be followed in order to receive responses to inquiries regarding the Policy Summary.~~
- ~~(3) The full name and home office or administrative office address of the company in which the life insurance policy is to be or has been written.~~
- ~~(4) The generic name of the basic policy and each rider.~~
- ~~(5) The following amounts, where applicable, for the first five (5) policy years and representative policy years thereafter sufficient to clearly illustrate the premium and benefit patterns; including, but not necessarily limited to, the years for which Cost Comparison Indexes are displayed and the earlier of at least one age from sixty (60) through sixty-five (65) and policy maturity:~~
  - ~~(a) The annual premium for the basic policy;~~
  - ~~(b) The annual premium for each optional rider;~~
  - ~~(c) The amount payable upon death at the beginning of the policy year regardless of the cause of death, other than suicide or other specifically enumerated exclusions, which that is provided by the basic policy and each optional rider; with benefits provided under the basic policy and each rider shown separately;~~
  - ~~(d) The total guaranteed cash surrender values at the end of the year with values shown separately for the basic policy and each rider; and~~
  - ~~(e) The cash dividends payable at the end of the year with values shown separately for the basic policy and each rider (dividends need not be displayed beyond the twentieth policy year);~~
  - ~~(fe) Any endowment amounts payable under the policy which that are not included under cash surrender values above;~~
  - ~~(g) If the policy has a nonguaranteed factor, the maximum premium, minimum amount payable upon death, minimum cash value, and minimum endowment amounts allowed by the policy. These amounts may be shown in addition on the basis of the company's current rate schedule and current dividend scale.~~

(6) The effective policy loan annual percentage interest rate, if the policy contains this provision, specifying whether this rate is applied in advance or in arrears. If the policy loan interest rate is adjustable, the policy summary shall also indicate that the annual percentage rate will be determined by the company in accordance with the provisions of the policy and the applicable law.

~~(7) The Cost Comparison Indexes for ten (10) and twenty (20) years but in no case beyond the premium-paying period. Indexes shall be shown on the Guaranteed Basis as defined in Sections 4D(2) and 4D(4) and, if there are dividends or a Nonguaranteed Factor, shall also be shown on the illustrated basis as defined in Sections 4D(1) and 4D(3). Separate indexes shall be displayed for the basic policy and for each optional term life insurance rider. Such indexes need not be included for optional riders which are limited to benefits, such as accidental death benefits, disability waiver of premium, preliminary term life insurance coverage of less than twelve (12) months and guaranteed insurability benefits; nor for any basic policies or optional riders covering more than one life.~~

~~(8) A policy summary which includes dividends shall also include a statement that dividends are based on the company's current dividend scale and are not guaranteed.~~

~~(9) If the policy has a nonguaranteed factor, a statement indicating that the insurer reserves the right to change the nonguaranteed factor at any time and for any reason. However, if the insurer has agreed to limit this right in any way, such as, for example, if it has agreed to change a nonguaranteed factor only at certain intervals or only if there is a change in the insurer's current or anticipated experience, the statement may indicate any such limitation on the insurer's right.~~

~~(10) This statement in close proximity to the Cost Comparison Indexes:~~

~~"An explanation of the intended use of these indexes is provided in the Life Insurance Buyer's Guide."~~

~~(11) The date on which the policy summary is prepared.~~

The policy summary must consist of a separate document. All information required to be disclosed must be set out in such a manner as not to minimize or render any portion thereof obscure. Any amounts which remain level for two (2) or more years of the policy may be represented by a single number if it is clearly indicated what amounts are applicable for each policy year. Amounts in Item (6) of this section shall be listed in total, not on a per thousand nor per unit basis. If more than one insured is covered under one policy or rider, death benefits shall be displayed separately for each insured or for each class of insureds if death benefits do not differ within the class. Zero amounts shall be displayed as a blank space.

~~N. Portfolio Average Method. The portfolio average method is the method of determining dividends so that, except for the effect of policy loans, dividends reflect investment earnings on funds attributable to all policies whenever issued.~~

~~OH. Preneed Funeral Contract or Prearrangement. An means an agreement by or for an individual before that individual's death relating to the purchase or provision of specific funeral or cemetery merchandise or services.~~

~~P. Yearly Price of Death Benefits. The yearly price of death benefits per \$1,000 is calculated by applying the following formula:~~

$$\begin{aligned}
 &\text{YP} = (P - D) \div (CVC - CVP) \times (F \div 1.05) \\
 &\text{Where YP} = \text{Yearly Price of Death Benefits per } \$1,000 \\
 &\quad P = \text{Annual premium} \\
 &\quad CVP = \text{Sum of the cash value and terminal dividend at the end of the preceding year.} \\
 &\quad CVC = \text{Sum of the cash value and terminal dividend at the end of the current year.} \\
 &\quad D = \text{Annual dividend} \\
 &\quad F = \text{Face amount} \\
 &\quad \div = 1 \div (1.05)
 \end{aligned}$$

## Section 5. Duties of Insurers

### A. Requirements Applicable Generally

(1) The insurer shall provide, a Buyer's Guide to all prospective purchasers, a Buyer's Guide and a policy summary prior to accepting the applicant's initial premium or premium deposit; provided, however, that, However:

(a) If the policy for which application is made or its policy summary contains an unconditional refund provision of at least ten (10) days, the Buyer's Guide and policy summary must may be delivered with the policy or prior to delivery of the policy.

(b) If the equivalent level death benefit of the policy for which application is made does not exceed \$5,000, the requirement for providing a policy summary will be satisfied by delivery of a written statement containing the information described in Section 4M, Items (2), (3), (4), (5a), (5b), (5c), (6), (7), (9), (10), and (11).

~~(2) In the case of universal life and indeterminate premium products, the Statement of Policy Information for Applicant illustrated in Appendix D must be delivered at the time of application or within fifteen (15) working days thereafter, but at least five (5) days before delivery of the policy.~~

~~If the policy is delivered sooner than five (5) days after delivery of the disclosure statement, the free look period shall be extended to fifteen (15) days. In the event the disclosure statement is not delivered at the time of application, the disclosure shall be accompanied by a statement that it is delivered for the express purpose of allowing comparison with other policies.~~

~~(3) In the case of a solicitation by direct response methods, the insurer shall provide the Statement of Policy Information for Applicant prior to accepting the applicant's application; provided however, that if the policy for which application is made contains an unconditional refund provision of at least ten days, the Statement of Policy Information for Applicant may be delivered with the policy.~~

~~(2) The insurer shall provide a policy summary to prospective purchasers where the insurer has identified the policy form as one that will not be marketed with an illustration. The policy summary shall show guarantees only. It shall consist of a separate document with all required information set out in a manner that does not minimize or render any portion of the summary obscure. Any amounts that remain level for two (2) or more years of the policy may be represented by a single number if it is clearly indicated what amounts are applicable for each policy year. Amounts in Section 4G(5) shall be listed in total, not on a per thousand or per unit basis. If more than one insured is covered under one policy or rider, death benefits shall be displayed separately for each insured or for each class of insureds if death benefits do not differ within the class. Zero amounts shall be displayed as a blank space.~~

~~(4) If any prospective purchaser requests a Buyer's Guide, a policy summary or policy data, the insurer shall provide the item or material requested. Unless otherwise requested, the policy data shall be provided for policy years one through twenty, and for indeterminate premium and universal life products shall substantially conform to the illustration in Appendix D.~~

~~(5) If the Discontinuity Index of any policy exceeds:~~

~~(a) Any of the test limits for discontinuity set forth in Appendix C herein, the insurer shall, prior to the sale of any such policy, provide to the commissioner a statement identifying as accurately as possible the specific policy premium or benefit causing the policy's Discontinuity Index to exceed the test limits. Upon request of the commissioner, the insurer shall also provide to the commissioner the policy data for policy years one through thirty (30), and the Discontinuity Index and its component calculations.~~

~~(b) The test limit set forth in Appendix C herein for the applicant's issue age, the insurer shall provide:~~

~~(i) The following statement displayed prominently on the policy summary and on all other sales material that show or incorporate a Cost Comparison Index: "This policy has an unusual pattern of premiums or benefits that may make comparison with the cost indexes of other policies unreliable. You should discuss this with your agent or this company. A statement of year by year information is available."~~

~~(ii) If the prospective purchaser requests it, a statement identifying as accurately as possible the specific policy premium or benefit causing the policy's Discontinuity Index to exceed the applicable test limit.~~

**B.—Requirements Applicable to Participating Policies.** If a life insurance company illustrates policyholder dividends that are calculated in a manner or on a basis that:

~~(1) Deviates substantially from the contribution principle, the policy summary and all other sales material showing illustrated policyholder dividends must display prominently the following statement: "The illustrated dividends for this policy have not been determined in accordance with the contribution principle. Contact this company for further information."~~

~~(2) Uses the portfolio average method, the policy summary and all other sales material showing illustrated policyholder dividends must include the following statement: "Illustrated dividends reflect current investment earnings on funds applicable to all policies and are based on the current dividend scale. Refer to your Buyer's Guide for further information."~~

~~(3) Uses the investment generation method, the policy summary and all other sales material showing illustrated policyholder dividends must include the following statement: "Illustrated dividends reflect current investment earnings on funds attributable to policies issued since 19[ ] and are based on the current dividend scale. Refer to your Buyer's Guide for further information."~~

**Drafting Note:** Insert at [ ] the earliest year of the issue year grouping used to determine the investment earnings on currently issued policies.

~~(4) Uses any combination of the portfolio average method and the investment generation method, the policy summary and all other sales material showing illustrated policyowner dividends must include an appropriate~~

~~statement, analogous to the statements required by Sections 5B(2) and 5B(3), indicating how current investment earnings are reflected in illustrated dividends.~~

**6B. Requirements Applicable to Existing Policies.**

(1) ~~If a policy owner residing in this state requests it, the insurer shall provide policy data for that policy. If the policy is one that has been designated to be illustrated, an in force illustration shall be provided as required in Section [insert reference to state law equivalent to Section 10C of the Life Insurance Illustrations Model Regulation]. At the option of the insurer, a policy illustration consistent with Section [insert reference to state law equivalent to Section 10C of the Life Insurance Illustrations Model Regulation] may be provided for a policy issued prior to the effective date of Section [insert reference to state law equivalent to Section 10C of the Life Insurance Illustrations Model Regulation]. Otherwise Unless otherwise requested, the policy data shall be provided that for twenty consecutive years beginning with the previous policy anniversary. The statement of policy data shall include cash dividends or interest that has already been credited to the policy value according to the current dividend scale, the amount of outstanding policy loans, and the current policy loan interest rate. Policy values shown shall be based on the dividend option in effect at the time of the request. The insurer may charge a reasonable fee, not to exceed \$[insert amount], for the preparation of the statement.~~

(2) If a life insurance company:

(a) ~~Deviates substantially from the contribution principle, it shall annually advise each affected policy owner residing in this state that the dividend paid that year was not determined in accordance with the contribution principle and that the policy owner may contact the company for further information.~~

(b) ~~Is determining dividends, as of the effective date of this regulation, using the investment generation method; it shall, within eighteen (18) months of such date, advise each affected policy owner residing in this state that the dividend for the policy reflects current investment earnings on funds applicable to policies issued from 19[ ] through 19[ ]. This requirement shall not apply to policies for which the amount payable upon death under the basic policy as of the date when advice would otherwise be required does not exceed \$5,000.~~

**Drafting Note:** Insert at [ ] the applicable years of issue.

(c) ~~Changes its method of determining dividend scales or interest on existing policies from or to the investment generation method; it shall, no later than when the first dividend is payable payment is made on the new basis, advise each affected policy owner residing in this state of this change and of its implication on dividends payable on affected policies. This requirement shall not apply to policies for which the amount payable upon death under the basic policy as of the date when advice would otherwise be required does not exceed \$5,000.~~

(3) If the insurer makes a material revision in the terms and conditions under which it will limit its right to change any nonguaranteed factor; it shall, no later than the first policy anniversary following the revision, advise accordingly each affected policy owner residing in this state.

**Section 6. — Special Plans**

~~This section modifies the application of this regulation as indicated for certain special plans of life insurance:~~

**A. — Enhanced Ordinary Life Policies.**

(1) ~~An enhanced ordinary life policy is a participating policy which has the following characteristics for all issue ages:~~

(a) ~~The basic policy has a guaranteed death benefit that reduces after an initial period of one or more years to a basic amount; and~~

(b) ~~A special dividend option that provides~~

(i) ~~A combination of immediate paid-up additions and one year term insurance; or~~

(ii) ~~Deferred paid-up additions;~~

~~either of which on the basis of the current dividend scale will provide a combined death benefit (reduced basic amount plus paid-up additions plus one-year term insurance) at least equal to the initial face amount.~~

(2) ~~The crossover point of an enhanced ordinary life policy is the first policy anniversary at which the sum of the reduced basic amount and paid-up additions equals or exceeds the initial death benefit. For these policies:~~

(a) ~~The cash value of benefits purchased by dividends payable on or before the crossover point is included in the cash surrender value for the purpose of Section 4D(1)(a);~~

~~(b) The death benefit purchased by dividends payable on or before the crossover point is included in the amount payable upon death for the purpose of Section 4H(1);~~

~~(c) Dividends payable after the crossover point are assumed to be paid in cash for the purpose of Section 4D(1)(b).~~

**B. Flexible Premium and Benefit Policies.** For policies commonly called "universal life insurance policies," which:

- ~~(1) Permit the policy owner to vary, independently of each other, the amount or timing of premium payments, or the amount payable on death; and~~
- ~~(2) Provide for a cash value that is based on separately identified interest credits and mortality and expense charges made to the policy.~~

~~All indexes and other data shall be displayed assuming specific schedules of anticipated premiums and death benefits at issue. In addition to all other information required by this regulation, the policy summary shall indicate when the policy will expire based on the interest rates and mortality and other charges guaranteed in the policy and the anticipated or assumed annual premiums shown in the policy summary.~~

**C. Multitrack Policies.** For policies which allow a policyowner to change or convert the policy from one plan or amount to another, the policy summary:

- ~~(1) Shall display all indexes and other data assuming that the option is not exercised; and~~
- ~~(2) May display all indexes and other data using a stated assumption about the exercise of the option.~~

**D. Policies with Any Rate Subject to Continued Insurability.** For policies which allow a policyowner a reduced premium rate if the insured periodically submits evidence of continued insurability, the policy summary:

- ~~(1) Shall display cost indexes and other data assuming that the insured always qualifies for the lowest premium;~~
- ~~(2) Shall display cost indexes and other data assuming that the company always charges the highest premiums allowable; and~~
- ~~(3) Shall indicate the conditions that must be fulfilled for an insured to qualify periodically for the reduced rate.~~

**E. Individualized Policy Information**

- ~~(1) In addition to all other information required by this regulation, in those situations specified in Section 8I, the information illustrated in Appendix E shall be prepared on an individual basis.~~
- ~~(2) If an insurer uses a form other than the Financial Review of This Policy form, that form shall be approved for use by the state insurance department. An insurer may use the appropriate box or boxes from the top of the disclosure form for the specific policy being illustrated without seeking state insurance department approval for this change in the form.~~
- ~~(3) If cost of insurance, nonguaranteed dividends or benefits or potential preferential tax implications are presented in the policy, advertising, marketing materials, or verbally explained to the consumer, the agent, or company if a direct marketer, shall attach all those materials or representations to the Financial Review of This Policy form before issuance of the policy if not previously provided.~~
- ~~(4) If any method other than the Financial Review of This Policy form is used to explain the death benefit, a copy of the illustration signed by the applicant and the agent must be attached to the form.~~
- ~~(5) The information contained in Appendix E must be furnished to the applicant no later than the point of issue of the policy.~~
- ~~(6) The original of the individual information form shall be delivered simultaneously with the policy at issue and a copy shall be retained by the insurer as long as the policy remains in force, plus two (2) years.~~

**Drafting Note:** This language cannot be construed to limit the ability of a regulator or a consumer to hold the insurer responsible for the actions of an agent in any misrepresentations on the disclosure form.

**F.** For all other special plans of life insurance, an insurer shall provide or deliver both a policy summary substantially similar to that described in Section 4M and a Buyer's Guide. Use of these materials shall be deemed to be substantial compliance with this regulation unless the commissioner makes a finding that such disclosure materials misrepresent a material term or condition of the contract or omit a material fact.

## Section 76. Preneed Funeral Contracts or Prearrangements

The following information shall be adequately disclosed at the time an application is made, prior to accepting the applicant's initial premium or deposit; for a preneed funeral contract or prearrangement ~~as defined in Section 40 above which that is~~ funded or to be funded by a life insurance policy:

- A. The fact that a life insurance policy is involved or being used to fund a prearrangement ~~as defined in Section 40 of this regulation;~~
- B. The nature of the relationship among the soliciting agent or agents, the provider of the funeral or cemetery merchandise or services, the administrator and any other person;
- C. The relationship of the life insurance policy to the funding of the prearrangement and the nature and existence of any guarantees relating to the prearrangement;
- D. The impact on the prearrangement:
  - (1) Of any changes in the life insurance policy including but not limited to, changes in the assignment, beneficiary designation or use of the proceeds;
  - (2) Of any penalties to be incurred by the policyholder as a result of failure to make premium payments;
  - (3) Of any penalties to be incurred or monies to be received as a result of cancellation or surrender of the life insurance policy;
- E. A list of the merchandise and services which are applied or contracted for in the prearrangement and all relevant information concerning the price of the funeral services, including an indication that the purchase price is either guaranteed at the time of purchase or to be determined at the time of need;
- F. All relevant information concerning what occurs and whether any entitlements or obligations arise if there is a difference between the proceeds of the life insurance policy and the amount actually needed to fund the prearrangement ~~as defined in Section 40;~~
- G. Any penalties or restrictions, including but not limited to geographic restrictions or the inability of the provider to perform, on the delivery of merchandise, services or the prearrangement guarantee; and
- H. ~~If so, the~~ The fact that a sales commission or other form of compensation is being paid and ~~if so, the~~ identity of ~~such the~~ individuals or entities to whom it is paid.

## Section 87. General Rules

- A. Each insurer shall maintain, at its home office or principal office, a complete file containing one copy of each document authorized and used by the insurer pursuant to this regulation. ~~Such The~~ file shall contain one copy of each authorized form for a period of three (3) years following the date of its last authorized use unless otherwise provided by this regulation.
- B. An agent shall inform the prospective purchaser, prior to commencing a life insurance sales presentation, that he or she is acting as a life insurance agent and inform the prospective purchaser of the full name of the insurance company which the agent is representing to the buyer. In sales situations in which an agent is not involved, the insurer shall identify its full name.
- C. Terms such as financial planner, investment advisor, financial consultant, or financial counseling shall not be used in such a way as to imply that the insurance agent is primarily engaged in an advisory business in which compensation is unrelated to sales unless ~~such that~~ is actually the case.
- D. Any reference to a dividend or nonguaranteed factor ~~must include a statement that such item is not guaranteed and is based on the company's current dividend scale or current rate schedule. If a dividend or nonguaranteed factor would be reduced by the existence of a policy loan, a statement to this effect must be included in any reference to such dividend or nonguaranteed factor shall be governed by the rules contained in~~ insert reference to state equivalent of Life Insurance Illustrations Model Regulation. Reference shall not be made to nonguaranteed factors if the insurer has chosen not to illustrate the policy form.
- E. ~~A system or presentation which does not recognize the time value of money through the use of appropriate interest adjustments shall not be used for comparing the cost of two (2) or more life insurance policies. Such a system may be used for the purpose of demonstrating the cash flow pattern of a policy if the presentation is accompanied by a statement disclosing that the presentation does not recognize that, because of interest, a dollar in the future has less value than a dollar today.~~
- F. ~~A presentation of costs or benefits, other than that required pursuant to this regulation, shall not display guaranteed and nonguaranteed factors as a single sum unless they are shown separately in close proximity thereto.~~

~~G. Any statement regarding the use of the Cost Comparison Indexes shall include an explanation to the effect that the indexes are useful only for the comparison of the relative costs of two (2) or more similar policies.~~

~~H. A Cost Comparison Index which reflects a dividend or nonguaranteed factor shall be accompanied by a statement that it is based on the company's current dividend scale or current rate schedule and is not guaranteed.~~

~~I. Whenever a policy is issued for delivery in this state to an applicant at age sixty (60) or over, which limits death benefits during a period following the inception date of the policy or where the accumulated premiums exceed the death benefit at any point during the first ten (10) years, then the form and guide labeled Appendix E to this regulation or a form and guide containing substantially similar information and approved by the commissioner of insurance shall be completed by the insurer and delivered simultaneously with the policy and the free look period shall be extended to thirty (30) days.~~

~~J. Prior to taking an application for a policy which is subject to the disclosure requirements of Section 8I, the insurer provide the applicant with a prominent notice in the following form, or in a form containing substantially similar information approved by the commissioner:~~

#### ~~NOTICE TO APPLICANTS AGE SIXTY (60) OR OVER~~

~~With your policy, you may receive a "Financial Review of This Policy" form showing premiums and benefits for a ten (10) year period. You should review the form and your policy, and decide if the policy is suitable for you. If you are not entirely satisfied, please review the cancellation provision on the form for directions on obtaining a full refund of any premiums paid.~~

#### Section 98. Failure to Comply

Failure of an insurer to provide or deliver a Buyer's Guide, a policy summary or policy data as provided in Sections 5 and 6 shall constitute an omission ~~which that~~ misrepresents the benefits, advantages, conditions or terms of an insurance policy.

#### Section 109. Separability

If any provisions of this rule be held invalid, the remainder shall not be affected.

#### Section 110. Effective Date

This rule shall become effective [insert a date at least 6 months following adoption by the regulatory authority].

#### APPENDIX A

##### LIFE INSURANCE BUYER'S GUIDE

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

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

##### Life Insurance Buyer's Guide

This guide can help you when you shop for life insurance. It discusses how to:

- Find a Policy That Meets Your Needs and Fits Your Budget
- Decide How Much Insurance You Need
- Make Informed Decisions When You Buy a Policy

Prepared by the National Association of Insurance Commissioners

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

This guide does not endorse any company or policy.

Reprinted by . . .

##### Important Things to Consider

1. Review your own insurance needs and circumstances. Choose the kind of policy that has benefits that most closely fit your needs. Ask an agent or company to help you.
2. Be sure that you can handle premium payments. Can you afford the initial premium? If the premium increases later and you still need insurance, can you still afford it?
3. Don't sign an insurance application until you review it carefully to be sure all the answers are complete and accurate.

4. Don't buy life insurance unless you intend to stick with your plan. It may be very costly if you quit during the early years of the policy.
5. Don't drop one policy and buy another without a thorough study of the new policy and the one you have now. Replacing your insurance may be costly.
6. Read your policy carefully. Ask your agent or company about anything that is not clear to you.
7. Review your life insurance program with your agent or company every few years to keep up with changes in your income and your needs.

### Buying Life Insurance

When you buy life insurance, you want coverage that fits your needs.

First, decide how much you need—and for how long—and what you can afford to pay. Keep in mind the major reason you buy life insurance is to cover the financial effects of unexpected or untimely death. Life insurance can also be one of many ways you plan for the future.

Next, learn what kinds of policies will meet your needs and pick the one that best suits you.

Then, choose the combination of policy premium and benefits that emphasizes protection in case of early death, or benefits in case of long life, or a combination of both.

It makes good sense to ask a life insurance agent or company to help you. An agent can help you review your insurance needs and give you information about the available policies. If one kind of policy doesn't seem to fit your needs, ask about others.

This guide provides only basic information. You can get more facts from a life insurance agent or company or from your public library.

### What About the Policy You Have Now?

If you are thinking about dropping a life insurance policy, here are some things you should consider:

- If you decide to replace your policy, don't cancel your old policy until you have received the new one. You then have a minimum period to review your new policy and decide if it is what you wanted.
- It may be costly to replace a policy. Much of what you paid in the early years of the policy you have now, paid for the company's cost of selling and issuing the policy. You may pay this type of cost again if you buy a new policy.
- Ask your tax advisor if dropping your policy could affect your income taxes.
- If you are older or your health has changed, premiums for the new policy will often be higher. You will not be able to buy a new policy if you are not insurable.
- You may have valuable rights and benefits in the policy you now have that are not in the new one.
- If the policy you have now no longer meets your needs, you may not have to replace it. You might be able to change your policy or add to it to get the coverage or benefits you now want.
- At least in the beginning, a policy may pay no benefits for some causes of death covered in the policy you have now.

In all cases, if you are thinking of buying a new policy, check with the agent or company that issued you the one you have now. When you bought your old policy, you may have seen an illustration of the benefits of your policy. Before replacing your policy, ask your agent or company for an updated illustration. Check to see how the policy has performed and what you might expect in the future, based on the amounts the company is paying now.

### How Much Do You Need?

Here are some questions to ask yourself:

- How much of the family income do I provide? If I were to die early, how would my survivors, especially my children, get by? Does anyone else depend on me financially, such as a parent, grandparent, brother or sister?
- Do I have children for whom I'd like to set aside money to finish their education in the event of my death?
- How will my family pay final expenses and repay debts after my death?
- Do I have family members or organizations to whom I would like to leave money?
- Will there be estate taxes to pay after my death?



- How will inflation affect future needs?

As you figure out what you have to meet these needs, count the life insurance you have now, including any group insurance where you work or veteran's insurance. Don't forget Social Security and pension plan survivor's benefits. Add other assets you have: savings, investments, real estate and personal property. Which assets would your family sell or cash in to pay expenses after your death?

### What Is the Right Kind of Life Insurance?

All policies are not the same. Some give coverage for your lifetime and others cover you for a specific number of years. Some build up cash values and others do not. Some policies combine different kinds of insurance, and others let you change from one kind of insurance to another. Some policies may offer other benefits while you are still living. Your choice should be based on your needs and what you can afford.

There are two basic types of life insurance: term insurance and cash value insurance. Term insurance generally has lower premiums in the early years, but does not build up cash values that you can use in the future. You may combine cash value life insurance with term insurance for the period of your greatest need for life insurance to replace income.

Term Insurance covers you for a term of one or more years. It pays a death benefit only if you die in that term. Term insurance generally offers the largest insurance protection for your premium dollar. It generally does not build up cash value.

You can renew most term insurance policies for one or more terms even if your health has changed. Each time you renew the policy for a new term, premiums may be higher. Ask what the premiums will be if you continue to renew the policy. Also ask if you will lose the right to renew the policy at some age. For a higher premium, some companies will give you the right to keep the policy in force for a guaranteed period at the same price each year. At the end of that time you may need to pass a physical examination to continue coverage, and premiums may increase.

You may be able trade many term insurance policies for a cash value policy during a conversion period—even if you are not in good health. Premiums for the new policy will be higher than you have been paying for the term insurance.

Cash Value Life Insurance is a type of insurance where the premiums charged are higher at the beginning than they would be for the same amount of term insurance. The part of the premium that is not used for the cost of insurance is invested by the company and builds up a cash value that may be used in a variety of ways. You may borrow against a policy's cash value by taking a policy loan. If you don't pay back the loan and the interest on it, the amount you owe will be subtracted from the benefits when you die, or from the cash value if you stop paying premiums and take out the remaining cash value. You can also use your cash value to keep insurance protection for a limited time or to buy a reduced amount without having to pay more premiums. You also can use the cash value to increase your income in retirement or to help pay for needs such as a child's tuition without canceling the policy. However, to build up this cash value, you must pay higher premiums in the earlier years of the policy. Cash value life insurance may be one of several types; whole life, universal life and variable life are all types of cash value insurance.

Whole Life Insurance covers you for as long as you live if your premiums are paid. You generally pay the same amount in premiums for as long as you live. When you first take out the policy, premiums can be several times higher than you would pay initially for the same amount of term insurance. But they are smaller than the premiums you would eventually pay if you were to keep renewing a term policy until your later years.

Some whole life policies let you pay premiums for a shorter period such as 20 years, or until age 65. Premiums for these policies are higher since the premium payments are made during a shorter period.

Universal Life Insurance is a kind of flexible policy that lets you vary your premium payments. You can also adjust the face amount of your coverage. Increases may require proof that you qualify for the new death benefit. The premiums you pay (less expense charges) go into a policy account that earns interest. Charges are deducted from the account. If your yearly premium payment plus the interest your account earns is less than the charges, your account value will become lower. If it keeps dropping, eventually your coverage will end. To prevent that, you may need to start making premium payments, or increase your premium payments, or lower your death benefits. Even if there is enough in your account to pay the premiums, continuing to pay premiums yourself means that you build up more cash value.

Variable Life Insurance is a kind of insurance where the death benefits and cash values depend on the investment performance of one or more separate accounts, which may be invested in mutual funds or other investments allowed under the policy. Be sure to get the prospectus from the company when buying this kind of policy and **STUDY IT CAREFULLY**. You will have higher death benefits and cash value if the underlying investments do well. Your benefits and cash value will be lower or may disappear if the investments you chose didn't do as well as you expected. You may pay an extra premium for a guaranteed death benefit.

### Life Insurance Illustrations

You may be thinking of buying a policy where cash values, death benefits, dividends or premiums may vary based on events or situations the company does not guarantee (such as interest rates). If so, you may get an illustration from the agent or company that helps explain how the policy works. The illustration will show how the benefits that are not guaranteed will change as interest rates and other factors change. The illustration will show you what the company guarantees. It will also show you what

could happen in the future. Remember that nobody knows what will happen in the future. You should be ready to adjust your financial plans if the cash value doesn't increase as quickly as shown in the illustration. You will be asked to sign a statement that says you understand that some of the numbers in the illustration are not guaranteed.

#### Finding a Good Value in Life Insurance

After you have decided which kind of life insurance is best for you, compare similar policies from different companies to find which one is likely to give you the best value for your money. A simple comparison of the premiums is not enough. There are other things to consider. For example:

- Do premiums or benefits vary from year to year?
- How much do the benefits build up in the policy?
- What part of the premiums or benefits is not guaranteed?
- What is the effect of interest on money paid and received at different times on the policy?

Once you have decided which type of policy to buy, you can use a cost comparison index to help you compare similar policies. Life insurance agents or companies can give you information about several different kinds of indexes that each work a little differently. One type helps you compare the costs between two policies if you give up the policy and take out the cash value. Another helps you compare your costs if you don't give up your policy before its coverage ends. Some help you decide what kind of questions to ask the agent about the numbers used in an illustration. Each index is useful in some ways, but they all have shortcomings. Ask your agent which will be most helpful to you. Regardless of which index you use, compare index numbers only for similar policies—those that offer basically the same benefits, with premiums payable for the same length of time.

Remember that no one company offers the lowest cost at all ages for all kinds and amounts of insurance. You should also consider other factors:

- How quickly does the cash value grow? Some policies have low cash values in the early years that build quickly later on. Other policies have a more level cash value build-up. A year-by-year display of values and benefits can be very helpful. (The agent or company will give you a policy summary or an illustration that will show benefits and premiums for selected years.)
- Are there special policy features that particularly suit your needs?
- How are nonguaranteed values calculated? For example, interest rates are important in determining policy returns. In some companies increases reflect the average interest earnings on all of that company's policies regardless of when issued. In others, the return for policies issued in a recent year, or a group of years, reflects the interest earnings on that group of policies; in this case, amounts paid are likely to change more rapidly when interest rates change.

#### APPENDIX B

##### Examples of Calculations of the Discontinuity Index

##### Example 1

The first example is a participating whole life policy issued to a male aged 35. The calculation is made on a per \$1,000 basis:

Policy Year	Guaranteed Cash Value	Illustrated		Premium
		Annual Dividend	Terminal Dividend	
1	0.00	0.00	0.00	21.40
2	8.77	2.40	0.00	21.40
3	31.27	2.65	0.00	21.40
4	64.28	2.90	0.00	21.40
5	77.82	3.16	0.00	21.40
6	94.24	3.16	0.00	21.40
7	110.08	3.16	0.00	21.40
8	127.88	3.41	0.00	21.40
9	145.00	3.41	0.00	21.40
10	162.54	3.66	8.00	21.40
11	180.22	4.16	8.00	21.40
12	198.11	4.67	8.00	21.40
13	216.20	5.17	8.00	21.40
14	234.46	5.68	8.00	21.40
15	252.88	6.18	8.00	21.40
16	271.43	6.69	8.00	21.40
17	290.10	7.19	8.00	21.40
18	308.87	7.95	8.00	21.40
19	327.73	8.46	8.00	21.40
20	346.65	9.47	25.00	21.40
21	365.62	10.48	25.00	21.40
22	384.60	11.49	25.00	21.40
23	403.57	12.50	25.00	21.40
24	422.50	13.51	25.00	21.40

25	441.37	14.52	25.00	21.40
26	460.14	15.53	25.00	21.40
27	478.78	16.54	25.00	21.40
28	497.28	17.55	25.00	21.40
29	515.60	18.56	25.00	21.40
30	533.70	19.57	25.00	21.40

The yearly prices, (backward) second differences in yearly prices, and their squares for this policy are:

	(1)	(2)	(3)
Policy Year	Yearly Price	Second Difference in Yearly Price	Second Difference Squared
-1	21.40	—	NA
-2	10.76	—	NA
-3	-2.13	-2.25	NA
-4	-1.70	-12.23	NA
-5	-1.44	-.01	NA
-6	-6.46	-7.55	NA
-7	-6.98	-7.38	NA
-8	-7.29	-.21	-.0441
-9	-7.85	-.25	-.0625
10	-.59	-7.82	-61.1524
11	-8.72	-15.39	-236.8521
12	-8.88	-7.97	-63.5209
13	-9.06	-.02	-.0004
14	-9.28	-.04	-.0016
15	-9.52	-.02	-.0004
16	-9.78	-.02	-.0004
17	10.08	-.04	-.0016
18	10.15	-.23	-.0529
19	10.47	-.25	-.0625
20	-5.84	-16.63	-276.5569
21	11.05	-33.20	-1,102.2400
22	10.98	-16.96	-287.6416
23	10.93	-.02	-.0004
24	10.91	-.03	NA
25	10.91	-.02	NA
26	10.94	-.03	NA
27	11.00	-.03	NA
28	11.06	-.00	NA
29	11.15	-.03	NA
30	11.27	-.03	NA

Column (2) is calculated by subtracting the change observed in the yearly price in year  $t-1$  from the change observed in the yearly price in year  $t$ . For example, the second difference of -16.63 in year 20 is calculated:

$$\begin{aligned} -16.63 &= (-5.84 - 10.47) - (10.47 - 10.15) \\ &= -16.31 - .32 \\ &= -16.63 \end{aligned}$$

Column (3), second difference squared, is the square of the figure in column (2). The sum of the squared second differences between years 8 and 23 is 2028. This sum exceeds by 1528 the test limit for issue age 35 of 500.

#### Example 2

The second example is a guaranteed cost policy issued to a male aged 25. The calculation is made on a per \$1,000 basis:

Policy Year	Guaranteed Cash Value	Illustrated Annual Dividend	Terminal Dividend	Premium
-1	0.00	0.0	0.0	11.34
-2	0.00	0.0	0.0	11.34
-3	0.20	0.0	0.0	11.34
-4	9.77	0.0	0.0	11.34
-5	19.84	0.0	0.0	11.34
-6	30.23	0.0	0.0	11.34
-7	40.95	0.0	0.0	11.34
-8	52.01	0.0	0.0	11.34
-9	63.41	0.0	0.0	11.34
10	75.17	0.0	0.0	11.34
11	87.27	0.0	0.0	11.34
12	99.71	0.0	0.0	11.34

13	112.48	0.0	0.0	11.34
14	125.64	0.0	0.0	11.34
15	138.90	0.0	0.0	11.34
16	152.58	0.0	0.0	11.34
17	166.43	0.0	0.0	11.34
18	180.59	0.0	0.0	11.34
19	195.03	0.0	0.0	11.34
20	224.12	0.0	0.0	11.34
21	230.80	0.0	0.0	11.34
22	252.71	0.0	0.0	11.34
23	268.85	0.0	0.0	11.34
24	284.20	0.0	0.0	11.34
25	299.73	0.0	0.0	11.34
26	315.43	0.0	0.0	11.34
27	331.29	0.0	0.0	11.34
28	347.29	0.0	0.0	11.34
29	363.43	0.0	0.0	11.34
30	379.67	0.0	0.0	11.34

Policy Year	(1) Yearly Price	(2) Second Difference in Yearly Price	(3) Second Difference Squared
1	11.34	—	NA
2	11.34	—	NA
3	11.32	-.02	NA
4	2.06	-9.24	NA
5	2.21	-9.41	NA
6	2.39	-.03	NA
7	2.57	-.00	NA
8	2.76	-.01	-.0001
9	2.96	-.01	-.0001
10	3.16	-.00	-.0000
11	3.40	-.04	-.0016
12	3.65	-.01	-.0001
13	3.93	-.03	-.0009
14	4.26	-.05	-.0025
15	4.59	-.00	-.0000
16	4.97	-.05	-.0025
17	5.37	-.02	-.0004
18	5.78	-.01	-.0001
19	6.19	-.00	-.0000
20	7.08	-17.68	-187.1424
21	15.66	-36.00	1,296.0000
22	51	-37.87	1,434.1369
23	9.00	-22.63	558.3769
24	9.52	-7.97	NA
25	10.08	-.04	NA
26	10.66	-.02	NA
27	11.26	-.02	NA
28	11.88	-.02	NA
29	12.51	-.01	NA
30	13.18	-.04	NA

The sum of the squared second differences between years 8 and 23 for example two is 3476. It exceeds by 3176 the test limit for issue age 25 of 300.

#### APPENDIX C

##### Test Limits for Discontinuity

Drafting Note: The test limits for discontinuity contained in this Appendix were developed by the NAIC Advisory Committee on Manipulation to be applicable to the traditional type of whole life policy. Corresponding test limits need to be developed for other plans. Also, further refinement in the test limits for issue ages over 45 appears necessary.

Issue Age	Test Limit	Issue Age	Test Limit
25 and under	300	36	515
26	325	37	528
27	343	38	541
28	371	39	552
29	392	40	563

30	413	41	572
31	432	42	581
32	451	43	590
33	468	44	595
34	485	45 and over	600
35	500		

## APPENDIX D

## POLICY INFORMATION FOR APPLICANT—UNIVERSAL LIFE POLICY

This information is being provided to help you to understand this policy and to compare it to similar policies, so you can choose the one that is best for you. If you have questions about this form, be sure to ask your agent for an explanation.

{Name of Insurance Company}  
{Address of Insurance Company}

Policy Name: {insert name}  
Form Number: {insert number}

A policy for {Name of Insured(s)}  
Social Security Number(s): {Insert number}  
Date of Birth: {Insert DOB}

Applied for on {insert date}

Your Agent is {Name of Agent}  
{Agent's Address}  
{Agent's Telephone Number}

## POLICY APPLIED FOR

Type of Universal Life Insurance Policy: \_\_\_\_\_ Flexible Premium  
Fixed Premium

{A flexible premium policy means that you may vary the premiums paid subject to any minimum and maximum payments stated in the policy. If you do not pay enough to cover the cost of insurance, part of your cash value will be used. Some policies can lapse without value if premiums are not paid.}

{A fixed premium policy means that you have agreed to pay a scheduled premium on each due date.}

The first year death benefit applied for is \${insert amount}. The death benefit option applied for is {describe the option}.

The first year annual premium is \${insert amount}.

You have agreed to pay premiums {insert frequency} and each premium payment is scheduled to be \${insert amount}.

This information does not include any riders for which you may apply with this policy. Riders give you extra benefits not included in the basic policy. Riders may affect your premium and cash values. Ask your agent for a full explanation of any riders.

Risk Classification Information (as applied for):

M \_\_\_\_\_ F \_\_\_\_\_ Age \_\_\_\_\_ Smoker \_\_\_\_\_ Non-Smoker \_\_\_\_\_

Other \_\_\_\_\_ (Specify) \_\_\_\_\_

## YOUR POLICY CHARGES

The mortality charge is the amount used to pay for the basic insurance death benefit. The current mortality charge is \${insert amount} for the first year, so this much of your first year premium pays for the death benefit. This amount may increase as you get older. In addition, the mortality charge can change. The maximum mortality charge for your current age is \${insert amount}. The company reviews mortality charges every {insert frequency}.

The company's fee for administration of this policy may change from time to time. The current fee is \${insert amount} per {insert period}, so this much of your yearly premium pays for the company's administrative costs. The maximum fee that can be charged is \${insert amount} per {insert period}.

**Expense Deductions** (front end loads) These are additional charges that may be deducted from your premium. The amount of the charge may change depending on how long the policy has been in force. The amount currently being charged in the first year is {insert dollar amount or percentage}, and the maximum charge permitted in the first year is {insert dollar amount or percentage}.

**Surrender charges** (back end loads) are charges you may pay when your policy is surrendered. The current charge is {insert dollar amount or percentage} and the maximum charge permitted is {insert dollar amount or percentage}. Surrender charges are assessed for {insert number} years {in decreasing amounts}.

## YOUR POLICY CREDITS

The part of your premium not used for the above charges earns interest for you. It is the cash surrender value which you can take if you should cancel this policy.

The company has the right to change the interest rates credited to amounts paid into this policy to reflect current investment earnings. The company reviews interest rates every {insert time period}. We guarantee our rates will not go below {insert amount} %.

This policy's interest rate {is/is not} interest indexed. Interest indexing means that the interest rate credited to the amounts paid in to the policy follows a formula based on changes in the {insert index}.

## OTHER IMPORTANT INFORMATION ABOUT THIS POLICY

The company will pay an endowment benefit to the insured if the policy is still in force, and the insured is living and attains the age of [insert number]. This is called the "maturity age." This means the company will pay your [death benefit amount] [cash surrender value] when you have reached the maturity age, instead of waiting until you die.

If interest rates and charges were to be consistent with those illustrated in Chart A, the expenses of the policy could cause it to terminate before the maturity age. This policy would terminate at age [insert number].

Under the Chart A assumptions, the level annual premium required to provide the first year death benefit to maturity age is \$(insert amount).

Based on the current assumption used to develop Chart B, the policy [would/would not] terminate before the maturity age. [If it would, indicate the policy year in which it would terminate.]

## ILLUSTRATION OF POLICY VALUES

Chart A shows the guaranteed minimum interest rate and how your cash value would grow if the illustrated premium and interest rate were credited every year. Chart B shows how your cash value will grow if the interest rate remains at the level currently being paid. In both cases, the effect of any riders added to the policy is not shown.

## CHART A

The following values are based on the interest rates which are guaranteed by the company and based on your timely payment of the premiums in Column 1 as applied for. If you pay a different premium in any year, results will differ.

## CHART B

The following values are based on the current interest rates which the company is crediting on this policy form. Interest rates may increase or decrease from this rate. Also this chart assumes you pay the premiums shown in Column 1 as applied for.

Policy Year	1 Annual Premium	2 Death Benefit	3 Interest Rate	4 Cash Surrender Value at Year End	1* Annual Premium	2 Death Benefit	3 Interest Rate	4 Cash Surrender Value at Year End	Policy Year
{1}									{1}
{2}									{2}
{3}									{3}
{4}									{4}
{5}									{5}
{6}									{6}
{7}									{7}
{8}									{8}
{9}									{9}
{10}									{10}
{11}									{11}
{12}									{12}
{13}									{13}
{14}									{14}
{15}									{15}
{16}									{16}
{17}									{17}
{18}									{18}
{19}									{19}
{20}									{20}

[Fill in other years as needed at five year intervals]

AGE									AGE
{60}									{60}
{65}									{65}
{70}									{70}

[To year of termination or maturity age]

\*The first year annual premium includes any additional amounts to be deposited as applied for.

In addition to interest rates, changes in mortality and expense charges may affect the illustrations in Chart B. Current charges are used to determine the values in Chart B. The maximum guaranteed charges are used to determine the values in Chart A.

## DISCLAIMER NOTICE REGARDING TAX LAW

The information in this "Policy Information for Applicant" is not intended to be used in tax planning nor is it intended for the purpose of providing tax advice. The possibility of future changes in tax laws must be recognized and taken into consideration.

**POLICY INFORMATION FOR APPLICANT  
INDETERMINATE PREMIUM LIFE POLICY**

This information is being provided to help you understand this policy and to compare it to similar policies, so you can choose the one that is best for you. If you have questions about this form, be sure to ask your agent for an explanation.

{Name of Insurance Company}  
{Address of Insurance Company}

Policy Name: {insert name}  
Form Number: {insert number}

A policy for {Name of Insured(s)}  
Social Security Number(s): {insert number}  
Date of Birth: {insert DOB}

Applied for on {insert date}

Your Agent is {Name of Agent}  
{Agent's Address}  
{Agent's Telephone Number}

This information does not include any extra benefit riders which you may apply for with this policy. Riders may affect your premium and cash values. Ask your agent for a full explanation of any riders.

The death benefit applied for is \$(insert amount). The death benefit option applied for is {describe the option}. The first year annual premium is \$(insert amount).

You have agreed to pay premiums {insert frequency} and each premium payment is scheduled to be \$(insert amount).

Risk Classification Information (as applied for):

M \_\_\_\_\_ F \_\_\_\_\_ Age \_\_\_\_\_ Smoker \_\_\_\_\_ Non-Smoker \_\_\_\_\_

Other \_\_\_\_\_ (Specify) \_\_\_\_\_

**OTHER IMPORTANT INFORMATION ABOUT THIS POLICY**

The company has the right to change the amounts of premiums required under this policy. The company reviews amounts of premiums every {insert frequency}. Amounts of premium required will not exceed the amounts shown in Column 2 of the "Illustration of Policy Values." If there are any other limitations on the company's right to change premiums explain here: { }

{If policy is a participating policy include this statement: There may be dividends paid to the policy owner. The "Illustration of Policy Values" does not include any dividends.}

**ILLUSTRATION OF POLICY VALUES**

The following values are based on your timely payment of the premiums required.

(1) Age	(2) Maximum Annual Premium (Guaranteed Assumptions)	(3) Possible Annual Premium (Current Assumptions)	(4) Death Benefit	(5) Cash Surrender Value at Year End
{1}	_____	_____	_____	_____
{2}	_____	_____	_____	_____
{3}	_____	_____	_____	_____
{4}	_____	_____	_____	_____
{5}	_____	_____	_____	_____
{6}	_____	_____	_____	_____
{7}	_____	_____	_____	_____
{8}	_____	_____	_____	_____
{9}	_____	_____	_____	_____
{10}	_____	_____	_____	_____
{11}	_____	_____	_____	_____
{12}	_____	_____	_____	_____
{13}	_____	_____	_____	_____
{14}	_____	_____	_____	_____
{15}	_____	_____	_____	_____
{16}	_____	_____	_____	_____
{17}	_____	_____	_____	_____
{18}	_____	_____	_____	_____
{19}	_____	_____	_____	_____
{20}	_____	_____	_____	_____

{Fill in other years as needed at five year intervals}  
**DISCLAIMER NOTICE REGARDING TAX LAW**

The information in this "Policy Information for Applicant" is not intended to be used in tax planning nor is it intended for the purpose of providing tax advice. The possibility of future changes in tax laws must be recognized and taken into consideration.

### INSTRUCTIONS FOR FILLING IN "POLICY INFORMATION FOR APPLICANT - UNIVERSAL LIFE POLICY"

The completed policy information statement may be delivered at, or before, the time an application is made. If the completed policy information statement is not delivered at the time of application, it must be delivered within fifteen working days after application is made, but at least five days before delivery of the policy except as provided in the next sentence. If the policy is delivered sooner than five days after the completed policy information statement is delivered, then the free look period shall be extended to fifteen days. This policy information statement is required in connection with all applications for universal life policies, except where the policy is solicited by direct mail.

If any of the information on this policy information statement changes between the date when it is delivered and the date the policy is delivered, then a revised policy information statement based on the changed information must be delivered at the same time as the policy. In any such case, a written notice shall be furnished which outlines the major reason for the change. For example, the notice might state that the "Interest Rate" shown in Chart B has changed. As another example, the applicant could have applied as a standard risk and after underwriting been found to be a substandard risk requiring higher mortality charges.

**"Joint Life Policy":** If the policy applied for is a joint policy, fill in the name, social security number, and date of birth of both persons under "Name of Insured." Also, fill in the blanks under "Risk Classification Information" on that sheet in duplicate with appropriate information on the sex, smoking status and age for each person, and indicating identity for each classification.

#### POLICY APPLIED FOR

**"Risk Classification Information (as applied for)":** If the insurance company does not distinguish between smokers and non-smokers for the policy applied for, check neither "smoker" or "non-smoker." Instead, fill in "composite" following the word "other" in the line below.

If the insured applies for a policy on a substandard basis, this should be disclosed following the word "other."

#### YOUR POLICY CHARGES

All of the information in this section continues to assume that the policy does not contain any extra benefit riders that require an additional premium or additional periodic charge.

**Mortality Charge:** Fill in the blank with the current mortality charge for Year 1. The paragraph also includes wording where it can be indicated whether the maximum mortality charge increases each year. All blanks in this paragraph must be filled in on the basis of an annual mortality charge, even if the insurance company actually makes calculations monthly. (In such cases, the annual mortality charge would be twelve times the applicable monthly charge.)

The paragraph also provides for information on the maximum mortality charge.

Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" for Year 1 must be calculated consistently with the amount filled in for this blank—subject to the two notes in the paragraph which follows.

Note, that if a negative Year 1 cash surrender value is generated by the calculation, the illustrated "Cash Surrender Value at Year End" for Year 1 in Chart A must be shown as zero. Note also that some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. In such cases, the illustrated "Cash Surrender Value at Year End" for Year 1 in Chart A must be filled in consistently with the provisions in policy language.

Since Chart B illustrates current values, the "Cash Surrender Value at Year End" for Year 1 must be calculated consistently with the amount filled in as the current mortality charge, subject to the two notes in the paragraph above which refers to Chart A, and are also true of Chart B.

**Fee for Administration:** The policy information statement contains blanks for both the current and the maximum fee for administration. For the purpose of filling in these blanks, a "fee for administration" refers to any type of charge made by the insurance company, other than a mortality charge, which is applied whether or not a premium is paid and which is required to maintain the policy in force. If the policy language makes no provision for a fee for administration, these blanks must be filled in with appropriate wording such as "none."

If there are such fees, the fill-in must describe those fees on a current basis and indicate the frequency with which the fee is charged. If the fee is only charged for a limited period, indicate that here. Thus, in the case of a universal life policy on which the current fee was \$5 each month for the first five years only, the paragraph could say: \$5 each month for the first five years, no fee thereafter."

In some cases, the policy language may provide for such a fee, but it is not currently being charged by the insurance company. In the case of such a policy, this paragraph could state: "No fee is currently being charged; however, policy language permits such a fee during the first five years."

Since Chart B illustrates current values, the "Surrender Value at Year End" amounts must be calculated consistently with the current fee for administration, if there is such a fee. However, this is subject to the two notes in the paragraph which follows.

Note that if any negative cash surrender values are generated by the calculations, the illustrated "Cash Surrender Value at Year End" in Chart B must be shown as zero for such years. Note also that some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. In such cases, the illustrated "Cash Surrender Value at Year End" in Chart B must be filled in consistently with the provisions in the policy language.

Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" amounts must be calculated consistently with the maximum fee for administration, if there is such a fee. However, this is subject to the two notes in the paragraph above which described Chart B, and are also true of Chart A.

**"Expense Deductions (Front End Loads)":** The policy information statement contains blanks for both the current and the maximum expense deductions. For the purpose of filling in these blanks, an "expense deduction" refers to a charge which is deducted by the insurance company when premiums are paid—but not otherwise.

These expense deductions are sometimes called "front end loads" because they are deducted immediately after premiums are paid. Therefore, they affect the amount earning interest under the policy while that policy is maintained in force.



If the policy language makes no provision for an expense deduction, these blanks must be filled in with appropriate wording such as "none."

Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" amounts for year one must be calculated consistently with the maximum expense deductions, if there are such deductions. However, this is subject to the two notes in the paragraph which follows.

Note that if any negative cash surrender values are generated by the calculations, the illustrated "Cash Surrender Values at Year End" in Chart A must be shown as zero for such years. Note also that some fixed premium universal life policies define cash surrender values as the larger of two separate quantities. In such cases, the illustrated Surrender Values at Year End in Chart A must be filled in consistently with the provisions in the policy language.

Since Chart B illustrates current values, the "Cash Surrender Value at Year End" amounts for year one must be calculated consistently with the current expense deductions, if there are such deductions. However, this is subject to the two notes in the paragraph above which referred to Chart A, and are also true of Chart B.

**"Surrender Charges (Back End Loads)"**—The policy information statement contains blanks for both the current and the maximum surrender charge. For the purpose of filling in these blanks, a "surrender charge" refers to a charge which is deducted by the insurance company if the policy is surrendered for its cash surrender value but not otherwise.

The surrender charges are sometimes called "back end loads" because they do not affect the amount earning interest under the policy, while that policy is maintained in force.

If the policy language makes no provision for a surrender charge, this blank must be filled in with appropriate wording such as "none." If the charges decrease as the years pass, indicate how at the end of the paragraph. For example the paragraph could say: "Year 1—\$400, Year 2—\$375, reducing by \$25 each year until it reaches 0 at Year 13."

A surrender charge must be disclosed if the policy contains a provision that this surrender charge can be charged under certain conditions, even if it is waived by the insurance company under other conditions. (Such provisions are commonly called "bail-out" provisions.)

Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" amounts must be calculated consistently with the maximum surrender charges, if there are such charges. However, please see the two notes in the paragraph which follows.

Note that if any negative cash surrender values are generated by the calculations, the illustrated "Cash Surrender Values at Year End" in Chart A must be shown as zero for such years. Note also that some fixed premium universal life policies define cash surrender values as the larger of two separate quantities. In such cases, the illustrated Surrender Values at Year End in Chart A must be filled in consistently with the provisions in the policy language.

Since Chart B illustrates current values, the "Cash Surrender Value at Year End" amounts must be calculated consistently with the current surrender charges, if there are such charges. However, please see the two notes in the paragraph above which referred to Chart A, and are also true of Chart B.

#### YOUR POLICY CREDITS

The fill-ins should be consistent with Charts A and B to the extent applicable.

#### OTHER IMPORTANT INFORMATION ABOUT THIS POLICY

**Maturity Age**—This must be filled in consistently with the policy language.

If, under the assumptions of Chart A, termination would occur during one of the years illustrated in that chart, indicate year.

If, under the Assumptions of Chart B, termination would occur during one of the years illustrated in that chart, indicate year. Since Chart B is based on current assumptions, the policy year of termination under chart B may be a later year than the policy year of termination under Chart A.

#### ILLUSTRATION OF POLICY VALUES

If "flexible premium policy" is checked, Charts A and B are based on a policy with level annual premiums and level death benefits, except that there may be an additional amount assumed to be deposited in year one as illustrated in Charts A and B. This policy is assumed not to contain any extra benefit riders that require an additional premium or additional periodic charge. This policy is also assumed not to have any policy loans against it at any time.

If "fixed premium policy" is checked, Charts A and B are based on a policy with annual premiums and death benefits consistent with automatic options in the language of the policy applied for. This policy is assumed not to contain any extra benefit riders that require an additional premium or periodic charge. This policy is also assumed not to have any policy loans against it at any time.

**"Age 60"**—Both Chart A and Chart B contains lines for "Age 60" in the "Year" columns. "Age 60" refers to the year that the insured would have attained age 60 by the end of that year. For example, if the issue age of the insured is filled in as 34, "Age 60" refers to the year that the insured would have attained age 60 at the end of that year. If the issue age is 34, "Age 65" would refer to the 31st year. The same rule will hold true for the other ages required to be listed.

**"Chart A"**—Chart A is an illustration on a "Guaranteed Basis," assuming that the insurance company consistently credits interest at the minimum rate permitted by the language in the policy, and that all charges and deductions are the maximums permitted by the policy language. However, as stated above, it is assumed that the policy contains no extra benefit riders requiring an additional premium or periodic charge.

The following instructions apply to Chart A if "flexible premium policy" is checked:

(1) The "Annual Premium" must be a level amount equal to the "First Year Annual Premium" shown, except that the "Annual Premium" must be shown as zero if there is no death benefit provided by the policy during that year, provided, however, that there may be an additional amount assumed to be deposited in year one as illustrated in Charts A and B.

(2) The "Death Benefit" shall be an amount equal to the "First Year Death Benefit" (but increased if the amount earning interest under the policy is so large that an increase in death benefit is generated by the policy language). However, if a

death benefit equal to the "First Year Death Benefit" cannot be provided for the entire year, the death benefit for that year shall be filled in as the "First Year Death Benefit" followed by a slash mark and a zero. The "Policy Information for Applicant" form may provide, but is not required to provide, an explanatory footnote to indicate how long into that particular year the "First Year Death Benefit" could be provided. The "Death Benefit" shall be shown as zero for any subsequent years.

(3) The "Interest Rate" column must disclose the applicable guaranteed interest rate, used in calculating the amounts in the "Cash Surrender Value at Year End" column. These guaranteed interest rates must be consistent with the guaranteed interest rates described in the policy. However, these guaranteed interest rates must be filled in on an annual interest rate basis. An equivalent annual interest rate must be filled in, if the "Cash Surrender Value at Year End" is determined by making monthly calculations for each twelve months.

(4) The "Cash Surrender Value at Year End" must be filled in as the amount which would actually be paid as a cash surrender value. If the cash surrender value would be negative at the end of any year which is illustrated, the "Cash Surrender Value at Year End" must be shown as zero for that year. Some universal life policies contain provisions for surrender charges which are deducted under certain conditions, but not under others. (Such provisions are commonly called "bail-out" provisions.) The surrender values for policies containing such provisions must be illustrated assuming that the insurance company can and will deduct the maximum surrender charge.

(5) The lines for "Age 60," "Age 65" and "Age 70" and on must be filled in unless the following sentence applies. This is not required if either (a) the "Death Benefit" is filled in as zero in Chart A for the twentieth year or (b) the "Death Benefit" would go down to zero before the year in which insured would attain age 60 at the end of the year. Guaranteed assumptions are used in testing for this possibility. Please see the note above in these instructions describing "Age 60," for additional information concerning these lines.

To fill in Chart A if "fixed premium policy" is checked, use the same principles described above for a flexible premium policy with the following three exceptions. First, the "Annual Premium" column must be filled in using annual premiums actually described in the universal life fixed premium policy, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of premiums. Second, the "Death Benefits" column must be filled in using the appropriate actual death benefits provided under the policy in each year, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of death benefits and also assuming that the premiums are paid consistently with the amounts of premiums shown in the "Annual Premiums" column. Third, some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. The "Cash Surrender Value at Year End" column must be filled in consistently with any such provision in the policy language.

"Chart B"—Chart B is an illustration on a "Current Basis," assuming that the company consistently credits interest at current interest rates, and all charges and deductions are also on a current basis. These current interest rates, current charges and deductions are not guaranteed. The insurance company has the right to change these current interest rates, charges and deductions to the extent described in the contract. However, as stated above, it is assumed that the policy contains no extra benefit riders requiring an additional premium or periodic charge.

The following instructions apply to Chart B if "flexible premium policy" is checked.

(1) The "Annual Premium" must be a level amount equal to the "First Year Annual Premium" shown, except that the "Annual Premium" must be shown as zero if there is no death benefit provided by the policy during that year, provided, however, that there may be an additional amount assumed to be deposited in year one as illustrated in Charts A and B. Since Chart B is based on current assumptions, the "Annual Premium" will in some cases become zero in a later year under Chart B than under Chart A.

(2) The "Death Benefit" shall be an amount equal to the "First Year Death Benefit" (but increased if the amount earning interest under the policy is so large that an increase in death benefit is generated by the policy language). However, if a death benefit equal to the "First Year Death Benefit" cannot be provided for the entire year, the death benefit for that year shall be filled in as the "First Year Death Benefit" followed by a slash mark and a zero. The "Policy Information for Applicant" form may provide, but is not required to provide, an explanatory footnote to indicate how long into that particular year the "First Year Death Benefit" could be provided. The "Death Benefit" shall be shown as zero for any subsequent years. Since Chart B is based on current assumptions, the "Death Benefit" may become zero in a later year under Chart B than Chart A.

(3) The "Interest Rate" column must disclose the applicable interest rate, used in calculating the amounts in the "Cash Surrender Value at Year End" column. No increase in this interest rate can be illustrated for future years, unless such an increase is specifically described and guaranteed in the policy language. However, the current interest rates must be filled in on an annual interest rate basis. An equivalent annual interest rate must be filled in, if the "Cash Surrender Value at Year End" is determined by making monthly calculations for each twelve months.

(4) The "Cash Surrender Value at Year End" is the amount which would actually be paid as a cash surrender value. Chart B is intended to illustrate cash surrender values on a current basis, and not on the basis of non-guaranteed future improvements that may be anticipated or hoped for. No enhancement or increment can be illustrated in Chart B unless such enhancement or increment is specifically described and guaranteed in the policy language. If the cash surrender value would be negative at the end of any year which is illustrated, the "Cash Surrender Value at Year End" must be shown as zero for that year. Some universal life policies contain provisions for surrender charges which are deducted under certain conditions, but not under others. (Such provisions are commonly called "bail-out" provisions.) The surrender values for policies containing such provisions must be illustrated assuming that the insurance company can and will deduct the current surrender charge.

(5) The lines for "Age 60," "Age 65" and "Age 70" and on must be filled in unless the following sentence applies. This is not required either if (a) the "Death Benefit" is filled in as zero in Chart B for the twentieth year, or (b) the "Death Benefit"

would go down to zero before the year in which the insured would attain age 60 at the end of the year. Current assumptions are used in testing for this possibility. Please see the note above in these instructions, describing "Age 60" for additional information concerning these three lines.

To fill in Chart B if "fixed premium policy" is checked, use the same principles described above for a "flexible premium policy" with the following three exceptions. First, the "Annual Premium" column must be filled in using annual premiums actually described in the universal life fixed premium policy, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of premiums. Second, the (b) Vacancies in the office of President, Vice President or Recording Secretary may be filled by the Executive Committee for the remaining period until the next Plenary Session of the NAIC. In the event of such vacancy, the Chairman of the Executive Committee, or in case of his inability to act from any cause, the Vice Chairman, or if he is unable, the President, may call a meeting of or conduct a mail ballot among the members of the Executive Committee to fill such vacancy until the next Plenary Session of the NAIC. If the vacancy is that of Chairman of the Zone, Vice Chairman of the Zone or Secretary of the Zone, the Chairman of the Zone, or in his absence, the Vice Chairman, shall immediately call a meeting of or conduct a mail ballot among the members of the Zone to fill such vacancy. In the event the immediate past President is unable, for any reason, to act as Vice Chairman of the Executive Committee, the membership of the Executive Committee shall elect one of their number to act as Vice Chairman, but no vacancy on the Executive Committee shall result from such inability of the immediate past President or from such election of a member to act as Vice Chairman. In the event the most immediate past president ceases to be a member of the NAIC, the office of vice chairman of the Executive Committee shall be filled automatically by the member who is the next most immediate past president. "Death Benefits" column must be filled in using the appropriate actual death benefit provided under the policy in each year, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of death benefits and also assuming that the premiums are paid consistently with the amounts of premiums shown in the "Annual Premiums" column. Third, some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. The "Cash Surrender Value at Year End" column must be filled in consistently with any such provision in the policy language.

#### INSTRUCTIONS FOR FILLING IN "POLICY INFORMATION FOR APPLICANT--INDETERMINATE PREMIUM LIFE PLANS"

The completed policy information statement may be delivered at, or before, the time an application is made. If the completed policy information statement is not delivered at the time of application, it must be delivered within fifteen working days after application is made, but at least five days before delivery of the policy except as provided in the next sentence. If the policy is delivered sooner than five days after the completed policy information statement is delivered, then the free look period shall be extended to fifteen days. This policy information statement is required in connection with all applications for indeterminate premium life policies, except where the policy is solicited by direct mail.

If any of the information filled in on this policy information statement changes between the date when it is delivered and the date the policy is delivered, then a new revised policy information statement based on the changed information must be delivered at the same time as the policy. In any such case, a written notice shall be furnished which outlines the major reason for the change. For example, the applicant could have applied as a standard risk and after underwriting been found to be a substandard risk requiring higher premium rates.

"Joint Life Policy": If the policy applied for is a joint policy, fill in the name, social security number and date of birth of both persons under "Name of Insured." Also, fill in the blanks under "Risk Classification Information" on that sheet in duplicate with appropriate information on the sex, smoking status and age for each person and indicating identity for each classification.

"Risk Classification Information (as applied for)": If the insurance company does not distinguish between smokers and non-smokers for the policy applied for, check neither "smoker" or "non-smoker." Instead, fill in "composite" following the word "other" in the line below.

If the insured applies for a policy on a substandard basis, this should be disclosed following the word "other."

#### OTHER IMPORTANT INFORMATION ABOUT THIS POLICY

"The company reviews amounts of premiums every \_\_\_\_." This blank must be filled in with a period of time, such as "month," "quarter" or "year." Of course, the fill-in must be appropriate for the manner in which the insurance company makes calculations under the policy applied for.

If there are any limitations on the company's right to change premiums, describe any such limitations which may apply. This would include calling attention to any provision in the policy language which could prevent the insurance company from charging the maximum premiums shown in the illustration on Page 2 of the policy information sheet.

#### ILLUSTRATION OF POLICY VALUES

The values in this illustration are based on a policy with annual premiums and death benefits consistent with automatic options in the language of the policy applied for. This policy is assumed not to contain any extra benefit riders that require an additional premium or periodic charge. This policy is also assumed not to have any policy loans against it at any time.

Maximum Annual Premiums (Guaranteed Assumptions) — The blanks in this column must be filled in with the maximum annual premium which is allowed under the policy language for the basic policy, but not including the additional premium for any extra benefit riders. For Year 1, this must be equal to the "First Year Annual Premium" shown elsewhere on Page 1 of the policy information statement.

Possible Annual Premium (Current Assumptions) — the blanks in this column must be filled in with the amount of annual premium which would be charged under the insurance company's current non-guaranteed premium rate schedule, but not including the additional premium for any extra benefit riders. For Year 1, this must be equal to the "First Year Annual Premium" shown elsewhere on Page 1 of the policy information statement.

The "Death Benefit" column must be filled in with the amount of death benefit provided at the beginning of the year under the basic policy, but not including the death benefit for any riders that require an additional premium. For Year 1, this must be identical to the "Death Benefit," shown elsewhere on Page 1 of the policy information statement.

The "Cash Surrender Value at Year End" column must be filled in with the amount which would actually be paid as a cash surrender value, under the basic policy. The cash value of any extra benefit riders, requiring an extra premium, is not included. If the cash surrender value would be negative at the end of any year which is illustrated, the "Cash Surrender Value at Year End" must be shown as zero for that year.

## APPENDIX E

## FINANCIAL REVIEW OF THIS POLICY

NOTICE: You have thirty (30) days to review your policy and, if not entirely satisfied, to return it for a full refund of any premium paid.

[This is a guaranteed issue policy offered without an attempt to classify risks by determining your state of health. Premiums may have been lower if health information had been obtained.]

Applicant Information:

This is a policy issued on the basis of the answers to the health questions set forth in the application. Premiums may have been lower if further health information had been obtained.]

This is a policy where the accumulated premium exceeds the death benefit in ten years or less.]

NAME: \_\_\_\_\_ AGE: \_\_\_\_\_ SEX: \_\_\_\_\_

List other personal information used in determining the premium for this policy:

End of Policy Year	<sup>1</sup> Premiums	<sup>2</sup> Premiums Accumulating Interest at 5%*	<sup>3</sup> Death Benefits**	<sup>4</sup> Cash Surrender Value	<sup>5</sup> Column 3 Minus Column 2 Net Gain (Net Loss)
1					
2					
3					
4					
5					
6					
7					
8					
9					
10					

Definitions: The following terms used in the above chart are defined as:

1. **Premiums** - Amount you must pay each year to keep this policy in force.
2. **Premiums Accumulating Interest at 5%** - The amount which could be earned if, instead of purchasing insurance, the dollars were left to accumulate at 5% interest.
3. **Death Benefits** - The amount that will be paid upon your death exclusive of any supplementary benefits.
4. **Cash Surrender Value** - The amount the insurance company will pay you if you surrender your policy to the company for cash.
5. **Net Gain or Loss** - This column shows whether your money would have earned more or less at 5% interest than your life insurance benefit.

\*Note: This figure does not take into account the cost of insurance, any dividends or additional benefits which are not guaranteed under the policy, nor potential preferential tax implications.

\*\*Agent/Company: If death benefits have been explained in any manner other than shown on the above chart (through use of GPI index, dividends, or other non-guaranteed increase or a reduction in premium), a copy of the illustration signed by the applicant and agent must be attached.]

## Appendix F

## GUIDE TO BUYING LIFE INSURANCE AFTER AGE 60

— This guide is designed to help you review your life insurance policy. Like many financial products, life insurance is regulated to protect buyers. It's not possible to discuss all of the consumer protections in this guide. Also, they vary from state to state. This guide discusses two items of particular importance to older buyers, the "free look" period and the Financial Review of This Policy form.

— You will also receive a Life Insurance Buyer's Guide. It has additional information you may wish to review. Both guides were prepared by the National Association of Insurance Commissioners, an association of state insurance officials. Neither guide endorses any company or policy.

**"Free Look" Period**

— With every new policy, your state requires insurance companies to provide policyholders with a "free look" period. During that period you can reconsider your decision to purchase the policy. Your policy has a 30-day "free look" period. If you choose to cancel during the "free look" period, the company must refund the premium paid (premiums are the amount you pay for coverage). The clock starts ticking when you receive the policy.

— The "free look" period is the time for you to decide if the life insurance policy meets your needs.

**Financial Review**

— To help you make a financial evaluation of your policy, before you make your final decision to keep it, insurance regulations in your state require life insurance companies to furnish some buyers over age 60 with a financial review of their policy. This review displays your policy's premiums, death benefits (the amount your beneficiary, the person you designate, receives after death) and cash values (the amount available if you cancel). Not every buyer over 60 will receive this form. Persons receiving the form purchased a policy where:

- Premiums for the policy, plus 5 percent interest, compounded annually, exceed death benefits at some time during the first 10 years; or
- Death benefits are limited for some period after the policy is issued (for example, a policy that limits death benefits for the first two years).

Drafting note: State law may require full death benefits for accidental death.

— The review form is an individual analysis of your policy. It's displayed on a form called a "Financial Review of This Policy." The review is designed to help you decide if this policy makes financial sense for you and your family.

— This guide uses two examples to let you see how the review form works with two different policies. These are real policies purchased by people over age 60. The policy you buy will almost surely be different from these two. Nevertheless, these illustrations should help you evaluate your policy.

**Marvin Policyholder**

— Marvin Policyholder is 77 years old and bought an increasing benefit life policy. Even though he pays premiums over a 10-year period, his death benefits begin on day one. The policy returns an increasing death benefit as long as Marvin pays his annual premium of \$507.38 (\$5,073.80 over 10 years). The death benefit starts at \$1,500.00 and increases by \$75.00 each year. Marvin received a copy of his policy and the review form at the same time.

— Forms may vary from state to state, but Marvin's looked like this:

**FINANCIAL REVIEW OF THIS POLICY**

Notice: You have thirty (30) days to review your policy and, if not entirely satisfied, to return it for a full refund of any premiums paid.

[ ] This is a guaranteed issue policy offered without an attempt to classify risks by determining your state of health. Premiums may have been lower if health information had been obtained.

[x] This is a policy issued on the basis of the answers to the health questions set forth in the application. Premiums may have been lower if further health information had been obtained.

[x] This is a policy where the accumulated premium exceeds the death benefit in 10 years or less.

Applicant information:

Name: Marvin Policyholder Age: 77 Sex: M List other personal information used in determining the premium for this policy:

End of Policy Year	1 Premiums	2 Premiums Accumulating Interest at 5%*	3 Death Benefits	4 Cash Surrender Value	5 Column 3 minus Column 2 Net Gain (Net Loss)
1	\$507.38	\$532.74	\$1500.00	\$45.66	\$967.26
2	\$507.38	\$1092.12	\$1575.00	\$206.79	\$482.88
3	\$507.38	\$1679.47	\$1650.00	\$374.59	\$(29.47)
4	\$507.38	\$2296.19	\$1725.00	\$559.79	\$(571.19)
5	\$507.38	\$2943.75	\$1800.00	\$737.55	\$(1143.75)
6	\$507.38	\$3623.68	\$1875.00	\$938.06	\$(1743.68)
7	\$507.38	\$4337.60	\$1950.00	\$1157.15	\$(2387.60)
8	\$507.38	\$5087.23	\$2025.00	\$1402.34	\$(3062.23)
9	\$507.38	\$5874.33	\$2100.00	\$1684.77	\$(3774.33)
10	\$507.38	\$6700.79	\$2175.00	\$2090.76	\$(4525.79)

Definitions: The following terms used in the above chart are defined as:

1. Premiums—Amount you must pay each year to keep this policy in force.
2. Premiums Accumulating Interest at 5%—The amount which could be earned if, instead of purchasing insurance, the dollars were left to accumulate at 5% interest.
3. Death Benefits—The amount that will be paid upon your death exclusive of any supplementary benefits.

4. **Cash Surrender Value**—The amount the insurance company will pay you if you surrender your policy to the company for cash.

5. **Net Gain or Loss**—This column shows whether your money would have earned more or less at 5% interest than your life insurance benefit.

**\*Note:** This figure does not take into account the cost of insurance, any dividends or additional benefits which are not guaranteed under the policy, nor potential preferential tax implications.

If death benefits have been explained in any manner other than shown on the above chart (through use of CPI index, dividends, or other non-guaranteed increase or a reduction in premium), a copy of the illustration signed by the applicant and agent must be attached.

At the top of the form (below the line discussing the 30-day "free look" period) are three boxes. The insurance company checked the second box because Marvin's policy was underwritten. He was required to answer several health questions on his application.

The third box was checked because Marvin's premiums at 5 percent compound interest, exceed death benefits before the end of 10 years. This occurs in the third year. Whenever premiums accumulated at 5 percent interest exceed benefits within the first 10 years of a policy, the insurance company is required to check this box.

Next comes Marvin's name, age, and so on. Below that are six columns of information about his policy. Columns 1, 2, 3, and 5 explain in more detail the relationship between the actual premiums Marvin paid, and what would have been the result if he had put money in a 5 percent compound interest account instead. It also displays how the death benefits increase.

**End of Policy Year**—This column gives the time frame on which columns 1 through 5 are based. That is, how do premiums and benefits, and cash surrender values, all of which change, compare at the end of each year for 10 years.

**Premiums**—This column (Number 1) shows that Marvin pays \$507.38 a year for each of the 10 years shown in the chart. At the end of the 10-year period, Marvin has paid \$5073.80.

**Premiums Accumulating at 5%**—Here the form (column Number 2) provides Marvin with another way of looking at his life insurance policy. If his premium dollars were deposited every year in a savings instrument, an annuity or other financial product, earning 5 percent compound interest instead of buying this policy, how would they perform?

Life insurance really isn't a savings investment. For example, Marvin's eligible for \$1500 in death benefits on day one even though he paid only \$507.38. In addition, these benefits aren't taxed. Both of these could be to his advantage. On the other hand he also needs to look at how much it costs for these death benefits over time.

**Death Benefits**—Column Number 3 indicates the amount of the death benefits his policy provides as long as Marvin pays his premiums. Benefits with Marvin's policy increase every year during the first 10 years by an amount of \$75. This amount increases over the life of the policy.

**Cash Surrender Value**—This column (Number 4) tells Marvin how much he would receive if he cancels his policy. This amount increases over the life of the policy. Not all policies, however, provide a cash surrender value\*.

\*Term insurance, for example, does not. See Life Insurance Buyer's Guide for more information.

**Net Gain, Net Loss**—The last column (Number 5) provides Marvin with cost-benefit information. It is a comparison of columns 2 and 3. Notice the column changes every year. Column 5 tells Marvin:

- For the first two years, his policy has a net gain (\$967.26 in year one, and \$482.88 in year two);
- In the third year, however, there is a net loss. His policy reports a net loss every year after that. Whenever there is a loss, it is reported inside parenthesis such as (\$20.47).

This is important information. Marvin needs to weigh this comparison with his reasons for buying life insurance and then decide if this policy best meets his needs.

#### Marla Policyholder

Now let's look at a policy purchased by Marla Policyholder. She is a 65-year-old woman who purchased a guaranteed issue policy. This means no health questions are asked. Her policy's death benefits are reduced for the first two years. Death benefits are \$470 at the end of the first year, and \$940 at the end of the second. After the third year, however, they rise to \$3880.

Her financial review looked like this:

#### FINANCIAL REVIEW OF THIS POLICY

**Notice:** You have thirty (30) days to review your policy and, if not entirely satisfied, to return it for a full refund of any premiums paid.

[x] This is a guaranteed issue policy offered without an attempt to classify risks by determining your state of health. Premiums may have been lower if health information had been obtained.

[ ] This is a policy issued on the basis of the answers to the health questions set forth in the application. Premiums may have been lower if further health information had been obtained.

[ ] This is a policy where the accumulated premium exceeds the death benefit in 10 years or less.

#### Application Information:

Name: Marla Policyholder Age: 65 Sex: F

List other personal information used in determining the premium for this policy:

End of Policy Year	1 Premiums	2 Premiums Accumulating Interest at 5%*	3 Death Benefits	4 Cash Surrender Value	5 Column 3 minus Column 2 Net Gain (Net Loss)
1	\$235.20	\$246.96	\$470.40	\$0.00	\$223.44
2	\$235.20	\$506.27	\$940.80	\$72.00	\$434.53
3	\$235.20	\$778.54	\$3880.00	\$96.00	\$3101.46
4	\$235.20	\$1064.43	\$3880.00	\$120.00	\$2815.57
5	\$235.20	\$1364.61	\$3880.00	\$140.00	\$2515.39
6	\$235.20	\$1679.80	\$3880.00	\$160.00	\$2200.20
7	\$235.20	\$2010.75	\$3880.00	\$176.00	\$1869.25
8	\$235.20	\$2358.25	\$3880.00	\$184.00	\$1521.75
9	\$235.20	\$2723.12	\$3880.00	\$188.00	\$1156.88
10	\$235.20	\$3106.24	\$3880.00	\$184.00	\$773.76

Definitions: The following terms used in the above chart are defined as:

1. **Premiums**—Amount you must pay each year to keep this policy in force.
2. **Premiums Accumulating Interest at 5%**—The amount which could be earned if, instead of purchasing insurance, the dollars were left to accumulate at 5% interest.
3. **Death Benefits**—The amount that will be paid upon your death exclusive of any supplementary benefits.
4. **Cash Surrender Value**—The amount the insurance company will pay you if you surrender your policy to the company for cash.
5. **Net Gain or Loss**—This column shows whether your money would have earned more or less at 5% interest than your life insurance benefit.

\*Note: This figure does not take into account the cost of insurance, any dividends or additional benefits which are not guaranteed under the policy, nor potential preferential tax implications.

If death benefits have been explained in any manner other than shown on the above chart (through use of CPI index, dividends, or other non-guaranteed increase or a reduction in premium), a copy of the illustration signed by the applicant and agent must be attached.

As you can see, Marla's policy is very different. The major differences are: (1) death benefits exceed premiums accumulating at 5 percent for all 10 years, and (2) death benefits are limited for the first 2 years.

Box number one is checked because this is a guaranteed issue policy. No health questions were asked of Marla. Therefore, the second box wasn't checked. This third box wasn't checked because benefits exceed premiums accumulating at 5 percent for all 10 years. Let's now look at how the policy compares in the five columns of information:

**Premiums**—Marla pays \$235.20 a year for 10 years for a total of \$2352.00.

**Premiums Accumulating at 5%**—The amount in this column is less than the amount if death benefits are payable in each of the first ten policy years.

**Death Benefits**—Marla's death benefits are reduced for the first two years and then are \$3,880.00 for the next eight years.

**Cash Surrender Value**—Cash surrender values are low with Marla's policy.

**Net Gain, Net Loss**—Marla's policy consistently reports a net gain for the first 10 years. This means her life insurance death benefits are greater than premiums accumulating at 5 percent interest for the first 10 years.

Part of the difference between Marvin and Marla's policies is tied to the fact that Marla is younger and she's a woman. Life insurance premiums are usually based on age and sex.

The difference between these policies is also related to the fact that different companies offer different policies. It's up to you to choose what's best for you. You should review your reasons for buying life insurance, your age, and health. In addition, a careful financial review of your policy is needed. This guide is designed to help you review your life insurance policy.

You should also read your policy carefully before deciding to keep it. If you have any questions or if anything is unclear, contact your agent, the insurance company, or your state insurance commissioner.

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#### ATTACHMENT FOUR

Suitability Working Group  
Atlanta, Georgia  
October 3, 1999

The Suitability Working Group of the Life Insurance and Annuities (A) Committee met in Atlanta, GA, on Oct. 3, 1999. Paul DeAngelo (NJ) chaired the meeting. The following working group members were present: Lester Dunlap, Vice Chair (LA); Robert Heisler (IL); Rosanne Mead (IA); Marilyn Burch (KS); Scott Borchert and Paul Hanson (MN); Cindy Amann (MO); David Sky (NH); Frank Stone (OK); Joel Ario (OR); and Rhonda Myron (TX).

#### 1. Consider Advertisements of Life Insurance and Annuities Model Regulation

Mr. DeAngelo reported that he redrafted the Life Insurance and Annuities Model Regulation (Attachment Four-A) based on the decisions made at two conference calls of the working group. Mr. Ario asked if it was the goal to finalize the document during

the Fall National Meeting and Mr. DeAngelo responded that he thought it would be realistic to set the Winter National Meeting as the time to complete the model.

Mr. DeAngelo outlined the changes to the regulation that he made in response to the conference calls. Mr. Sky asked the regulators to consider whether Section 5J could be made broader. He asked if they were carving out annuities from Subsection J for a reason and suggested deleting the word "life" in two places in Subsection J. Mr. DeAngelo said that, if this issue is not covered elsewhere, he would like to see a new paragraph added to address that issue. Mr. Sky agreed to bring suggested language to the interim conference call for the working group to consider.

Mr. DeAngelo discussed Section 5N as compared to the Life Disclosure Model Regulation. He said he thought the language in the Life Disclosure Model Regulation is stronger than that included in this draft, and he expressed a preference for that language. He said the agreement during the conference call was to put in language from the Unfair Trade Practices Act, and so that is what he did. Mr. Ario agreed because he thought that almost anyone could say that he was not "only" selling policies. Mr. DeAngelo suggested further consideration of that issue during a conference call in early November. Mr. DeAngelo asked the regulators to consider this alternative language, which reads, "Terms such as financial planner, investment advisor, financial consultant or financial counseling shall not be used to imply that the insurance agent is primarily engaged in an advisory business in which compensation is unrelated to sales unless that is the case." Mr. DeAngelo noted that the authority to adopt this regulation comes from the Unfair Trade Practices Act and asked if regulators could draft a regulation that is broader. Mr. Ario said he would argue that the language suggested by Mr. DeAngelo adds precision to the vague language of the Unfair Trade Practices Act.

Mr. Dunlap asked the working group to consider Section 5Y. He said it seems to imply that insurance departments can regulate preneed funeral contracts. He said that, in his state, insurance regulators can only regulate life insurance used to fund pre-need funeral contracts. Mr. DeAngelo said he thought the intention of this section is to regulate insurance and suggested that perhaps the definition of preneed funeral contract needs to be redrafted to reflect that more clearly. Mr. DeAngelo said he would provide language to be considered during the conference call.

Mr. DeAngelo pointed out that the existing language in Section 8 does not require disclosure of the ratings given to a company by all rating agencies; the insurer can pick only the one that is most favorable. The additional language proposed for Section 8 would require the advertising to state where the insurer's rating that it chose to cite falls in the hierarchy of that particular rating agency, for example, "third highest of 15 ratings."

## 2. Discuss Suitability White Paper

Mr. DeAngelo said he thought development of a white paper on suitability (Attachment Four-B) was the working group's most important charge. There may be many states out there waiting for the results of the working group's analysis. He said he wants to do a thorough job on this white paper. Mr. Ario said that he is receiving comments from states on how their suitability standards are working. He said Kansas responded that they were told that their regulation language is "too subjective" so they do not use it in enforcement actions. Mr. Ario said this shows how important it is for the working group to look at how suitability standards are working in the states. Mr. Burch said that the Kansas statute lacks specific guidelines. Mr. DeAngelo responded that perhaps some other state laws have more meat. Mr. DeAngelo suggested that he and Mr. Ario make phone calls to the other states to get the rest of their information quickly. He encouraged the regulators to complete their work on the white paper within the next two weeks. He said that Minnesota has been diligently working on a section describing the similarities and differences in the insurance and securities industry and will very shortly have a draft of that section to include in the white paper. Ms. Mead has nearly completed a reorganization of two sections that overlap. Mr. Ario asked when the working group will draft conclusions. Mr. DeAngelo said the American Council of Insurers (ACLI) offered conclusions in their comment letter but he expressed discomfort with the idea of the industry telling regulators what they think. Mr. Ario said that the Access to Information (E) Working Group included in its white paper an appendix that allows an unfiltered industry viewpoint and he suggested doing something similar for this white paper. Don Walters (ACLI) agreed to take the lead in drafting such a document, asking for the option to revise it as the white paper develops.

Mr. DeAngelo said he put together a series of questions (Attachment Four-C) to help regulators formulate conclusions and he asked that the regulators consider these before the next meeting. Mr. Ario said these are good questions and he thought they would be helpful in formulating the conclusions.

Mr. DeAngelo asked that the remaining sections of the white paper be provided to Carolyn Johnson (NAIC) by Oct. 22, 1999. Ms. Johnson agreed to place the white paper on the NAIC's web site by the end of October, which would allow time for comments. Mr. DeAngelo asked that all comments be provided to Ms. Johnson by the third week in November, so that regulators would have time to review them before the Winter National Meeting. Mr. Ario asked if the first draft of the industry appendix could also be prepared by that time and Mr. Walters answered in the affirmative.

## 3. Adopt Minutes of Aug. 6 and Sept. 23, 1999 Conference Calls

Mr. Sky moved and Mr. Heisler seconded a motion to adopt the minutes of the Aug. 6 and Sept. 23, 1999 conference calls (Attachment Four-D). The motion passed.

Having no further business, the Suitability Working Group adjourned.

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## ATTACHMENT FOUR-A

Rules Governing The Advertisements of  
Life Insurance and Annuities Model Regulation  
 Draft: 9/28/99

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Section 2.	Definitions
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## 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; and

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

C. "Guaranteed policy elements" means the premiums, benefits, values, credits or charges under a policy, or elements of formulas used to determine any of these that are guaranteed and determined at issue.

~~B-D "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 sell, solicit or negotiate insurance, person required to be licensed under the laws of this state to 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 from the NAIC Producer Licensing Model Act, which also defines the terms "sell," "solicit," and "negotiate," should be used. 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.

G. E. "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. F. "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. G.~~ "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. H.~~ "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 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~~ insurers 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. A system of 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 and procedures for company approval prior to the use of any advertisements that is not furnished by the insurer and that clearly sets forth within the notice the consequences of not obtaining the required prior approval.

### 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 if such the 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 that~~ 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 that 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 that~~ 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 life insurance policy containing graded or modified benefits 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.

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 that represents that 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) An advertisement shall not 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) An advertisement shall not use the term "vanish" or "vanishing premium," or a similar term that implies the policy becomes paid up, to describe a plan 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 shall~~ be complete and accurate. An advertisement shall not emphasize the investment or tax features of a life insurance policy to such a degree that the advertisement would mislead the purchaser to believe the policy 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 shall~~ 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. An advertisement may not, directly or indirectly, describe or refer to an insurance producer as a "financial planner," "investment adviser," "consultant," "financial counselor," or other specialist engaged in the business of giving financial planning or advice relating to investments, insurance, real estate, tax matters or trust and estate matters when the person is in fact engaged only in the sale of policies.~~

O. Nonguaranteed Policy Elements

(1) An advertisement shall not utilize or describe nonguaranteed policy elements in a manner ~~which that 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 insert reference to the state law or regulation based on the NAIC Life Insurance Illustrations Model Regulation,~~ If nonguaranteed policy elements are illustrated, they ~~must~~ shall be based on the insurer's current scale and the illustration ~~must~~ shall contain a statement to the effect that they are not to be construed as guarantees or estimates of amounts to be paid in the future.

(3) ~~Unless otherwise specified in insert reference to state equivalent to the NAIC Life Insurance Illustrations Model Regulation,~~ An advertisement that includes any illustrations or statements containing or based upon nonguaranteed policy elements shall set forth, with equal prominence comparable illustrations or statements containing or based upon the guaranteed policy elements.

(4) ~~An advertisement shall not use or describe determinable policy elements in a manner that is misleading or has the capacity or tendency to mislead.~~

(5) ~~Advertisement may describe determinable policy elements as guaranteed but not determinable at issue. This description should include an explanation of how these elements operate, and their limitations, if any.~~

Drafting Note: Paragraphs (4) and (5) above contain references currently only applicable to equity indexed annuity products but could apply beyond such products. Additional requirements with respect to these products can be found in the Annuity Disclosure Model Regulation.

~~(4)(6)~~ 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)(7)~~ 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.

(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 that 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 these~~ 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 that~~ 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 for a period of five (5) years after the discontinuance of its use or publication.

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~~ shall be identified clearly as coming from an insurer or insurance producer, if such is the case, and these entities ~~must~~ shall 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 that~~ utilizes a reduced initial premium rate in a manner ~~which that~~ 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 that~~ refers the reader to that specific portion of the advertisement ~~which that~~ 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 has 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 the~~ 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 that~~ 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 ~~nonguaranteed 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 nonguaranteed interest rate~~ shall not be greater than those currently being credited by the company unless the ~~higher nonguaranteed 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 the net 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 the~~ contract shall prominently state that cash surrender benefits are not provided.

(4) Any illustrations, depictions or statements containing or based on determinable policy elements shall likewise set forth with equal prominence comparable illustrations, depictions or statements containing or based on guaranteed policy elements.

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:

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

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 ~~that~~ 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 that is a composite of several different policies or contracts, the advertisement shall so state, shall indicate whether all insurers are authorized everywhere the advertisement appears, and shall 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, a reinsurer 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 that~~ 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 a~~ governmental program or agency.

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

A. An advertisement ~~which that~~ 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 a particular state or states 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 that~~ 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 including, but not limited to, the placement of insurer's rating in the hierarchy of the rating system cited.

#### 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) five (5) 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 that~~ 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 this regulation.~~

#### 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 \$1000 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~~ judgment shall not affect, impair or invalidate any other ~~Section, term or provision of this rule regulation~~, and the remaining sections, terms and provisions shall be and remain in full force and effect.

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## ATTACHMENT FOUR-B

[TITLE]  
Suitability Working Group White Paper  
Draft: 7/29/99

### 1. Introduction

The creation of this white paper is the result of a charge assigned to the Life Insurance and Annuities (A) Committee as follows:

Draft a white paper discussing issues related to suitability of sales of life insurance and annuities. Make recommendations as to the advisability of drafting a model law or regulation giving insurers responsibility to determine suitability of sales of life insurance and annuities.

The charge was precipitated, in large part, by concerns expressed by the members of two working groups, the Replacement Issues Working Group and the Annuities Working Group.

During the development of the new Life Insurance and Annuities Replacement Model Regulation, members of the Replacement Issues Working Group discussed the advisability of incorporating suitability standards for replacement transactions. After considerable discussion, it was agreed that the issues surrounding the development of suitability standards are so complex as to merit separate consideration and that suitability concerns are not limited to replacement transactions. Members of the working group decided to make a recommendation to the Life Insurance and Annuities (A) Committee, when its work on the new replacement model was completed, to form a working group to examine the subject of suitability in the sale of life insurance.

During approximately the same time period, the Annuities Working Group was considering various issues related to the sale of annuities. In the first half of 1997, a survey of the states was conducted to identify annuity related concerns. Included in the results was that 22 states had indicated that a model should be developed creating suitability requirements for annuity sales. Like the Replacement Issues Working Group, members of the Annuities Working Group recognized the difficulties associated with developing such suitability requirements. It, too, decided to recommend that the task be assigned by the parent committee to a separate working group.

In an effort to fulfill the charge, this white paper will attempt to examine the issue of the creation and enforcement of suitability standards. It will discuss the suitability requirements established by the Securities and Exchange Commission and the National Association of Securities Dealers for the sale of registered products and the effectiveness of their enforcement of those requirements, including applicable court decisions. Other sections of the white paper will summarize the standards established to date by various states and their experiences enforcing those standards; the other NAIC models that provide a measure of protection and disclosure to assist purchasers of life insurance and annuities to assess the suitability of such products for themselves; and the extent to which the industry has imposed upon itself requirements to sell products that are appropriate to the need of its customers. In developing the information offered and conclusions reached in this white paper, the working group has benefited from presentations by and input given by the National Association of Securities Dealers and various industry representatives.

### 2. Survey Results

In 1997 the Annuities (A) Working Group surveyed the states on a variety of issues related to their laws on annuities. Forty-four states responded to the survey. One of the questions was whether the states had in place standards for the suitability of annuity purchases. Three states responded that they had standards in place. One said it had standards only for variable life. Two said they intended to adopt a law or regulation. Seven states opined that they did not need a law in this area and 22 states said a model law should be developed.

### 3. State Suitability Statutes and Standards

There are at least five states (IA, KS, MN, VT, WI) 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 (AR, NM, OH, SD, UT) 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 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 of 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 on 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. Rejlek, 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 twenty percent 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 "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 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 Cruz he had 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, 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 (2nd 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).<sup>1</sup>

## 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 (the 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 (\_\_\_\_)).

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.

<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.

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 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 (9<sup>th</sup> 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 (9<sup>th</sup> 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

"Over the past several years, negative publicity in the popular and financial press has thrown the industry's market conduct into the public spotlight. The cumulative effect of adverse publicity could inflict long term damage to the life insurance market. Indeed, the deteriorating public perception of the industry's image has been vividly quantified in trend data generated through ACLI attitudinal research. Left unchecked, the views elicited by the public surveys translate into direct economic consequences affecting everyone in the life insurance business."<sup>2</sup>

During the late 1980s and early 1990s incidents of industry sales abuses and questionable business practices frequently became front page news. More important than the potential loss of revenue that could result from these practices was the issue of the loss of consumer trust. Of equal concern was what to do about it. Both the insurance industry and the state regulators had to address this issue and had to find a way to correct it.

In response to this negative publicity received by the life insurance industry, and based upon the collective experience of several states, it was recommended that the issue of company compliance be pursued at the national level via the NAIC. One approach taken was a result of a multistate settlement in March of 1995. The five states involved formed a working group within the Midwestern Zone to examine "industry compliance programs and the means by which regulators may encourage the industry in self-monitoring." One of the goals the working group hoped to accomplish was the establishment of a "process for regulators to work with the industry to develop industry standards for self-monitoring for the adherence to regulatory standards and good business practices."<sup>3</sup>

This working group developed the following charge: "the development of a model reciprocal compliance program law. The goal is to capitalize on the industry desire to project a public image of honesty and trustworthiness by establishing a process for regulators to work with the industry to develop industry standards for self-monitoring and discipline. The objective is to strengthen and broaden insurance industry adherence to regulatory standards and good business practices in all states by encouraging insurers to establish or strengthen compliance programs. The law will cover a number of product lines, including but not limited to the following, specified disease, Medicare supplement, and long-term care. measures may be included to assist interstate cooperation and encourage effective company compliance programs."<sup>4</sup> The goal was to draft a Model Compliance Program.

During the NAIC's Spring National Meeting in March of 1996, an open forum was held where the insurance industry was invited to make presentations to detail the current practices regarding compliance, as well as to present company proposals to address the many concerns of the public, the regulators and the industry. Many company representatives attended this meeting with comments ranging from no state involvement was needed, to no type of corporate compliance program was necessary, to such a program would be too expensive, to its an oversight problem with the states, to leave us alone and let us solve our problems ourselves. Given the broad charge that the group started with, and the apparent lack of consensus at the time for the ability to draft such a comprehensive program, at least from a mandated point of view, it was decided that the working group would not pursue the issue of drafting a mandated program but would, instead, continue to monitor these issues through the various established working groups. To date, committees such as the Replacement Issues Working Group, the Suitability Working Group, the Life Disclosure Working Group and various *Market Conduct Examiners Handbook* committees, have continued and will continue to monitor this issue.

<sup>2</sup>Dan Lonkevich, "ACLI Conduct Code Nears Completion; Proposal Drops Compliance Certification," *BestWeek* \* L/H, Release 41, Oct. 9, 1995, 1.

<sup>3</sup>March 5, 1996, letter from Commissioner Glenn Pomeroy to Interested Parties

<sup>4</sup>Oct. 23, 1995, Working Group's Charge

Also during this time period, The ACLI Task Force on Market Conduct, comprised of 16 life insurance company CEOs, was studying these issues and drafting its own recommendations. From this task force came the "code of life insurance ethical market conduct" which contained six principles and a code of conduct for each principle. These principles became the foundation of IMSA—the Insurance Marketplace Standards Association.

The principles are as follows:

1. To conduct business according to high standards of honesty and fairness and to render that service to its customers which, in the same circumstances, it would apply to or demand for itself.
2. To provide competent and customer-focused sales and service.
3. To engage in active and fair competition.
4. To provide advertising and sales materials that are clear as to purpose and honest and fair as to content.
5. To provide for fair and expeditious handling of customer complaints and disputes.
6. To maintain a system of supervision and review that is reasonably designed to achieve compliance with these Principles of Ethical Market Conduct.

"The Insurance Marketplace Standards Association (IMSA) is a voluntary membership organization whose purpose is to promote high ethical standards in the sale of individual life insurance and individual annuity products by its member companies. Through its Principles and Code of Ethical Market Conduct, IMSA encourages its member companies to develop and implement policies and procedures to promote sound market conduct practices. Companies must undergo a rigorous self and independent assessment of their practices to become a member of IMSA. IMSA membership must be renewed every three years to reasonably assure continued compliance with IMSA's Principles and Code. By promoting collective performance improvement, the Program aims to strengthen consumer confidence in the life insurance industry. Membership in the association means that a company has adopted IMSA's Principles of Ethical Market Conduct and an accompanying Code of Life Insurance Ethical Market Conduct. The principles set out general standards of ethical behavior and the code specifies the means for achieving the principles."<sup>5</sup>

The intent behind the six principles is that a company could use the principles as a guide to review its own compliance with each principle prior to undergoing a review by an independent third party assessment of that compliance. Upon demonstrating compliance with these principles, a company then becomes a member of the IMSA. Membership in the association serves to recognize the companies that have successfully completed the assessment program. A company is allowed to publicize its membership in the association through its advertising and sales materials. Currently the IMSA standards address only the advertising and sales practices for individual life and annuity products.

## 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 (46) states had adopted the 1984 version of this model. We 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

<sup>5</sup>Insurance Marketplace Standards Association Web Page. n. pag. Netscape. Aug. 2, 1999. Available: <http://www.imsaethics.org/pages/optl.htm>.

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 consumers to assist them in making informed decisions 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 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 Products

##### B. Annuity Contracts

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ATTACHMENT FOUR-C

#### Discussion Questions

1. Does the absence of principal risk obviate the need for suitability standards?
2. Do the up front protections provided by the model laws and regulations obviate the need for suitability standards?

3. What gives rise to the need for suitability standards now that did not exist previously?
4. Is there a difference between requiring suitability and determining the sale to not be unsuitable?
5. Is the system used by the National Association of Securities Dealers (NASD) appropriate for insurance transactions?
6. Has the experience of those states with suitability or unsuitability standards been positive? One, more so than the other?
7. What has been the judicial history of suitability violation actions?
8. Do the Insurance Marketplace Standards Association (IMSA) requirements sufficiently address suitability issues through the needs-based selling principles?
9. Are the voluntary steps taken by some companies and producers sufficient to address suitability concerns?
10. If a model is developed, should it be a model act or regulation?

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#### ATTACHMENT FOUR-D

#### Suitability Working Group Conference Calls August 6, 1999, and September 23, 1999

The Suitability Working Group of the Life Insurance and Annuities (A) Committee met by conference call on Aug. 6 and Sept. 23, 1999. Paul DeAngelo (NJ) chaired the meeting. The following working group members participated: Bill McAndrew and Chuck Budinger representing Robert Heisler (IL); Marlyn Burch (KS); Lester Dunlap (LA), Vice Chair; Susan Gormley Anderson and Richard Rose representing Linda Ruthardt (MA); Scott Borchert and Paul Hanson (MN); Cindy Amann (MO); David Sky (NH); Frank Stone, Dalora Schaffer and Joan Williams (OK); Joel Ario (OR); Ted Becker (TX); and Tom Crompton representing Tom Van Cooper (VT).

#### 1. Review Draft of Advertisements of Life Insurance and Annuities Model Regulation

Mr. DeAngelo said comments had been received on the Advertisements of Life Insurance and Annuities Model Regulation from the American Council of Life Insurance (ACLI), Primerica and Principal Mutual. Mr. DeAngelo suggested using the ACLI's redraft as the vehicle for discussion of the comment letters. He said, if further discussion on the issues is needed, the issue can be placed on the agenda for the Fall National Meeting.

#### Section 2. Definitions

The ACLI recommends deleting the provision that an advertisement includes general advertising about the company and limiting it only to advertising about a particular product. Mr. DeAngelo disagreed with that recommendation and would not be comfortable narrowing the scope of the model in this way. Julie Spiezio (ACLI) said her organization believes this is important because the Unfair Trade Practices Act already covers general information. She said the ACLI believes the intent of this regulation is to regulate the advertising of the life insurance products and the ACLI does not want this regulation to apply when an insurer sponsors a sporting event, for example, and shows its logo. Mr. DeAngelo responded that the New Jersey Unfair Trade Practices Act on false advertising is only one paragraph long and the department has been criticized for not telling the industry in its regulations what is false and misleading, for example. This regulation expounds on the language of the Unfair Trade Practices Act. No other regulators spoke in support of the ACLI suggestion, so it will not be included in the next draft.

Mr. DeAngelo said there had been a suggestion that Section 2A(1)(c) be revised. He said if materials for agents are misleading or incomplete, then agents may in turn mislead the public. He asked if regulators were interested in deleting the language that says "which is designed to be used or is used to induce the public..." Mr. Hanson said he would like to see all training materials included and Mr. Burch said he was also in favor of deleting the language. Mr. DeAngelo said he did not recall seeing incorrect or misleading training materials, so this is somewhat a theoretical question. Mr. Hanson responded that he had seen misleading materials in market conduct examinations. Diana Marchesi (Transamerica) said this language would then be broad enough to include material designed to inspire agents to sell more for the company. All of the information in the regulation would then need to be included in that inspirational brochure. Mr. DeAngelo asked if there is a middle ground, such as requiring the regulation to apply to material that describes to the producer the features, advantages or disadvantages of an insurance product. The regulators agreed that was an appropriate compromise. Bill Geiger (Aegon) said some states require filing of advertising and he asked if it would be a burden to file and perhaps get prior approval of agent training material. Mr. DeAngelo responded that limiting it to product-specific material would help and states will have to consider that as they adopt the model regulation. David Nelson (Northwestern Mutual) opined that even product-specific material should not be included in the rule. He gave as an example the use of the term "nonmedical" in agent training materials. If this is called advertising, the disclosures of what that term means would have to be included in the training materials. Anda Olson (ING) gave another example where the full mailing address of the insurance company would have to be included on a flyer used for stimulating sales. She submitted that the activity of the plaintiffs' bar has encouraged companies to improve the quality of their training materials. Mr. DeAngelo said that as the regulators go through the rule, they might find quite a few parts of the regulation that they would not want to apply to agent training materials. Because of that fact, the model would have to be reconfigured to

segregate requirements for agent training materials. What the regulators really want to say is that the agent training materials should not be misleading or incomplete. Mr. Burch said that he has been convinced that the requirement for agent training materials should be deleted and the rest of the regulators agreed.

Mr. DeAngelo said the ACLI suggests adding definitions from the Annuity Disclosure Model Regulation as Subsections B and C. He indicated that he is comfortable with this suggestion. Mr. McAndrew opined "determinable policy elements" would not mean anything to policy analysts and asked if these only apply to equity indexed products. Charlotte Liptak (American General Life) said this could apply beyond equity indexed products, but currently is only applicable to them. Mr. McAndrew suggested adding a drafting note to point out the connection to the Annuity Disclosure Model Regulation. Mr. DeAngelo suggested doing that in the context of the regulation rather than in the definition section and Mr. McAndrew agreed that was appropriate.

Mr. DeAngelo said the definition of insurance producer should be consistent with the Producer Licensing Model Act and agreed to make sure that it is.

### Section 3. Applicability

The May 10, 1999, draft includes a sentence in Subsection B that says, "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." The ACLI suggested deleting this sentence. Mr. DeAngelo said he was not in favor of that change because he felt insurers should be responsible for their agents. Several states spoke up in agreement with that position. Ms. Spiezio said the language added to the draft is language from law in Florida, but that state's law includes language saying that the insurer is not responsible for an agent that violates its guidelines. He said this protects the insurer from a bad actor. She said it seems unfair to impose the burdens of the Florida law, without including the one section that limits that burden to some extent. Mr. DeAngelo responded that he tries to avoid micromanaging New Jersey companies and telling them how to police their agents. He said he would be in favor of the ACLI suggestion to delete Paragraphs (1) and (2) but would want to see a copy of the notice to agents. Joan Marcoe (CIGNA) asked if the ACLI members think this language will absolve insurers from liability in a private cause of action or just from regulatory sanctions. Mr. DeAngelo responded that he is sure companies would use this as evidence. Ms. Olson suggested that Mr. DeAngelo talk to the Florida Insurance Department to see how their requirements are working. Mr. DeAngelo said he would like to have the authority to look at this on a case-by-case basis. If the agent goes to great lengths to hide his bad actions from the company, he would probably not recommend regulatory sanctions, but if the company is not policing its agents carefully, he would hold them responsible. Mr. Geiger said the problem with the language in the current draft is that it creates an absolute liability that would take away the discretion to weigh the insurer's activities. Mr. DeAngelo asked if the industry would be in favor of replacing Paragraphs (1) and (2) with a statement that the company must tell the agent the consequences of using unapproved materials. This was agreeable.

### Section 5. Disclosure Requirements

Glenn Joppa (Union Fidelity Life) said Subsection E is an example of where an institutional advertisement would have difficulty in complying. Mr. DeAngelo responded that it is inherent in that requirement that a particular type of policy would be discussed. Mr. Joppa responded that it is not clear.

Mr. DeAngelo said that the ACLI recommends deletion of Paragraphs (1), (2) and (3) of Subsection G, which are used to describe what "prominent" means in different types of media. He said the New Jersey Administrative Law Office often has criticized the department for using subjective terms like "prominent" without specific standards so that a company will know whether it has met the test of prominence. Ms. Spiezio responded that the current language of the model has worked for 15 years so this is a response to a problem that does not exist. Mr. DeAngelo said that he did not mind making the decision about what is prominent, but thought it helped the companies to have more concrete standards. Ms. Anderson said that she appreciated minimum standards in the regulation instead of having the discretion. Mr. DeAngelo said that it had been his impression also, but he is hearing from the industry that they are more comfortable with the regulators having broad discretion.

Tracy Glass (Primerica Life) said her company commented on Subsection I(1). Mr. DeAngelo said he had just heard from the industry that it is comfortable with the term prominent. Ms. Glass said that her company's concern is with the word "describe." Is anything less than an illustration adequate? She said they would like to see, for example, "describe by a statement that premiums are not level." Mr. DeAngelo responded that a statement that premiums are not level is not enough and Ms. Glass asked what he would envision as sufficient. Mr. DeAngelo said there are a number of ways, depending on how much it changes. For example, if the premium changes at age 65, the disclosure could say the premium is level to age 65 and then typically increases by 40%. He said he does not think this requires the disclosure of the dollar amount of the premium.

Primerica suggested replacing the words "complete and accurate" with "not misleading" in Subsection J. Mr. DeAngelo said it would be easy to avoid talking about something and not be misleading but not be complete. Mr. Glass responded that Primerica's concern is with the interpretation of "complete." How much information has to be disclosed in order to comply? Mr. DeAngelo responded that this is another example where specific standards would help.

Primerica also suggested deleting Subsection K. Mr. DeAngelo said he was reluctant to remove a long-standing provision that has given clear guidance. Mr. Nelson said he agreed with that position wholeheartedly.

The ACLI recommended deletion of Paragraph N, again referring to the Unfair Trade Practices Act. Mr. DeAngelo said this language is not in the New Jersey law and he wondered how many states include this language in their laws. He opined that producers seem to be more aware of the regulation than the act in any case. Wanda Smith (Primerica) suggested that the

language be changed to reflect the language in the Unfair Trade Practices Act. Mr. DeAngelo said that he would look at the Act and revise the language to more accurately capture the concepts in the Unfair Trade Practices Act. He said the working group could discuss this further at the Fall National Meeting.

Discussion next turned to Subsection O and the recommendation of the ACLI to add new Paragraphs (4) and (5). Mr. DeAngelo suggested this is the appropriate location to place a drafting note referring to the product designs linked to an outside index. The ACLI also recommended deletion of the paragraphs added in the May 10, 1999, draft that were labeled Paragraphs (6), (7) and (8). Mr. DeAngelo said that it is a mistake to build into regulations standards so specific that they will not work with innovative product designs. The Annuity Disclosure Regulation is trying to deal with the specifics and companies will not look to this model to see how to treat two-tier annuities or equity indexed annuities. He agreed to delete these paragraphs. Paragraph (8) is designed to deal with the vanishing premium issue. Ms. Spiezio said that Section 5I(5) handles this issue better and the illustration regulation also addresses this. Mr. McAndrews said that Section 5I(5) deals with premiums and this Paragraph (8) talks about dividends. Ms. Spiezio agreed to bring the language from the Life Insurance Illustrations Model Regulation to further discuss this issue at the working group's next meeting.

Kevin Howe (Principal) commented that Subsection Q(4) requires an insurer to keep the information forever if a company is doing business in 50 states and one of these never does a market conduct examination. He recommended replacing the language of Paragraph 4 with a requirement to keep the material not more than five years after its use is discontinued. Mr. Hanson pointed out that this comment also is applicable to Section 9A. Mr. DeAngelo agreed to make that consistent. Gary Hoffman (Kansas City Life) drew the attention of the working group to the Market Conduct Record Retention Model Regulation of the NAIC and asked Mr. DeAngelo to make sure that these two are consistent. Mr. DeAngelo said the Market Conduct Handbook (EX3) Working Group is reviewing the model and opined that it probably will be updated.

Primerica suggested that Subsection R be changed so that the second sentence is preceded by "Unless the source of the information is itself, the source ...." Mr. DeAngelo said he could not go along with that suggestion. It is important to know if the statistic is based on the insurer's experience rather than that of the whole industry. The other regulators agreed that it would not be appropriate to change Subsection R.

The ACLI recommended changing the provisions in Subsection W to reference nonguaranteed interest rates. Mr. McAndrew pointed out that the defined term is "nonguaranteed policy elements" rather than "nonguaranteed interest rates." He asked if this is consistent. Mr. DeAngelo said the definition has already been adopted in another model and he suggested that in no other place would one find "nonguaranteed interest rate." He asked if the definition is needed at all because "nonguaranteed interest rate" is pretty clear. Ms. Liptak pointed out that the term "nonguaranteed policy elements" is used in other parts of the model. The working group agreed to leave the definition and to accept the recommendation of the ACLI for Subsection W.

#### Section 6. Identity of Insurer

Mr. DeAngelo explained that he added language to Subsection A to serve as a safe harbor so that insurers did not have to list every company in every composite. The ACLI recommended deletion of that additional language. Ms. Spiezio said the last phrase conflicts with the first phrase and asked how companies would be able to do both. Mr. DeAngelo explained that this was intended to be an exception. He said regulators need to decide whether they want to provide a safe harbor or whether all names should be required. Ms. Olsen said if a company includes ING's name in its advertisement, the advertisement must be submitted to the company for comment. She suggested that if the composite contains comparisons of six companies, it will get six ideas of what is an appropriate way to describe this. She said the interested parties had not understood this last addition to be an exception. Mr. Ario agreed that it was helpful to have a safe harbor. Mr. DeAngelo asked the interested parties to make suggestions for the redraft that would make this intent clearer.

Discussion turned to the new Subsection D, which was added to prohibit the use of the name of a holding company without disclosing that the subsidiary is a separate entity. Ms. Spiezio asked what consumer problem this new provision is trying to address. She said, if the holding company sponsors a sporting event, it would be necessary to describe the relationship of the insurer to the holding company. Mr. DeAngelo responded that, to the average person, referring to a holding company when it has no responsibility for the obligations of its insurers, gives a false sense of security. Ms. Olsen said that if the regulators want to include such a requirement, it would be helpful to phrase it so that the reference to the holding company should not mislead consumers. Mr. DeAngelo agreed that the goal is that the name of the parent should not be used in such a way that it misled consumers to think that the parent is responsible. He gave as an example an advertisement that said, "You can feel secure about buying from Fly-by-Night Insurance Company, because it is a member of the XYZ Holding Company." Mr. Ario pointed out that Subsection B addresses that the capacity to mislead and opined that Subsection D was not necessary. Mr. DeAngelo agreed to delete the section unless more information is received that would indicate this is necessary. Mr. Becker said he recently received a flyer that showed the assets of each company within the holding company and asked if that had the tendency to mislead. Mr. DeAngelo said this gives the impression that the assets of the whole holding company are standing behind the policy and saw that type of advertisement as a problem.

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

The ACLI letter comments that Subsections A and B are out of date in light of the current trend toward electronic commerce. Mr. DeAngelo said that it would be very easy to meet the requirements of Subsection A with a statement that not all products are available in all states. Mr. Nelson said that what appears to be a local broadcast can be placed on the Internet without the knowledge of the person who prepared it. Mr. Ario pointed out that the language of Subsection A would relieve that person of responsibility because it says the advertisement was intended to be heard beyond the limits of the jurisdiction. Ms. Spiezio pointed out a similar problem in Subsection B. She noted that the language "where the advertisement appears," leaves the

question of where an advertisement appears when it is on the Internet. Mr. Ario agreed that phrase was a problem and suggested its deletion. The working group agreed.

#### Section 8. Statements About the Insurer

Mr. DeAngelo referred to the cover letter from the ACLI about the existing language in Section 8 of the current NAIC model which reads: "An advertisement shall not contain a recommendation by any commercial rating system unless it clearly defines the scope and extent of the recommendation." The ACLI contends that the existence of this language means that no additional work is needed on the issue. Mr. DeAngelo said that regulators are interested in telling the reader about the range of ratings so he or she can see how the company fits in the hierarchy. He asked if the regulators felt that a person would understand that from the language of Section 8. Ms. Amman said that the language is a good start, but more needs to be added to it. At a minimum, the high and low of the range should be described. Ms. Olson said that her company uses a description that says this is the third rating out of 17 and she suggested that approach was easier to understand. Mr. DeAngelo asked if people would understand that means the third from the top and suggested that someone could say third out of 17 and mean the third from the bottom. Mr. McAndrew asked if that would also include nonrated companies. Mr. Hanson also pointed out that some agencies have a different rating system for those who have paid to be rated. Mr. DeAngelo offered to rewrite that part of Section 8 so that consumers will have a better understanding of what the ratings mean.

#### Section 9. Enforcement Procedures

Mr. DeAngelo said the comments pointed out that, if no examination is done, insurers would be required to keep advertisements forever. He suggested deleting the last part of the sentence so that the requirement was simply to keep the file for a period of four years after discontinuance of its use or publication. The working group agreed.

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

Mr. DeAngelo spoke in favor of the suggestion from the ACLI to add several words to Section 11 for clarification. These refer to other NAIC models that did not exist at the time the advertising model was developed.

#### 2. Discuss Suitability White Paper

Mr. DeAngelo noted that the working group received a comment from the ACLI on the white paper and asked if the working group members had any preliminary comments on that document. Mr. Becker said he was surprised that the ACLI focused on the line between fixed and variable products. He said he sees many products that sit on that line. He gave as an example equity indexed products, but noted that there are more. Don Walters (ACLI) said his organization believes there are significant differences between fixed and variable products. Mr. DeAngelo said this is an important issue to discuss at the Fall National Meeting.

Mr. Ario said that the ACLI also commented that the white paper lacks information about how suitability standards have worked in the states that have them. He said he is in the process of gathering that information from the states that have standards. He asked those on the call who represent such states to provide the information to him quickly.

Having no further business, the Suitability Working Group adjourned.

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*[Editor's Note: The following material was adopted by the NAIC Plenary Oct. 4, 1999, as part of Oct. 4, 1999, Executive Committee report.]*

#### ATTACHMENT FIVE

##### Life Insurance and Annuities (A) Committee and Viatical Settlements Working Group Joint Conference Call July 14, 1999

The Life Insurance and Annuities (A) Committee and the Viatical Settlements Working Group held a joint conference call on July 14, 1999. The following members of the Viatical Settlements Working Group participated: Lester Dunlap, Chair, (LA); Elizabeth Bookwalter representing Michael Bownes (AL); Jim Bracher representing Kevin McCarty (FL); Dale Freeman (ID); Betty Jo Teer representing Robert Heisler (IL); Roger Strauss (IA); Marlyn Burch (KS); Trent Heinemeyer representing Glenn Pomeroy (ND); Dalora Schafer (OK); Nancy Ellison representing Joel Ario (OR); Greg Martino (PA); Maliaka EssamelDin representing Jeanne Bryant (TN); and Neil Nevins (TN). The following members of the Life Insurance and Annuities (A) Committee participated: Terri Vaughan, Chair, (IA); Greg Martino representing Diane Koken, Vice Chair (PA); Marlyn Burch representing Kathleen Sebelius (KS); Lester Dunlap representing James H. Brown (LA); Linda Ruthardt (MA); and Dalora Schafer representing Carroll Fisher (OK).

#### 1. Consider Viatical Advisory Package

Commissioner Vaughan said that regulators and interested parties should have received a packet of information about June 24, which included the material to be discussed during the conference call. Mr. Dunlap thanked the members of the A Committee

for participating in the conference call, to allow this project to be considered by the Executive Committee at the Fall National Meeting. He encouraged regulators and interested parties to comment during the meeting to be sure that all concerns are adequately addressed before the product is distributed. Commissioner Vaughan asked if there were any comments on the cover letter and none were forthcoming. She asked for comments on the background paper entitled, "Advisory: Emerging Issues in the Sale of In Force Life Insurance Policies." Commissioner Ruthardt expressed concern that the document did not explain the different issues in a group insurance policy. Mr. Dunlap responded that the NAIC model law and regulation do address the differences and pointed out that they are highlighted in the brochure that accompanies the advisory. Commissioner Ruthardt thought that was satisfactory.

George Coleman (Prudential) said he did not agree with the statement under the pricing section that said, "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 settlement and insurance industries." Mr. Coleman said the price paid to investors is of no concern to the insurance industry. He said this statement blurs the focus that the insurance industry has on protecting life insurance purchasers. He also opined that the NAIC was not equally concerned about the viatical settlement investor. Paul Hansen (MN) pointed out that Minnesota and some other states do have one agency with joint regulation over insurance and securities. He agreed that in this case regulators' concern should be with the person selling the policy. Doug Head (Medical Escrow Society) suggested striking the word "equal." Commissioner Vaughan pointed out that the working group has prepared a brochure on buying viatical settlements so that would indicate some interest in the issue. Ms. EssameDin said the brochures show that this paragraph is relevant, and said Tennessee is another state that regulates both insurance and securities under the same commissioner. She noted that how much is paid out affects the price that will be paid to the viator. Mr. Hansen countered that he does not believe it is appropriate that they should be of equal concern. One person may have a dire need; the other person just wants a profit. The working group agreed to change the sentence to say, "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 also of concern to the NAIC and the viatical investment industry."

Mr. Heinemeyer said that Commissioner Pomeroy had asked him to pass along a general comment to the regulators. North Dakota has expressed concern that the content of the advisory and brochures may not be bold enough in apprising readers of the pitfalls of a viatical settlement. He suggested additional work is needed to make the document stronger. Commissioner Vaughan asked if Commissioner Pomeroy was suggesting that the project be postponed until that is finished. Mr. Heinemeyer responded that Commissioner Pomeroy does not want to hold up the project, but he is still concerned that the brochures need more work. Mr. Burch said that Kansas has taken the three brochures and revised them to be somewhat stronger. Vickie Buening (KS) said that this strengthening has been accomplished by the use of examples of consumer fraud. Mr. Burch offered to share the Kansas brochures with other regulators. Commissioner Vaughan suggested that the project for today should be to make the brochures as useful as possible and then consider whether changes can be incorporated at the Winter National Meeting to make the documents stronger. The regulators agreed that this was a reasonable solution.

Commissioner Vaughan asked the regulators to next turn their attention to the three brochures. Several technical amendments were made to the wording of these documents. Mr. Freeman suggested that the consumer alert section of the two brochures should be larger and bolded. This is the most important part of the brochure and it should not be hidden. The working group agreed to this suggestion. Commissioner Ruthardt suggested adding information to clarify that, if the life insurance policy was obtained through an employer, the employee needs to check with the employer on whether permission is needed to sell the policy. The regulators agreed to add a question in both brochures on selling your life insurance policy.

The Viatical Settlements Working Group first considered a motion from Mr. Martino, seconded by Mr. Burch to adopt the viatical advisory package. The motion passed with North Dakota and Tennessee voting against the motion.

Commissioner Vaughan asked for a vote of the Life Insurance and Annuities (A) Committee. Mr. Dunlap moved that the Life Insurance and Annuities (A) Committee adopt the viatical advisory package with the amendments made during the working group's deliberation. Commissioner Ruthardt seconded the motion. Commissioner Vaughan clarified that the group will continue to improve the brochures even after their adoption. Mr. Dunlap agreed that the working group will focus on providing stronger warnings in the brochures. The motion to adopt the viatical advisory package, as amended, (Attachment Five-A) passed unanimously.

## 2. Consider Appendices to the Viatical Settlement Model Regulation

Mr. Dunlap announced that a revised version of Appendix A (the Viatical Settlement Buyer's Guide) had been distributed by NAIC staff recently. He asked that comments be sent to Carolyn Johnson (NAIC) by Aug. 15. He noted that this revised buyer's guide was prepared by Ms. Buening and other members of the Kansas Insurance Department staff.

Mr. Dunlap noted that Appendices B and C have been adopted by the working group but that the working group does not recommend their adoption by the A Committee until Appendix A is completed. He said he expects this to happen at the Fall National Meeting and then all three appendices would be recommended to the A Committee for adoption. Joan Markoe (CIGNA) said she had not understood that Appendices B and C were already final and expressed concern about some of the wording. Commissioner Vaughan suggested that this issue be taken up at a working group meeting. Ms. Markoe agreed to send a letter describing her concerns to Ms. Johnson for the working group. Mr. Coleman suggested that this issue be reviewed by the technical resource advisors and turned around quickly so that companies could use the document.

Having no further business, the joint conference call adjourned.

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## ATTACHMENT FIVE-A

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

At our 1998 Winter Meeting, the Life & Annuities Committee, Chaired by Terri Vaughan of 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 a 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 encourage you to copy and distribute the brochures.

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

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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 lead 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 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 also of concern to the NAIC and the viatical investment industry. 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.

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## Brochure #1: Selling Your Life Insurance Policy: Understanding Viatical Settlements

Understanding Viatical Settlements	Know Your Options	Consider All Your Options
<p>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.</p> <p>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.</p> <p>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.</p>	<ul style="list-style-type: none"> <li>• Contact your insurance agent or company for information about viatical settlements.</li> <li>• Consult your own financial advisor, who knows your personal financial needs.</li> <li>• Contact your state insurance department for information about current laws.</li> </ul>	<p>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.</p> <p>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.</p>

Other Considerations	Consumer Tips	Defining the Terms
<ul style="list-style-type: none"> <li>• Contact a professional tax advisor. Find out the tax implications. Not all proceeds are tax free.</li> <li>• Know that the proceeds are subject to the claims of any creditors.</li> <li>• Find out if you'll lose any public assistance benefits such as food stamps or Medicaid if you get a cash settlement.</li> </ul> <p>Know that you must provide certain medical and personal information.</p>	<ul style="list-style-type: none"> <li>• Understand how the process works and when the phases will happen.</li> <li>• 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.</li> <li>• If you don't use a viatical settlement broker, comparison shop on your own.</li> <li>• You don't have to accept any viatical settlement offer.</li> <li>• Check all application forms for accuracy, especially information about your medical history.</li> <li>• You must be truthful in your answers to application questions.</li> <li>• 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.</li> <li>• 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.</li> <li>• Understand what information a buyer must know about you to buy your policy, and who else might get that information.</li> </ul>	<p>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.</p> <p>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.</p> <p>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.</p> <p>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. Your state insurance department may regulate viatical settlements transactions. Contact your state insurance department for a copy of those regulations.</p>

Questions to Consider	Consumer Alert	Check with Your State
<ul style="list-style-type: none"> <li>• Do I still need life insurance protection?</li> <li>• If I sell my policy, how do they decide how much cash I get?</li> <li>• Is this an employer or other group policy? If so, do I need their permission to sell it?</li> <li>• If I sell my policy, who will be the legal owner?</li> <li>• Do I need the advice of a tax or estate planning advisor before I decide to sell my policy?</li> <li>• Will investors have specific information about me, my family or my health status?</li> <li>• Is the broker or company I plan to sell to allowed to do business in my state?</li> <li>• After I sell my policy, can it be resold by the buyer?</li> </ul>	<ul style="list-style-type: none"> <li>• If you're asked to invest in or buy a viatical settlement, we recommend you contact your state insurance department. <b>Learn more about the issues and risks.</b></li> <li>• If you're interested in selling your life insurance policy, you should contact your state insurance department to get more information.</li> <li>• 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.</li> </ul>	<p>Your state insurance department may regulate viatical settlements transactions. Contact your state insurance department for a copy of those regulations.</p>

## Brochure #2: Selling Your Life Insurance Policy: Understanding Life Settlements

<p><b>Understanding Life Settlements</b></p> <p>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.</p> <p>People decide to sell their life insurance policies for many reasons. Some common ones are changed needs of dependents, wanting to reduce premiums, and cash for meeting expenses.</p> <p>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 making any decisions.</p>	<p><b>Know Your Options</b></p> <p>Before you enter into any life settlement transaction, you should:</p> <ul style="list-style-type: none"> <li>• Contact your insurance agent or company for information about life settlements.</li> <li>• Consult with your own financial advisor who knows your personal financial needs.</li> <li>• Contact your state insurance department for information about current laws.</li> </ul>	<p><b>Consider All Your Options</b></p> <ul style="list-style-type: none"> <li>• 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.</li> <li>• Review other sources of cash that may meet your financial needs at a lower cost than a life settlement.</li> </ul>
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<p><b>Other Considerations</b></p> <ul style="list-style-type: none"> <li>• Contact a professional tax advisor. Find out the tax implications. Proceeds are not tax free.</li> <li>• Know that creditors could claim the proceeds.</li> <li>• Find out if you will lose any public assistance benefits such as food stamps or Medicaid if you receive a cash settlement.</li> <li>• Understand you will be required to provide certain medical and personal information.</li> </ul>	<p><b>Consumer Tips</b></p> <ul style="list-style-type: none"> <li>• Understand how the process works and when different phases will happen.</li> <li>• 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.</li> <li>• If you don't use a life settlement broker, comparison shop on your own.</li> <li>• You don't have to accept any life settlement offer.</li> <li>• Check all application forms for accuracy, especially information about your medical history.</li> <li>• You must be truthful in your answers to application questions.</li> <li>• 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.</li> <li>• 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.</li> <li>• Understand what information the buyer must know about you to buy your policy, and who else might get that information.</li> </ul>	<p><b>Defining the Terms</b></p> <p>A life settlement is the sale of a life insurance policy to another person or company in return for cash now.</p> <p>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.</p> <p>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.</p>
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Questions to Ask	Consumer Alert	Check with Your State
<ul style="list-style-type: none"> <li>• Do I still need life insurance protection?</li> <li>• Will I qualify for a new life insurance policy in the future?</li> <li>• If I sell my policy, how will they decide how much cash I get?</li> <li>• Is this an employer or other group policy? If so, do I need their permission to sell it?</li> <li>• If I sell my policy, who will be the legal owner?</li> <li>• Can the policy be resold?</li> <li>• Will investors have specific information about me, my family or my health status?</li> <li>• Is the broker or company I plan to sell to allowed to do business in my state?</li> </ul>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• 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.</li> <li>• 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.</li> </ul>	<p>Your state may regulate the purchase of life settlements. Contact your state insurance department for a copy of those regulations.</p>

## Brochure #3: Buying Viatical Settlements

<p><b>Buying Viatical Settlements</b></p> <p>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.</p> <p>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 decisions.</p>	<p><b>Know Your Options</b></p> <p>If you're thinking of buying a Viatical settlement you should:</p> <ul style="list-style-type: none"> <li>• Understand the details and the risks before deciding.</li> <li>• 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.</li> </ul> <p>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.</p>	<p><b>Other Considerations</b></p> <ul style="list-style-type: none"> <li>• Typically, viatical settlements 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.</li> <li>• 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.</li> <li>• 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.</li> <li>• 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.</li> <li>• 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.</li> <li>• 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.</li> <li>• Find out if there are any trust fees, commissions or other expenses you may be required to pay and how much they will be.</li> <li>• Find out who would be responsible for monitoring the status of the insurance policy and the insured.</li> </ul>
<p><b>Defining the Terms Check with Your State</b></p> <p>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.</p> <p>A viatical settlement purchaser is the person or company that buys the life insurance policy.</p> <p>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.</p> <p>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.</p>	<p><b>Questions to Ask</b></p> <ul style="list-style-type: none"> <li>• Is the principal and return on my investment guaranteed?</li> <li>• How is the return on my investment calculated?</li> <li>• When is the principal and return on my investment paid?</li> <li>• Will I ever be asked to pay the premiums of the insurance policy?</li> <li>• Is the life insurance policy past the contestable period?</li> <li>• Does my state have regulations about buying viatical settlements?</li> </ul>	<p><b>Check with Your State</b></p> <p>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.</p> <p>Your state may regulate the purchase of viatical settlements. Contact your state insurance department for a copy of those regulations.</p> <p>This brochure doesn't include information about all of the risks associated with buying viatical settlements.</p> <p>To learn more about these or other investments in general, contact your state securities department for a free booklet about investments.</p>