

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 San Francisco, CA, on Dec. 7, 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); Kevin Beagan for Linda Ruthardt (MA); Tom Rushton for Don Letherer (NM); and Dalora Schafer for Carroll Fisher (OK).

1. Consider Adoption of Standard Valuation Law

Commissioner Vaughan said that this model is one of the set of models being revised to add regulatory confidentiality provisions. When the NAIC held a hearing on Dec. 4, 1999, several minor changes were discussed and these will be added by the Executive Committee before it considers adoption. Commissioner Koken moved and Ms. Schafer seconded a motion to adopt the revised Standard Valuation Law (Attachment One). The motion passed.

2. Report of Viatical Settlements Working Group

Mr. Dunlap said that one of the requests of the A Committee was that the brochures that were a part of the Viatical Advisory Package should be strengthened. Sue Anderson (ND) and Brenda Cude (University of Georgia) each provided significant comments to strengthen and to make the brochures understandable. The working group also discussed insurable interest and will have an interim meeting in January 2000 to talk about revisions to the Viatical Settlements Model Act to incorporate provisions related to life settlements and investor protection. Mr. Dunlap noted that states also have an option not to allow life settlements. Because of the regulatory vacuum that now exists, the working group will proceed vigorously to develop a model.

Commissioner Vaughan said there is no question that the working group can proceed immediately with development of the model because it was a 1999 charge which will be carried over to 2000. She

asked how the brochures were strengthened. Mr. Dunlap responded that the first set contained some inconsistencies between the three brochures and that was corrected. In the investor brochure the message about fraudulent practices was strengthened. Commissioner Vaughan asked if the working group discussed insurable interest in the context of life settlements generally. She said Iowa is seriously considering limiting life settlements to transfers only to those who have an insurable interest. Mr. Dunlap responded that the working group is considering that and may also look at a change to the insurable interest law.

Mr. Foley asked how a life settlement differs from a viatical settlement. Mr. Dunlap responded that a viatical settlement is limited to those who are terminally or chronically ill, as defined in the Health Insurance Portability and Availability Act (HIPAA). Mr. Foley asked if regulators had done any surveys to see how large a share of the market is in life settlements. He said it was his understanding that this was not a very large percentage of the market. Commissioner Vaughan said that she had seen some figures from the Viatical Association of America and asked that those be provided to the regulators. Mr. Foley said he served on several speakers panels with members of the viatical industry and it is his sense that the number of viatical and life settlements is growing at a tremendous rate, although it is still a small part of the life insurance industry. Mr. Dunlap said it is his impression that companies are moving away from viatical settlements into life settlements.

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

3. Report of Life Disclosure Working Group

Mr. Foley said the working group adopted the Life Disclosure Model Regulation at its meeting. Since that time, several industry representatives have come forward suggesting additional changes. He asked that the A Committee return the model to the working group with instructions to revise it further. He reported that the working group discussed equity indexed annuities and heard a report that the variable life insurance illustrations standards from the Securities and Exchange Commission (SEC) will be available soon. He noted that the working group is also beginning work on revisions to the Universal Life Insurance Model Regulation. Mr. Foley moved and Commissioner Koken seconded a motion to receive the Life Disclosure Working Group report (Attachment Three). The motion passed.

4. Report of Suitability Working Group

Paul DeAngelo (NJ) said this group had two charges to work on during 1999: revisions to the Advertisements of Life Insurance and Annuities Model Regulation and a white paper on Suitability Standards for Life Insurance and Annuities. Mr. DeAngelo reported that the working group has completed revisions to the advertising model and brings those to the A Committee for consideration. He said there were several changes to the regulation considered during the Winter National Meeting. The working group was urged to change the definition of advertisement to delete "branding" ads so they would not be included where states require filing of advertisements. The working group said this was not an appropriate way to address that problem and instead added a strongly worded drafting note to ask states with filing requirements to give this issue additional consideration. In addition the working group discussed the financial planner designation and added a sentence to allow someone who has a designation to use it even if he is only selling life insurance.

In addition the working group made progress on the suitability white paper and hopes to complete that project by the Spring National Meeting. He noted that the working group expects to recommend development of a model regulation on suitability standards for life insurance and annuity sales. Mr. Foley moved and Commissioner Koken seconded a motion to adopt the report of the Suitability Working Group (Attachment Four).

Ron Panneton (National Association of Insurance and Financial Advisors—NAIFA) said that some of the members of his organization are not in the business of giving financial advice but do so periodically. He noted that the word "only" in Section 5N could be confusing if the person mostly sells insurance but occasionally provides financial planning services. Commissioner Vaughan said she did

not agree with that interpretation and said that if a person does some financial planning he does not *only* sell insurance. Commissioner Vaughan suggested deleting the phrase "when they are only selling insurance" to clarify that issue. Mr. Panneton said his organization had only recently changed its name from the National Association of Life Underwriters and was concerned that it would be difficult for some one who was not a financial advisor to say that he was a member of NALFA. He asked for some language to clarify that in the model. Mr. DeAngelo said the purpose of the provision is to be sure that consumers are not misled and he did not see any problem with adding a phrase to clarify that. Commissioner Vaughan suggested that the model be returned to the working group to review this issue. She said she was not entirely comfortable with the suggestion and would welcome the opportunity to think about it a little bit longer. She asked the working group to review the narrow issues raised by Mr. Panneton and bring the model back to the A Committee at the Spring National Meeting. The motion to adopt the report was amended to receive the report of the working group and the motion passed.

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

Mr. Foley said the task force intends to change its meeting structure so that it has two four-hour slots of time to consider in depth major topics before the task force. He asked Commissioner Vaughan, in her new position as an officer of the NAIC, to request that the officers move the Life and Health Actuarial Task Force meeting back to Thursday and Friday prior to the NAIC meeting. Mr. Foley noted that as more meetings are scheduled again for Saturday, the task force members have conflicts with other sessions they would like to attend. Mr. Foley moved and Commissioner Koken seconded a motion to adopt the Life and Health Actuarial (Technical) Task Force oral report. The motion passed.

6. Consider Revised Charges for 2000

The task force reviewed the charges for 2000, which had been adopted by the Executive Committee in June 1999 and revised at the Winter National Meeting. Commissioner Vaughan noted that the Executive Committee adopted an additional charge to consider changes to the Life Insurance and Annuities Replacement Model Regulation to address issues identified by states that are actively pursuing the adoption of the replacement regulation. She said she would appoint a working group within the next week to deal with those narrow issues. She asked that states that are currently considering the regulation indicate a willingness to serve on that committee. Mr. Dunlap and Mr. DeAngelo said that their respective states are working on adoption of the regulation. Mr. DeAngelo pointed out that the other states working on the regulation may have additional issues that have been raised, but he agreed it was important to move quickly. Mr. Foley moved and Commissioner Koken seconded a motion to adopt the revised charges for 2000 (Attachment Five). The motion passed.

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

[Editor's Note: The minutes of the Life Insurance and Annuities Committee's Oct. 27, 1999, meeting are published here as Attachment Six. These minutes were adopted by the Plenary on Dec. 6, 1999.]

ATTACHMENT ONE

Standard Valuation Law (#820)

October 2, 1999

Adopted by the Life Insurance and Annuities (A) Committee

Suggestions from Technical Group in Italics

As amended to incorporate confidentiality and information sharing provisions and adopted by the Executive Committee and Plenary at their joint conference call Jan. 27, 2000.

See pages 14-17 in Volume I of this *NAIC Proceedings*.

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Section 3. Actuarial Opinion of Reserves

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D. Requirement for All Opinions

Every opinion shall be governed by the following provisions:

- (1) The opinion shall be submitted with the annual statement reflecting the valuation of such reserve liabilities for each year ending on or after December 31, 19[].
- (2) The opinion shall apply to all business in force including individual and group health insurance plans, in form and substance acceptable to the commissioner as specified by regulation.
- (3) The opinion shall be based on standards adopted from time to time by the Actuarial Standards Board and on such additional standards as the commissioner may by regulation prescribe.
- (4) In the case of an opinion required to be submitted by a foreign or alien company, the commissioner may accept the opinion filed by that company with the insurance supervisory official of another state if the commissioner determines that the opinion reasonably meets the requirements applicable to a company domiciled in this state.
- (5) For the purposes of this section, "qualified actuary" means a member in good standing of the American Academy of Actuaries who meets the requirements set forth in the regulation.
- (6) Except in cases of fraud or willful misconduct, the qualified actuary shall not be liable for damages to any person (other than the insurance company and the commissioner) for any act, error, omission, decision or conduct with respect to the actuary's opinion.
- (7) Disciplinary action by the commissioner against the company or the qualified actuary shall be defined in regulations by the commissioner.
- (8) Except as provided in Paragraphs (12), (13) and (14), documents, materials or other information in the possession or control of the Department of Insurance that are a memorandum in support of the opinion, and any other material provided by the company to the commissioner in connection with the memorandum, shall be confidential by law and privileged, shall not be subject to insert open records, freedom of information, sunshine or other appropriate phrasel, shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action. However, the commissioner is authorized to use the documents, materials or other information in the furtherance of any regulatory or legal action brought as a part of the commissioner's official duties.
- (9) Neither the commissioner nor any person who received documents, materials or other information while acting under the authority of the commissioner shall be permitted or required to testify in any private civil action concerning any confidential documents, materials or information subject to Paragraph (8).
- (10) In order to assist in the performance of the commissioner's duties under this Act, the commissioner:
 - (a) May share documents, materials or other information, including the confidential and privileged documents, materials or information subject to Paragraph (8) with other state, federal and international regulatory agencies, with the National Association of Insurance Commissioners and its affiliates and subsidiaries, and with state, federal and international law enforcement authorities, provided that the recipient agrees to maintain the confidentiality and privileged status of the document, material or other information;
 - (b) May receive documents, materials or information, including otherwise confidential and privileged documents, materials or information, from the National Association of Insurance Commissioners and its affiliates and subsidiaries, and from regulatory and law enforcement officials of other foreign or domestic jurisdictions, and shall maintain as confidential or privileged any document, material or information received with notice or the understanding that it is confidential or privileged under the laws of the jurisdiction that is the source of the document, material or information; and

(c) [Optional provision] May enter into agreements governing sharing and use of information consistent with Paragraphs (8) to (10).

Drafting Note: The language in Paragraph (10)(a) assumes the recipient has the authority to protect the applicable confidentiality or privilege, but does not address the verification of that authority, which would presumably occur in the context of a broader information sharing agreement.

(11) No waiver of ~~an existing~~ any applicable privilege or claim of confidentiality in the documents, materials or information shall occur as a result of disclosure to the commissioner under this section or as a result of sharing as authorized in Paragraph (10).

(12) A memorandum in support of the opinion, and any other material provided by the company to the commissioner in connection with the memorandum, ~~shall be kept confidential by the commissioner and shall not be made public and shall not be~~ may be subject to subpoena, other than for the purpose of defending an action seeking damages from a person the actuary submitting the memorandum by reason of an action required by this section or by regulations promulgated hereunder.

(13) However, ~~t~~The memorandum or other material may otherwise be released by the commissioner with the written consent of the company or to the American Academy of Actuaries upon request stating that the memorandum or other material is required for the purpose of professional disciplinary proceedings and setting forth procedures satisfactory to the commissioner for preserving the confidentiality of the memorandum or other material.

(14) Once any portion of the confidential memorandum is cited by the company in its marketing or is cited before a governmental agency other than a state insurance department or is released by the company to the news media, all portions of the confidential memorandum shall be no longer confidential.

ATTACHMENT TWO

Viatical Settlements Working Group
San Francisco, California
December 6, 1999

The Viatical Settlements Working Group of the Life Insurance and Annuities (A) Committee met in San Francisco, CA, on Dec. 6, 1999. Lester Dunlap (LA) chaired the meeting. The following working group members were present: Kevin McCarty (FL); Jim Genetti for Dale Freeman (ID); Bill McAndrew for Robert Heisler (IL); Roger Strauss (IA); Marilyn Burch (KS); Paul DeAngelo (NJ); Tom Jacks (NC); Sue Anderson (ND); Nick Alexander for John Pouliot (OH); Dalora Schafer (OK); Randy Rohrbach for Greg Martino (PA); Maliaka EssamelDin for Jeanne Bryant (TN); and Mike Boerner for Rhonda Myron (TX).

1. Consider Revisions to the Brochures from the Viatical Advisory Package

Mr. Dunlap said the Life Insurance and Annuities (A) Committee asked this working group to review the brochures that were adopted in July by the A Committee and to make recommendations to strengthen the brochures. Sue Anderson took the initial responsibility for redrafting the brochures and they were discussed during a conference call. The draft was sent to Brenda Cude (University of Georgia) for review for readability. Ms. Cude said none of the brochures made clear the difference between life settlements and viatical settlements. For a person purchasing a policy, this is an important consideration. Ms. Cude said she also reviewed the document for consistency and added text to clarify. The working group reviewed her clarifications and expressed support. Doug Head (Medical Escrow Society) expressed concern about the "Consumer Alert" in the investor brochure. He asked the working group to clarify the contestability period and the time after that period (generally two years) when the policy is no longer at risk of being rescinded. Rob Shear (Enhanced Life Benefits) opined that if a viatical settlement provider knows there is misrepresentation in the application, it should not purchase the policy. He asked the working group not to put this limit in the document. Julie Spiezio (American Council of Life Insurance—ACLI) said she did not agree with Mr. Head's interpretation of the law. In the vast majority of states, fraud does not limit the contestability period. She said she knew of only three states where that was not a true statement. Mike McNeerney (Mutual Benefits) spoke in support of Mr. Head's interpretation. Mr. McAndrew suggested changing the language from "the entire investment is at risk," to say that the investment "may be at risk." Mr. DeAngelo suggested that it does not do a service to consumers to tell them to wait until after the contestability period and then buy a fraudulently obtained policy. Ms. Cude pointed out there is nothing in the investor brochure to indicate whether it is better to buy a viatical settlement or a life settlement and she asked whether the brochure should give that type of guidance. The regulators decided not to include such advice. Mr. Dunlap said the intent of the brochure is to trigger questions of other advisors and noted the limit on space in a trifold brochure. Mr. Strauss moved and Mr. McCarty seconded a motion to adopt the revised brochures with the changes discussed by the working group (Attachment Two-A). The motion passed.

2. Consider Insurable Interest Issues

Ms. Spiezio said that when someone is enticed to buy a life insurance policy with the sole purpose of selling it, that nullifies the insurable interest. Since insurable interest serves a public policy purpose, it may be an immediate violation of the statute, which would void the policy. Mr. Shear said the Viatical Association of America (VAA) thinks this is an important issue and has a clear statement of policy to oppose "wet paper" transactions where someone buys a policy for the purpose of selling it. He

expressed concern that any statement on this not be made too broad. Mr. McCarty agreed that an insurable interest is axiomatic to the formation of an insurance contract and asked regulators to consider what their response to this should be. Ms. Spiezio said she did not have an answer to this issue but felt it was something regulators needed to address. John Mathews (Allstate Life) said one possible way to address the problem would be to say that a transfer within a certain period of time could only be made to someone with an insurable interest. He noted that New York recently amended its insurable interest law to add some restrictions. Mr. Dunlap noted that this is an issue the working group will need to discuss again. He asked interested parties to provide comments on the insurable interest issue in writing to Carolyn Johnson (NAIC) by Jan. 12, 2000. Mr. Strauss added that it would be very helpful to the working group if the comments included suggested language to address this issue. Gary Chodes (Viaticus) agreed that this is a critical issue. He opined that intent is going to be very difficult to discern and suggested that a device like a time period would avoid having to evaluate intent.

3. Discuss Life Settlement Provisions for Viatical Settlements Model Act

Scott Borchert (MN) expressed concern about the process of development of a life settlement regulation. He asked whether this type of arrangement should even be allowed in the marketplace. He opined that the NAIC tacitly endorses the concept by adopting a model. He said there are serious concerns that need to be examined by regulators. Mr. Dunlap said the working group had previously decided to proceed with incorporating life settlement provisions in the existing Viatical Settlements Act. He asked if that is still the intent of the working group. Mr. McCarty said that Florida attempted to get a separate law for life settlements that duplicated the Viatical Settlement Act in some places. It did not pass. That means that investors are protected if they buy a viatical settlement, but not if they buy a life settlement. He agreed that it made some sense to bifurcate the process but, for simplicity, he recommended doing it as one package. He said it runs less of a risk of confusing legislators. Ms. Schafer said that Oklahoma intends to do a separate life settlement law and suggested that it will help keep the two transactions distinct from each other. Mr. McNerney reminded the working group that the viatical settlement industry prepared a draft act for the working group's consideration. That draft proposed two separate models because some states will not want to do a life settlement act. Mr. Dunlap asked the viatical settlement industry to send another copy of the proposal to Ms. Johnson for the working group's review. Mr. McNerney noted that the industry's document also contains purchaser protections.

Mr. DeAngelo asked why a state would choose not to regulate life settlements. Mr. Head said that some states see a need for a viator protection because the individual selling a policy are ill but may not be as interested in protecting other sellers of policies. Mr. McCarty said the original idea was to protect people who were in a vulnerable condition, but the dynamics of the marketplace have not changed. Viators are now getting paid, but regulators hear about investor problems. Mr. DeAngelo suggested that if regulators believe that both types of sellers of policies should be protected, then a model should be developed that covers both. Ms. Spiezio said that consumer protection and investor issues will be the same to a great extent. Mr. Chodes said his company's experience is that the life settlement market is policies with a face value of over \$1 million generally corporate owned or by sell agreements policies. He said the type of attention that should be paid is different because of it. The typical purchase by his company is someone who has a 10-year life expectancy. For small investors that is too long and he sees it as a marketplace for institutional capital. Mr. McCarty said that he sees much of the life settlement market as smaller policies of lower value. He asked Mr. Chodes if he was suggesting that the working group carve out policies sold to large institutional investors and Mr. Chodes affirmed that was his suggestion. He said disclosure to large investors does not make sense. Mr. Shear said that a suitability issue is a gapping hole on the investment side. Mr. Strauss said that Commissioner Terri Vaughan (IA) is very interested in a product on life settlements, and suggested that if the working group needs to concentrate on one or the other it should work on life settlements. Mr. Shear suggested that the model should define chronic and life threatening illness and anything that does not fit under that category should be separate. He noted that some products are called life settlements or senior settlements or other names, and he suggested not narrowing the definition in that manner.

4. Consider Recommendations on Charge Related to Investments

Mr. Burch and Mr. McCarty prepared a document that highlights some of the investor issues (Attachment Two-B) and said that if a state is going to regulate the securities side of the transaction, these are recommendations to include. Mr. Burch said this is very similar to what Kansas securities regulators are developing. Mr. Strauss said that the Securities Bureau is part of the insurance department in Iowa and a regulation on disclosure requirements for the investor has been developed by that organization. He offered to provide a copy of that document to Ms. Johnson for the working group.

5. Adopt Minutes of Nov. 9, 1999, Conference Call

Ms. Schafer moved and Mr. McAndrew seconded a motion to adopt the minutes of the Nov. 9, 1999, conference call (Attachment Two-C). The motion passed.

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

ATTACHMENT TWO-A

Brochures from Viatical Advisory Package

Buying Viatical Settlements

Buying Viatical or Life Settlements: Be an Informed Investor

Buying Viatical or Life Settlements	Know Your Options	Other Considerations
<p>Individuals 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 or 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 consumers may not fully understand viatical or life settlements. Please read on before you make decisions.</p>	<p>If you're thinking of buying a viatical or life settlement you should:</p> <ul style="list-style-type: none"> • Understand the details and the risks before deciding. • Consult your own professional financial advisor who knows your personal financial circumstances, investment objectives, age and other considerations. You may want to consider other investment choices. • Ask your tax advisor about any possible tax consequences of buying a viatical or life settlement. Find out if it's appropriate to use 401(k), IRA, Keogh, or other qualified retirement plan funds to buy a viatical or life settlement. 	<ul style="list-style-type: none"> • Typically, viatical or life 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. The annual rate depends on when the insured dies and no one can perfectly predict a person's life expectancy. • A viatical or life settlement shouldn't be considered a liquid investment. It doesn't give a return on the investment until the individual dies and the death benefit is paid. • There are risks specific to a group policy that is owned by an employer or other organization. The primary risk is the possibility that the owner (i.e., the employer) or the insurance company may terminate the group policy. This termination will trigger the need to convert the group coverage to an individual policy. You should ask if there are any limits or caps in the conversion rights. Also ask who will be responsible for paying any additional premiums once a group policy is converted. • Insurance companies may contest death claims for policies that haven't been in effect at least two years at the date of death. The death benefit could be denied on various grounds. If the insured commits suicide within two years of taking out the policy, the insurance company may not pay the death benefit. • You should understand who estimates the life expectancy of the insured. It could be in-house staff, independent physicians or a specialty firm that analyzes medical and actuarial data. The estimated life expectancy is based on the medical information provided by the insured's physician or hospital. It's important to note that developments in medical treatments or unexpected changes in the insured's medical condition could affect the accuracy of the estimated life expectancy. • It's important to know who will be responsible for future premium payments after you invest in the policy. Ask how these payments are guaranteed. If the premiums are prepaid in escrow for a certain period, know who will pay the premiums if the insured lives beyond his or her life expectancy. In some cases, you (as the buyer) can be responsible for making these payments so that the policy doesn't lapse. • Find out if there are any trust fees, commissions or other expenses you may be required to pay and how much they will be. • Find out who would be responsible for monitoring the status of the insurance policy and the insured.

Defining the Terms	Questions to Ask	Consumer Alert
<p>A viatical settlement occurs when a person with a terminal or chronic illness sells his or her life insurance policy to a third party. A life settlement occurs when a person who does not have a terminal or chronic illness sells his or her life insurance policy to a third party. In either case, the owner of the life insurance policy sells the policy for a cash payment that is less than the full amount of the death benefit in the life insurance policy.</p> <p>A viatical or life settlement provider is the person or company that buys the life insurance policy. The viatical or life settlement provider 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 or life settlement purchase agreement is the contract or agreement in which the viatical or life settlement buyer agrees to buy all or part of a life insurance policy.</p> <p>The viatical or life settlement broker arranges the transaction between the seller of the life insurance policy and the viatical or life settlement buyer, typically using a viatical or life settlement purchase agreement.</p>	<ul style="list-style-type: none"> • Are the principal and return on my investment guaranteed? • How is the return on my investment calculated? • When is principal and return on my investment paid? • Will I ever be asked to pay the premiums of the insurance policy? • Is the insurance policy past the contestable period? • Does my state have regulations about buying viatical or life settlements? 	<p>If you're looking at investing in a viatical or life settlement, carefully check the credentials and reputation of the company or representative that will handle the transaction for you.</p> <p>Next, learn about the process the company or representative uses to assure that you receive exactly what you believe you're buying. Get detailed information about any viatical or life settlement you're considering to make certain the life insurance policy is a valid insurance contract. Be sure that it can't be contested at a later date. Also, be aware that if you invest in policies that were obtained through fraud, whether or not you knew about the fraud, the entire investment may be at risk.</p> <p>As you think about buying a viatical or life settlement, make sure you get the facts and aren't misled by unsupported projections or guarantees of returns. Don't ignore the risk that your investment will return less than you've been led to believe. Be sure you carefully think through your decision before you invest your money.</p> <p><i>To learn more about these or other investments in general, contact your state securities department for a free booklet about investments.</i></p>

Check with Your State

Your state may regulate the purchase of viatical settlements. Some states regulate the purchase of viatical or life settlements as securities through the state securities department. Others regulate it as insurance through the state insurance department. If you're interested in buying a life insurance policy, contact the appropriate state department.

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

This publication was issued in joint cooperation with the:
National Association of Insurance Commissioners
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Kansas City, Mo. 64105
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<http://www.naic.org>

Selling your Life Insurance Policy: Understanding Viatical Settlements

Understanding Viatical Settlements	Get All of the Facts	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 occurs when an individual with a terminal or chronic illness sells a life insurance policy to a third party. The owner of the policy sells it for a cash payment that is less than the full amount 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>	<p>Before you enter into any viatical settlement transaction, you should:</p> <ul style="list-style-type: none"> • Contact your life insurer to learn about all of your possible options under your policy. • Contact a viatical broker or viatical settlement provider for information about viatical settlements. • Consult your own financial advisor, who knows your personal financial needs. Be sure to ask about tax and other financial consequences if you sell your policy. • Contact your state insurance department for information about current laws that may protect you. 	<ul style="list-style-type: none"> • 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 without having to sell it to a third party. You may also be able to use the cash value as security for a loan from a financial institution. • Find out if your life insurance carrier will offer accelerated death benefits. It could pay you a substantial portion of your policy's death benefit and you wouldn't have to sell your policy to a third party.

Other Considerations	Consumer Tips	Defining the Terms
<ul style="list-style-type: none"> • Contact a professional tax advisor. Find out the tax implications. Proceeds are only tax-free under certain circumstances. • Know that your creditors could claim the proceeds. • Find out if you'll lose any public assistance benefits such as food stamps or Medicaid if you get a cash settlement. • Know that you must provide certain medical and personal information to third parties who will be paid the proceeds from your policy upon your death. These third parties may sell your policy and pass along your medical and personal information to other individuals. 	<ul style="list-style-type: none"> • Understand how the process works and when the different phases will happen. • Decide whether to sell your policy directly to a viatical settlement provider or to go through a viatical settlement broker who will do the comparison shopping for you. • If you don't use a viatical settlement broker, comparison shop on your own. • You don't have to accept any viatical settlement offer. • Check all application forms for accuracy, especially information about your medical history. • You must be truthful in your answers to application questions. • Make sure the viatical settlement provider agrees to put your settlement proceeds in escrow with an independent party or financial institution to be sure your funds are safe during the transfer. • Find out if you have the right to change your mind about the viatical settlement after you get the proceeds. In many states you have the right to change your mind for a certain period of time. If you have that right, you'll have to return the money you were paid and the premiums the buyer paid. • Understand whether buyers may learn your identity when they buy your policy, and whether they will know certain medical and personal information about you, such as your address and life expectancy. 	<p>The person selling the life insurance policy is the viator. He or she will get a cash payment from the settlement. This person gives up ownership of the policy in return for a cash payment that is less than the full amount of the death benefit in the life insurance policy. Typically, the viator has a terminal illness.</p> <p>A viatical settlement provider is the person or company that buys the life insurance policy. The viatical settlement provider becomes the policy owner, must pay any premiums that are due, and eventually collects the full amount of the death benefit from the insurance company.</p> <p>The person or company who represents the seller (viator) and can "comparison 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.</p>

Additional Questions to Consider	Consumer Alert
<ul style="list-style-type: none"> • Do I still need life insurance protection? • If I sell my policy, how will they decide how much cash I get? • If I sell my policy, will there be any costs I have to pay? • If I sell my policy, will the money be put into an escrow account? If so, who will the escrow agent be? Does state law require the agent to be licensed? • Is my policy an employer or other group policy? If so, do I need their permission to sell it? • If I sell my policy, who will be the legal owner? • Is the viatical settlement provider I plan to sell to allowed to do business in my state? • After I sell my policy, can the buyer resell it? 	<ul style="list-style-type: none"> • If you're asked to invest in or buy a viatical settlement, contact your state insurance department. Learn more about the issues and risks. • If you're interested in selling your life insurance policy, contact your state insurance department to get more information. • If you've been contacted by someone who wants you to buy a policy and then sell it immediately, contact your state insurance department. This activity may be considered fraudulent and the parties may be prosecuted by the appropriate authorities.

Check with Your State

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

This publication was issued in joint cooperation with the:
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Selling Your Life Insurance Policy: Understanding Life Settlements

Understanding Life Settlements	Get All of the Facts	Consider All Your Options
<p>A life settlement is the sale of a life insurance policy to a third party. The owner of a life insurance policy sells it for a cash payment that is less than the full amount 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 full amount of the death benefit when the insured dies.</p> <p>People decide to sell their life insurance policies for many reasons. When an individual with a terminal or chronic illness sells his or her life insurance policy, that is known as a viatical settlement. When an individual who does not have a terminal or chronic illness sells a policy for other reasons, including changed needs of dependents, wanting to reduce premiums, and cash for meeting expenses, that is known as a life settlement.</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 continue reading before making any decisions.</p>	<p>Before you enter into any life settlement transaction, you should:</p> <ul style="list-style-type: none"> • Contact your life insurer to learn about all of your possible options under your policy. • Contact a life settlement broker or life settlement provider for information about life settlements. • Consult with your own financial advisor who knows your personal financial needs. Be sure to ask about tax and other financial consequences if you sell your policy. • Contact your state insurance department for information about current laws that may protect you. 	<ul style="list-style-type: none"> • 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 without having to sell it to a third party. You may also be able to use the cash value as security for a loan from a financial institution. • Review other sources of cash that may meet your financial needs at a lower cost than a life settlement.

Other Considerations	Consumer Tips	Defining the Terms
<ul style="list-style-type: none"> • Contact a professional tax advisor. Find out the tax implications. Proceeds are only tax-free under certain circumstances. • Know that your creditors could claim the proceeds. • Find out if you'll lose any public assistance benefits such as food stamps or Medicaid if you get a cash settlement. • Know that you must provide certain medical and personal information to third parties who will be paid the proceeds from your policy upon your death. These third parties may sell your policy and pass along your medical and personal information to other individuals. 	<ul style="list-style-type: none"> • Understand how the process works and when the different phases will happen. • Decide whether to sell your policy directly to a life settlement provider or go through a life settlement broker who will do the comparison shopping for you. • If you don't use a life settlement broker, comparison shop on your own. • You don't have to accept any life settlement offer. • Check all application forms for accuracy, especially information about your medical history. • You must be truthful in your answers to application questions. • Make sure the life settlement provider agrees to put your settlement proceeds in escrow with an independent party or financial institution to make sure your funds are safe during the transfer. • Find out if you have the right to change your mind about the life settlement offer after you get the proceeds. In many states, you have the right to change your mind for a certain period of time. If you have that right, you'll have to return the money you were paid and premiums the buyer paid. • Understand whether buyers may learn your identity when they buy your policy, and whether they will know certain medical and personal information about you, such as your address and life expectancy. 	<p>A life settlement is the sale of a life insurance policy to another person or company in return for a cash payment of less than the full amount of the death benefit.</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 life settlement provider becomes the policy owner, must pay any premiums that are due, and eventually collects the full amount of the 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 buyer pays the broker a commission if the sale is completed.</p>

Additional Questions to Consider	Consumer Alert
<ul style="list-style-type: none"> • Do I still need life insurance protection? • Will I qualify for a new life insurance policy in the future? • If I sell my policy, how will they decide how much cash I get? • If I sell my policy, will there be any costs I have to pay? • If I sell my policy, will the money be put into an escrow account? If so, who will the escrow agent be? Does state law require the agent to be licensed? • Is my policy an employer or other group policy? If so, do I need their permission to sell it? • If I sell my policy, who will be the legal owner? • Is the viatical settlement provider I plan to sell to allowed to do business in my state? • After I sell my policy, can the buyer resell it? 	<ul style="list-style-type: none"> • If you're asked to invest in or buy a life settlement, contact your state insurance department to learn more about the issues and risks. • If you don't have a life-threatening illness and you're interested in selling your life insurance policy, 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, contact your state insurance department. This activity may be considered fraudulent and the parties may be prosecuted by the appropriate authorities.

Check with Your State

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

This publication was issued in joint cooperation with the:
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NAIC Model Act Amendments
(Investor Issues)
Draft #2: December 2, 1999

XX.XXXX Designation of Viatical Settlement Brokers or Sales Agent

On or before, March 1, 2000, a licensed life agent, performing the functions of a viatical settlement broker or viatical sales agent, must notify the department in writing of their transacting business as a viatical settlement broker, viatical settlement sales agent or both. Upon receipt of such notification, the department shall designate such person's license as a viatical settlement broker, viatical settlement sales agent or both. After March 1, 2000, no person licensed as a life agent shall perform the functions of a viatical settlement broker or viatical settlement sales agent unless such person's life license contains the designation required by this section.

XX.XXXX Use of Licensed Viatical Settlement Brokers, Providers and Sales Agents Required

- (1) A licensed viatical settlement provider may not transact business with a viatical settlement broker as defined in this act unless the viatical settlement broker holds a current, valid license as a viatical settlement broker.
- (2) A licensed viatical settlement provider may not transact business with a viatical settlement sales agent as defined in this act unless the viatical settlement sales agent holds a current, valid license as a viatical settlement sales agent.
- (3) A licensed viatical settlement broker or a viatical settlement sales agent may not transact business as a viatical settlement broker or viatical settlement sales agent except with a licensed viatical settlement provider as defined in this act.
- (4) No person may perform the functions of a viatical sales agent unless such person is licensed as a life agent and designated as a viatical settlement sales agent as provided in this act.

XX.XXXX Viatical Settlement Provider Performance

- (1) To assure the faithful performance of its obligations to viators and purchasers in the event of insolvency or non-compliance with this act, a viatical settlement provider must deposit in escrow and maintain deposited in escrow, either with the department or with a federal or state chartered financial institution in this state acceptable to the department, securities eligible for deposit under Section [applicable state law]. The escrow account must be maintained for as long as the viatical settlement provider has viatical settlement contracts or viatical settlement purchase agreements outstanding. Whenever the market value of the securities on deposit is less than 95% of the amount required, the viatical settlement provider must immediately deposit additional securities or otherwise increase the deposit to the amount required. Such securities must have at all times a market value equal to the lesser of ten percent of the face value of all insurance policies viaticated by the provider or \$1,000,000.
- (2) If the escrow account is established with a federal or state chartered financial institution such arrangement must be evidenced by a written escrow agreement and is subject to approval by the department.
- (3) The escrow agreement must provide, in addition to any other provisions required by law, that funds held in escrow must be kept and maintained separate and apart from the provider's business accounts; that its purpose is to ensure the faithful performance of the provider in its viatical settlement transactions with viators and purchasers; that the escrow agent agrees to abide by the duties imposed; and, that funds may only be released upon order of a court of competent jurisdiction or by order of the department as may be directed.
- (4) The agreement must provide that the escrowed funds must not be subject to any liens, judgments, garnishments, creditor's claims, or any other encumbrances or charges by the escrow agent except escrow fees associated with administering the account.
- (5) The deposit requirements of this section are subject to audit by the department at any time and at the request of the department or the provider the escrow agent must issue a statement indicating the status of the escrow account.

XX.XXXX Required Advertising Records

- (1) Each provider shall have and maintain for at least (3) years after the advertisement was first published, distributed or circulated at its home or principal office in this state a complete file containing a copy of every printed, published, or prepared advertisement or "invitation to inquire" including any electronic advertising it has used in this state or authorized for use in this state.
- (2) Each provider shall also have and maintain as set forth in this paragraph any and all advertising for any affiliate, associated person, controlling person, broker or agent including independent contractors, escrow agents or trusts.

(3) Each advertisement or "invitation to inquire" shall contain a notation clearly stating the name of the individual authorizing the advertisement, the dates the advertisements were printed or published and the manner and extent of distribution of each advertisement.

(4) Each file shall be available for inspection by the Department.

XX.XXX Required Business Records in General

(1) Each provider conducting business in this state, from offices in this state, or with residents of this state, shall have and maintain in its home office or its main office of record in this state if its home office is not in this state, the records, files and documents required by this rule. Such records, accounts, documents, files and other information relating to all business transactions including transactions with affiliates, associated persons, controlling persons and independent contractors shall be maintained for a period of at least three years from the date of death of a viator.

(2) Each provider, its officers, accountants, employees, agents, escrow agents, trustees or representatives, including any affiliated, associated, or controlling person, and any independent contractor shall permit and make freely available to the department or its examiners or investigators the accounts, records, documents, files, information, and matters in their possession, custody or control relating to its business or affairs regarding any viatical settlement transaction or viatical settlement contract or viatical settlement purchase agreement.

(3) Each provider shall have and maintain at a minimum, the following books and records as permanent office records:

(a) A complete set of accounting records, including but not limited to, a general ledger or book of original entry, cash receipts and disbursement journals, accounts receivable and accounts payable ledgers, sales journals, payroll and expense registers;

(b) A listing of all bank accounts and bank reconciliation records for each account so listed together with cancelled checks, escrow statements, wire transfers, money orders, or other evidences of cash transactions.

(4) A provider shall establish and maintain for at least three years after the death of a viator, a viatical settlement transaction file for each application for a viatical settlement contract. The viatical settlement transaction file shall contain original or exact copies of the following documents and information:

(1) The application for a viatical settlement contract;

(2) The viatical settlement contract and all related forms;

(3) The insurance policy or group certificate if a group policy;

(4) The application for the insurance policy or application for conversion of a group certificate to individual coverage;

(5) The authorization for release of the medical records of the insured;

(6) The medical records of the insured;

(7) The policy acquisition worksheet, underwriting worksheet or similar form by whatever name called, used to determine whether or not to make an offer to purchase or reject a life insurance policy on a given insured from a given viator;

(8) The life expectancy used as the basis of payment to the viator;

(9) Proof of the amount and timely payment to the escrow agent;

(10) Proof of the amount and timely payment to the viator;

(11) Proof of assignment of the insurance policy to the provider;

(12) Verification of coverage and change of ownership and beneficiary forms submitted to and received from the insurer;

(13) Acknowledgement of assignment, transfer, or conveyance by the insurer;

(14) A copy of any and all assignments, transfers or conveyances of any interest in the insurance policy to any person other than the provider;

(15) A copy of any and all viatical settlement purchase agreements evidencing the purchase of an interest in a life insurance policy of an insured that is the subject of a given viatical settlement contract;

(16) The name, address and [state] license number of any broker or sales agent representing the purchaser;

- (17) Proof of receipt of funds and proof of deposit from each purchaser;
- (18) A certified copy of the Death Certificate and a copy of the death claim if the insured has died together with proof of payment of insurance proceeds and to whom such payments were made;
- (19) A copy of any rescission notices, requests for refunds, lapse notices, etc., by an insurer, a viator, or from any purchaser, and proof of any such notices sent to or any refunds paid to any person;
- (20) The name and address of the person(s) responsible for tracking the viator and the method used to track the viator;
- (21) Proof that premium payments have been or are being made and by whom;
- (22) Proof that the insurance policy has been reviewed to determine if it was fraudulently obtained, and if so, proof that it was properly reported to the department;
- (23) Copies of any and all correspondence, memorandums, notes, etc., in whatever form and howsoever maintained, to or from any person, including but not limited to a broker, agent, medical professional, provider, insurer, insured, viator, purchaser, purchasers representative, or attorney regarding the viatical settlement transaction, the viatical settlement application or contract, the viatical settlement purchase agreement or the insurance policy which is the subject of the viatical settlement application or contract.

XX.XXXX Confidentiality of Medical Records

A viatical settlement provider shall maintain the confidentiality of the medical records of an insured; however, pursuant to Section [applicable state law], such records shall be accessible by the department during the course of any examination or investigation and shall be deemed confidential unless such records are necessary to sustain a violation of law.

ATTACHMENT TWO-C

Viatical Settlements Working Group Conference Call November 9, 1999

The Viatical Settlements Working Group of the Life Insurance and Annuities (A) Committee met by conference call on Nov. 9, 1999. Lester Dunlap (LA) chaired the meeting. The following working group members participated: Elizabeth Bookwalter for Michael Bownes (AL); Kevin McCarty (FL); Dale Freeman (ID); Chuck Budinger for Robert Heisler (IL); Roger Strauss (IA); Marilyn Burch (KS); Paul DeAngelo (NJ); Tom Jacks (NC); Sue Anderson (ND); John Pouliot (OH); Dalora Schafer (OK); Joel Ario (OR); Paul Makurath for Greg Martino (PA); Maliaka EssamelDin for Jeanne Bryant (TN); and Rhonda Myron (TX).

1. Consider Revisions to Viatical Brochures

Mr. Dunlap said that in July 1999 the working group held a joint conference call with the Life Insurance and Annuities (A) Committee and adopted an advisory package to be distributed to the states, media and consumer groups. At that time the North Dakota Insurance Department expressed concern that the brochures that were a part of the advisory package needed to be improved. The working group agreed to submit recommendations for the A Committee to consider in December. Since the majority of changes were drafted by North Dakota, Mr. Dunlap asked Ms. Anderson to review the changes North Dakota is recommending.

The working group first discussed the brochure entitled "Selling Your Life Insurance Policy: Understanding Viatical Settlements." Ms. Anderson suggested changing the phrase in the second paragraph to say the owner of the policy sells it for a "reduced percentage of the death benefit." Mike McNerney (Mutual Benefits) said that the difference with a viatical settlement is that the individual receives cash for the policy and asked that the changes reflect that reality. The working group agreed to change the second sentence in all of the brochures to say that the owner of the policy sells it for "a cash payment of a reduced amount of the death benefit."

Discussion next turned to the second heading under that brochure. Ms. Anderson suggested changing it from "Know Your Options" to "Inform Yourself." She added a phrase that was in the life settlement brochure saying, "Before you enter into a viatical settlement transaction, you should:" followed by several bullet points. She suggested changing the bullet point that recommends consulting your financial advisor to say that you should talk to your financial advisor about the tax consequences. Mr. McNerney said that there are many things that you might want to talk to your financial advisor about. The advice should be broader than just consultation about tax consequences. Ms. Anderson said she highlighted that because she thinks many people believe that, since this is a life insurance policy, no tax will be due. The working group agreed to leave the original text and add information about taxes so that the bullet now reads, "Consult your own financial advisor, who knows about your personal financial needs, especially about possible tax consequences if you sell your policy." Doug Head (Medical Escrow Society) said the first bullet added by Ms. Anderson that says "contact your life insurer to find out all your possible options under your policy. ..." is inappropriate. He said that life insurers cannot explain all of the options under a life insurance policy impartially. Karen Klinkman (New York Life) said the insurer has all the information about that policy. The working group

agreed to leave the bullet as suggested. The second bullet suggested that an individual contact the insurance agent or company for information about viatical settlements. The working group decided that was inappropriate and changed it to suggest contacting a viatical settlement broker or provider for information. Mr. McNerney suggested exchanging the position of the first two bullets so that the first suggestion was to contact a viatical settlement broker or viatical settlement provider. Ms. Anderson said the first emphasis should be on looking at options under the life insurance policy and the working group agreed.

Discussion next turned to the heading "Other Considerations." Ms. Anderson suggested adding information to the last bullet to say that personal information could be provided to "third parties who benefit from your death." Mr. McNerney said this was too harsh and asked the working group to rephrase it. Ms. Anderson said this was a major concern of Commissioner Glenn Pomeroy (ND). She said the fact is that the person who buys your policy does benefit from your death. Mr. McNerney said that family members also benefit. Ms. Schafer said that there are different considerations for a family. Mr. DeAngelo suggested compromise language that would say "third parties who will receive the proceeds from your policy upon your death." He said that it was factual and not quite as harsh, but he believed it would drive home the same point. The working group members agreed with that change. Mr. McNerney said it is true, but he asked the working group to remember that more and more securities regulators are requiring that the information be given to the investor, as they consider purchaser protection.

Discussion next focused on the "Questions to Consider" portion of the brochure. Ms. Anderson suggested some additional questions to include. She suggested adding a question that asked if the money will be put in an escrow account with a licensed financial institution. Mr. McNerney said he does not know of any state that requires the escrow agent to be a financial institution. He said this questions gives the impression that, if the answer is no, this is not good. Stacy Braverman (Viaticus) said most states require that the escrow agent be an independent party, regulated by the state. The working group agreed to change the question to say, "If I sell my policy, will the money be put into an escrow account? Who is the escrow agent, and is it required by state law to be licensed?" The working group agreed to delete some of the questions so that the brochure does not become too long. Mr. Freeman cautioned that a brochure with too much information would not serve its purpose because people will not read it.

Discussion next turned to the "Consumer Alert" section of the brochure. Ms. Anderson suggested adding to the last bullet that if you are contacted by someone who wants you to buy a policy and then sell it immediately, this activity "is considered fraudulent and may be prosecuted by the appropriate authorities." Mr. McNerney said the majority of states do not consider this action to be fraudulent. Mr. Jacks suggested toning it down a bit because it is not illegal at the present time unless there is a question on the application. He cautioned that it is a growing concern of regulators. The working group agreed to change the phrase to say "this activity may be considered fraudulent and the parties may be prosecuted by the proper authorities."

Discussion next turned to the brochure entitled "Selling Your Life Insurance Policy: Understanding Life Settlements." The working group agreed to make changes consistent with the viatical settlements brochure. Ms. Anderson said the tax implications would be different in this instance. Mr. McNerney said there may still be some places where the proceeds would not be taxed. The working group agreed to change the sentence under "Other Considerations" to say that "proceeds are only tax free under certain circumstances."

Discussion next turned to the investor brochure. Mr. Dunlap endorsed a recommendation from the American Council of Life Insurance (ACLI) to refer to both viatical settlements and life settlements in this brochure. The working group agreed to redraft the title to say "Buying Viatical or Life Settlements: Being An Informed Investor." Mr. Burch said the securities commissioners now have their own committee and are developing their own brochures. He asked if this working group needs to touch base with them before making revisions to this brochure. Mr. McNerney said that committee is six months or more behind. Their earliest product will be available in the spring. Ms. Anderson said she took her revised brochures to Syver Vinje (North Dakota Securities Commissioner) and he made only one comment for the end of this brochure. Mr. Dunlap said the working group will need to periodically review this issue, and later, when that group has progressed, the two can work together on revising the brochures again. Mr. Dunlap said he thought this brochure needs a Consumer Alert section because current events warrant a special alert to consumers. He suggested an alert that covers three points: 1) some are investment scams with only a pretense of investing the money; 2) investments in fraudulently obtained policies; and 3) address misleading claims on returns and principal guarantees. Mr. Dunlap agreed to draft language with the assistance and input from the viatical and insurance industries and submit it to Carolyn Johnson (NAIC) for inclusion in the revised brochures.

The working group reviewed the language from Mr. Vinje saying that many states regulate the purchase of viatical settlements as securities. The working group agreed to include that language.

Joan Markoe (CIGNA) said this brochure does not completely address the risks of investing in group policies. The working group decided that the brochures were already long enough but did agree that more could be said about group policies. Ms. Klinkman suggested amending the Viatical Settlements Model Regulation to require these brochures be provided. Mr. Dunlap said the working group can discuss that at the Winter National Meeting.

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

ATTACHMENT THREE

Life Disclosure Working Group
San Francisco, California
December 5, 1999

The Life Disclosure Working Group of the Life Insurance and Annuities (A) Committee met in San Francisco, CA, on Dec. 5, 1999. Tom Foley (KS) chaired the meeting. The following working group members were present: John Shields for John Hartnedy (AR); Sheldon Summers (CA); Roger Strauss (IA); Lester Dunlap (LA); Daniel Judson for Linda Ruthardt (MA); Paul DeAngelo (NJ); Mike Batte (NM); Louis Belo for Tom Jacks (NC); Frank Stone (OK); and Rhonda Myron for Ted Becker (TX).

1. Consider Comments on Life Disclosure Model Regulation Amendments

Mr. Foley noted that the Life Disclosure Working Group was charged to update the Life Disclosure Model Regulation to remove any conflicts with the Life Insurance Illustrations Model Regulation. Michael Herndon (Certified Financial Planner Board of Standards) said the rules the NAIC is considering might prevent a person who is a Certified Financial Planner (CFP) from putting the initials "CFP" on his or her letterhead. He opined that the issue of what they might be holding themselves out to be is different than the designation they maintain. He provided language for a drafting note and suggested that it be added under the language of Section 7C. Mr. DeAngelo said the Suitability Working Group is considering the same suggestion for the Advertisements of Life Insurance and Annuities Model Regulation. Mr. DeAngelo said that working group also received a recommendation to change the language in that regulation that is similar to Subsection C to match language from the Unfair Trade Practices Act. Mr. DeAngelo said that language clearly gives the impression that the designation cannot be used and opined that the language in the Unfair Trade Practices Act created a problem that created the need for the drafting note. The working group agreed to add the drafting note suggested by Mr. Herndon.

George Coleman (Prudential) said he has suggestions for several technical amendments to preserve the policy data requirement for policies issued prior to the effective date of the Life Insurance Illustrations Model Regulation. He said the current scale needs to be put back in for those old policies. Mr. Coleman said that would allow companies to use illustrations for old policies. The working group agreed to the suggestion of Mr. Coleman to return Subsection 4C and 4F to the original language. Dennis Herchel (MassMutual) said that there may be states that adopt the new Life Disclosure Model Regulation but retain their old replacement regulation. He said that there might be some confusion as to whether a policy summary has to be created for a form marketed with an illustration for older replacement regulation compliance. He suggested adding at the end of Section 5A(2) a sentence that said "an illustration provided in accordance with [insert reference to state equivalent of Life Insurance Illustrations Model Regulation] fulfills any policy summary requirements." The working group agreed to that suggestion.

Mr. Dunlap asked the regulators to consider changes to Section 6 on preneed funeral contracts or prearrangements. He pointed out that Subsections E, F and G really apply to the funeral director or seller of a preneed funeral contract. He opined those three subsections are beyond the scope of insurance regulation and asked if any regulators have the authority to enforce those provisions. Mr. Foley asked if there was someone else in the states who would have the authority to regulate. Most agreed that there would be. Mr. Batte said he was familiar with two states' regulations. In Texas the banking regulator regulates preneed funeral contracts and in New Mexico it is the superintendent of insurance. He suggested adding a drafting note asking states to consider whether they have the authority to regulate as stated in Subsections E, F and G. Mr. Foley responded that he would prefer a drafting note eliminating those subsections to assure that someone would look at those issues. Brenda Cude (University of Georgia) said the Federal Trade Commission has a funeral rule that requires disclosures on products and services. The working group agreed to add the drafting note described by Mr. Batte.

Mr. Strauss moved and Mr. Batte seconded a motion to adopt the Life Insurance Disclosure Model Regulation with the amendments discussed (Attachment Three-A). The motion passed.

2. Consider Suggestions for Equity Indexed Annuities Buyer's Guide Revisions

Charlotte Liptak (American General Life) said the technical resource advisors considered, at the request of the working group, whether changes in the marketplace would require changes to the Equity Indexed Annuities Buyer's Guide. She said there are a number of changes that the working group may want to consider. The marketplace changes are more in the nature of how various equity indexed annuity (EIA) product features are being combined, rather than a whole new product. She said more EIA forms now use indices other than or in addition to the Standard & Poor's 500. EIAs are starting to be combined with other annuity forms in "multiple option" annuities. Transfers are generally allowed between types and options at specified times. Averaging is a more popular crediting methodology and there are some forms with multi-year resets. In general, crediting methodologies involve many moving parts. For example, the design may use a participation rate, a spread and averaging. There is also more variation in the way in which companies describe and set their contractual guarantees. Ms. Liptak said the working group could make technical corrections to the guide because the marketplace is going through many changes. She noted that it is difficult to anticipate what changes might need to be made in the future. She suggested that, if the working group wished to revise the guide, it be made more generic. Mr. Dunlap noted that Louisiana just printed 5,000 copies of the buyer's guide adopted by the NAIC previously. Ms. Liptak responded that she recognized there are many practical reasons for not making constant changes to the guide. Mr. DeAngelo said he did not believe the working group could keep up with the changes and opined that regulators should exert more control over the complexity of the product rather than trying to describe the changes. Ms. Liptak asked the working group to remember that this document is part of the Annuity Disclosure Model Regulation, which requires a more specific description in the disclosure statement. The working group decided not to update the buyer's guide at this time.

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

Julie Spiezio (American Council of Life Insurance—ACLI) reported that the SEC staff says that it will soon publish Form N-6, which will address illustrations for variable life insurance products. It is the ACLI's understanding that it borrows heavily from the Life Insurance Illustrations Model Regulation. Mr. Foley said that once this document is published, the NAIC will be able to draft a variable life illustrations model. Mr. Coleman said it was his hope that the regulators would decide that a regulation is not needed because of consistency on the federal side with the NAIC's illustration regulation as it currently exists. Mr. Foley agreed that would be a good result.

4. Discuss Charges for 2000

The working group reviewed the charges for 2000 that were adopted by the Executive Committee in June 1999, and added charges from 1999 that had not yet been completed. The working group suggested moving the charge on the Annuity Disclosure Model Regulation to 2001 because it is premature to consider how the model was working at this time. Mr. Dunlap noted that, during its conference call adopting the Equity Indexed Annuities Checklist, the Life Insurance and Annuities (A) Committee suggested that the Life Disclosure Working Group be charged to update the checklist as needed. A charge to do so was added. Mr. DeAngelo suggested adding a charge to work more extensively on the Life Disclosure Model Regulation on issues other than coordination with the Life Insurance Illustrations Model Regulation, as the group was charged to do. The working group agreed to add such a charge for 2000.

5. Consider Amendments to Universal Life Insurance Model Regulation

Mr. Foley said he asked the NAIC staff to prepare a first draft of amendments to the Universal Life Insurance Model Regulation (Attachment Three-B). He asked interested parties and regulators to review that draft and comment prior to the Spring National Meeting. He said revisions to that model will be a major topic of discussion during the Spring National Meeting.

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

ATTACHMENT THREE-A

Life Insurance Disclosure Model Regulation (#580) Draft: December 5, 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 34.710.~~

~~(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. Current Dividend Scale. 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 Data. The policy data is a display or schedule of numerical values, both guaranteed and nonguaranteed for each policy year or a series of designated policy years of the following information: illustrated annual, 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);~~
- ~~(f) 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:~~

$$YP = (P - Dv - (CVCv - GVP)) / (F \cdot 0.001)$$

Where YP = Yearly Price of Death Benefits per \$1,000

P = Annual premium

GVP = Sum of the cash value and terminal dividend at the end of the preceding year.

CVC = Sum of the cash value and terminal dividend at the end of the current year.

D = Annual dividend

F = Face amount

v = 1/(1.05)

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. Delivery of the policy summary shall be consistent with the time for delivery of the Buyer's Guide as specified in Paragraph (1). An illustration provided in accordance with ~~insert reference to state adoption of Life Insurance Illustrations Model Regulation~~ fulfills any policy summary requirements.~~

~~(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]. Unless otherwise requested, the policy data shall be provided for twenty (20) consecutive years beginning with the previous policy anniversary. The statement of policy data shall include cash dividends or interest 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 those 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 4O 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 4O 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 4O;~~

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

Drafting Note: States should consider whether the insurance regulator has the authority to enforce the provisions of Subsections E, F and G.

H. ~~If so, t~~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.

Drafting Note: This provision is not intended to preclude persons who hold some formal recognized financial planning or consultant designation from using this designation when they are only selling insurance. This does not permit persons to charge an additional fee for services that are customarily associated with the solicitation, negotiation or servicing of policies.

~~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 element 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 elements 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 1110. 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 to 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	Illustrated Guaranteed Cash Value	Annual Dividend	Terminal Dividend	Premium
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	54.28	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	110.03	3.16	0.00	21.40
8	127.88	3.41	0.00	21.40
9	145.09	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:

Policy Year	(1) Yearly Price	(2) Second Difference in Yearly Price	(3) Second Difference Squared
1	21.40	—	NA
2	10.76	—	NA
3	-2.13	-2.25	NA
4	-1.79	13.23	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	.50	-7.82	61.1524
11	8.72	15.89	252.8521
12	8.88	-7.07	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 25 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:

Illustrated				
Policy Year	Guaranteed Cash Value	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	125.54	0.0	0.0	11.34
15	138.90	0.0	0.0	11.34
16	152.53	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	253.71	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	331.20	0.0	0.0	11.34
28	347.20	0.0	0.0	11.34
29	363.43	0.0	0.0	11.34
30	379.67	0.0	0.0	11.34

				(1)	(2)	(3)
Policy Year	Yearly Price	Second Difference in Yearly Price	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	15.65	36.00	1,296.0000
22	.51	-37.87	1,434.1369
23	9.00	23.63	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	348	38	541
28	371	39	552
29	392	40	563
30	413	41	572
31	432	42	581
32	451	43	588
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} Policy Name: {insert name}
 {Address of Insurance Company} Form Number: {insert number}

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

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

CHART B

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.

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*	2	3	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}

Policy Name: {insert name}

{Address of Insurance Company}

Form Number: {insert number}

A policy for {Name of Insured(s)}

Applied for on {insert date}

Social Security Number(s): {Insert number}

Date of Birth: {Insert DOB}

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)	(2)	(3)	(4)	(5)
Age	Maximum Annual Premium (Guaranteed Assumptions)	Possible Annual Premium (Current Assumptions)	Death Benefit	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.]

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.]

Applicant Information:

NAME: _____ AGE: _____ SEX: _____

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

End of Policy Year	<u>1</u> Premiums	<u>2</u> Premiums Accumulating Interest at 5%*	<u>3</u> Death Benefits**	<u>4</u> Cash Surrender Value	<u>5</u> 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 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.]

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	\$550.79	\$(571.19)
5	\$507.38	\$2943.75	\$1800.00	\$737.55	\$(1143.75)
6	\$507.38	\$3623.68	\$1875.00	\$938.06	\$(1748.68)
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	\$2020.76	\$(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 (\$29.47).

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	\$2358.26	\$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 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.~~

~~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.~~

ATTACHMENT THREE-B

Universal Life Insurance Model Regulation (#585)
Draft: November 30, 1999

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Section 1. Authority

This regulation is promulgated under the authority of Section [insert applicable section], of the Insurance Laws of [insert state], and is effective [insert date].

Section 2. Purpose

The purpose of this regulation is to supplement existing regulations on life insurance policies in order to accommodate the development and issuance of universal life insurance plans.

Drafting Note: It is the position of the drafters of this regulation that universal life insurance is simply another competing type of life insurance which should be treated, to the extent possible, in the same regulatory manner as other life insurance products. This regulation is designed to address those areas where universal life insurance does not "fit" into the existing

regulatory framework. This regulation does not supersede existing requirements relating to filing, solicitation, advertising, etc., but is supplementary to them.

Section 3. Definitions

As used in this regulation:

- A. "Cash surrender value" means the net cash surrender value plus any amounts outstanding as policy loans.
- B. "Commissioner" means the Insurance Commissioner of this state.

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

- C. "Fixed premium universal life insurance policy" means a universal life insurance policy other than a flexible premium universal life insurance policy.
- D. "Flexible premium universal life insurance policy" means a universal life insurance policy which permits the policyowner to vary, independently of each other, the amount or timing of one or more premium payments or the amount of insurance.
- E. "Interest-indexed universal life insurance policy" means any universal life insurance policy where the interest credits are linked to an external referent.

Drafting Note: This definition is not intended to include those policies which only have a variable policy loan interest rate provision, but have no other link to an external referent. This regulation presently addresses only the indexing of interest credits. The regulation does not preclude the indexing of other factors, e.g., mortality or expenses. Should other products be developed which involve the indexing of factors other than interest credits, this regulation may require modification. The regulation does not preclude insurance departments from adding requirements regarding the indexing of such other factors.

~~F. "May" is permissive.~~

~~GF. "Net cash surrender value" means the maximum amount payable to the policyowner upon surrender.~~

~~HG. "Policy value" means the amount to which separately identified interest credits and mortality, expense, or other charges are made under a universal life insurance policy.~~

Drafting Note: Universal life insurance policies may use designated amounts for different purposes. These include the following: the base upon which interest credits are calculated; the amount subtracted from the policy's face value to determine net amount at risk for calculation of mortality charges, and the amount paid upon surrender. These amounts may all be the same or may be different. For purposes of this regulation, these amounts do not define policy value, although they may be coincidentally equal to that amount as defined above.

Care should be taken not to place undue emphasis on the policy or "account" value. Very often the policy value is not directly available to the policyowner. Instead, the policy value is an intermediate step used to determine benefits actually available to the policyowner such as cash surrender values, net cash surrender values, death benefits, or maturity values. The benefits actually provided the policyowner should be considered in establishing valuation and nonforfeiture standards.

~~I. "Shall" is mandatory.~~

~~JH. "Universal life insurance policy" means any individual life insurance policy under the provisions of which where separately identified interest credits (other than in connection with dividend accumulations, premium deposit funds, or other supplementary accounts) and mortality and expense charges are made to the policy. A universal life insurance policy may provide for other credits and charges, such as charges for the cost of benefits provided by rider.~~

Drafting Note: This regulation is specifically designed for individual life insurance policies. It is not intended, however, to prohibit the issuance of group universal life insurance policies. States are free to adopt whatever portions of this regulation which are appropriate for group insurance and which are in accordance with state law.

Unlike the unitary nature of traditional whole life insurance, a distinguishing feature of universal life insurance is the existence of an indeterminate policy value from which specified periodic charges are deducted and to which specified periodic interest is credited at a rate not determined at issue. This indeterminate policy value feature with separately identified charges and credits may or may not have a premium pattern predetermined by the insurer at issue. Valuation and nonforfeiture treatment of these products varies depending upon the nature of the premium pattern. To distinguish these treatments, a definitional distinction has been made between "flexible" and "fixed" premium policy forms.

Section 4. Scope

This regulation ~~encompasses~~ ~~applies to all~~ individual universal life insurance policies except those policies defined under ~~Section 26 of the NAIC Model Variable Life Insurance Regulation~~ variable universal life.

Section 5. Valuation

A. Requirements

The minimum valuation standard for universal life insurance policies shall be the Commissioners Reserve Valuation Method, as described below for such policies, and the tables and interest rates specified below. The terminal reserve for the basic policy and any benefits and/or riders for which premiums are not paid separately as of any policy anniversary shall be equal to the net level premium reserves less (C) and less (D), where:

Reserves by the net level premium method shall be equal to $((A)-(B))r$ where (A), (B) and "r" are as defined below:

(A) is the present value of all future guaranteed benefits at the date of valuation.

(B) is the quantity $\frac{PVFB}{a_x} a_{x+t}$

where PVFB is the present value of all benefits guaranteed at issue assuming future guaranteed maturity premiums are paid by the policyowner and taking into account all guarantees contained in the policy or declared by the insurer.

a_x and a_{x+t} are present values of an annuity of one per year payable on policy anniversaries beginning at ages x and $x+t$, respectively, and continuing until the highest attained age at which a premium may be paid under the policy. The letter "x" is defined as the issue age and the letter "t" is defined as the duration of the policy.

The guaranteed maturity premium for flexible premium universal life insurance policies shall be that level gross premium, paid at issue and periodically thereafter over the period during which premiums are allowed to be paid, which will mature the policy on the latest maturity date, if any, permitted under the policy (otherwise at the highest age in the valuation mortality table), for an amount which is in accordance with the policy structure.¹ The guaranteed maturity premium is calculated at issue based on all policy guarantees at issue (excluding guarantees linked to an external referent). The guaranteed maturity premium for fixed premium universal life insurance policies shall be the premium defined in the policy which at issue provides the minimum policy guarantees.²

The letter "r" is equal to one, unless the policy is a flexible premium policy and the policy value is less than the guaranteed maturity fund, in which case "r" is the ratio of the policy value to the guaranteed maturity fund.

The guaranteed maturity fund at any duration is that amount which, together with future guaranteed maturity premiums, will mature the policy based on all policy guarantees at issue.

(C) is the quantity $\frac{((a)-(b))a_{x+t}}{a_x} r$ where (a)-(b) is as described

in [insert reference to Section 4 of the Standard Valuation Law] for the plan of insurance defined at issue by the guaranteed maturity premiums and all guarantees contained in the policy or declared by the insurer.

a_{x+t} and a_x are defined in (B) above.

(D) is the sum of any additional quantities analogous to (C) which arise because of structural changes³ in the policy, with each such quantity being determined on a basis consistent with that of (C) using the maturity date in effect at the time of the change.

The guaranteed maturity premium, the guaranteed maturity fund and (B) above shall be recalculated to reflect any structural changes in the policy. This recalculation shall be done in a manner consistent with the descriptions above.

Future guaranteed benefits are determined by (1) projecting the greater of the guaranteed maturity fund and the policy value, taking into account future guaranteed maturity premiums, if any, and using all guarantees of interest, mortality, expense deductions, etc., contained in the policy or declared by the insurer; and (2) taking into account any benefits guaranteed in the policy or by declaration which do not depend on the policy value.

All present values shall be determined using (i) an interest rate (or rates) specified by [insert reference to the Standard Valuation Law] for policies issued in the same year; (ii) the mortality rates specified by the [insert reference to the Standard Valuation Law] for policies issued in the same year or contained in such other table as may be approved by the Commissioner for this purpose; and (iii) any other tables needed to value supplementary benefits provided by a rider which is being valued together with the policy.

Drafting Note: To the extent that the insurer declares guarantees more favorable than those in the policy (contractual guarantees), such declared guarantees shall be applicable to the determination of future guaranteed benefits.

The mortality and interest bases for calculating present values are the minimum standards in the Standard Valuation Law.

Ever since the adoption of the original Standard Valuation Law (SVL) in 1942, provision has been made for valuation calculations on the basis of substandard mortality. (See Section 4G of SVL). While this provision has been used infrequently in the past, it is anticipated that substandard mortality will be more frequently utilized in universal life insurance, given its flexible nature, to reflect the mortality classification assigned to the policy by the insurer.

In effecting structural changes, consistent methods are prescribed when calculating reserves. Several such methods are possible, but perhaps the simplest such method would be that of maintaining proportionality between the Guaranteed Maturity Fund and Guaranteed Maturity Premium values and the current face amount. In applying this method, Guaranteed Maturity Fund and Guaranteed Maturity Premium values could be calculated per dollar of face amount and simply multiplied by the new face amount. This would eliminate much of the complexity involved in other methods.

B. Alternative Minimum Reserves

If, in any policy year, the guaranteed maturity premium on any universal life insurance policy is less than the valuation net premium for such policy, calculated by the valuation method actually used in calculating the reserve thereon but using the minimum valuation standards of mortality and rate of interest, the minimum reserve required for such contract shall be the greater of (1) or (2).

- (1) The reserve calculated according to the method, the mortality table, and the rate of interest actually used.
- (2) The reserve calculated according to the method actually used but using the minimum valuation standards of mortality and rate of interest and replacing the valuation net premium by the Guaranteed Maturity Premium in each policy year for which the valuation net premium exceeds the Guaranteed Maturity Premium.

For universal life insurance reserves on a net level premium basis, the valuation net premium is $\frac{PVFB}{a_x}$

and for reserves on a Commissioners Reserve Valuation Method, the valuation net premium is $\frac{PVFB}{a_x} + \frac{(a)-(b)}{a_x}$

Section 6. Nonforfeiture

A. Minimum Cash Surrender Values for Flexible Premium Universal Life Insurance Policies

Minimum cash surrender values for flexible premium universal life insurance policies shall be determined separately for the basic policy and any benefits and riders for which premiums are paid separately. The following requirements pertain to a basic policy and any benefits and riders for which premiums are not paid separately.

The minimum cash surrender value (before adjustment for indebtedness and dividend credits) available on a date as of which interest is credited to the policy shall be equal to the accumulation to that date of the premiums paid minus the accumulations to that date of (i) the benefit charges, (ii) the averaged administrative expense charges for the first policy year and any insurance-increase years, (iii) actual administrative expense charges for other years, (iv) initial and additional acquisition expense charges not exceeding the initial or additional expense allowances, respectively, (v) any service charges actually made (excluding charges for cash surrender or election of a paid-up nonforfeiture benefit) and (vi) any deductions made for partial withdrawals; all accumulations being at the actual rate or rates of interest at which interest credits have been made unconditionally to the policy (or have been made conditionally, but for which the conditions have since been met), and minus any unamortized unused initial and additional expense allowances.

Interest on the premiums and on all charges referred to in items (i)-(vi) above shall be accumulated from and to such dates as are consistent with the manner in which interest is credited in determining the policy value.

The benefit charges shall include the charges made for mortality and any charges made for riders or supplementary benefits for which premiums are not paid separately. If benefit charges are substantially level by duration and develop low or no cash values, then the Commissioner shall have the right to require higher cash values unless the insurer provides adequate justification that the cash values are appropriate in relation to the policy's other characteristics.⁴

The administrative expense charges shall include charges per premium payment, charges per dollar of premium paid, periodic charges per thousand dollars of insurance, periodic per policy charges, and any other charges permitted by the policy to be imposed without regard to the policyowner's request for services.

The averaged administrative expense charges for any year shall be those which would have been imposed in that year if the charge rate or rates for each transaction or period within the year had been equal to the arithmetic average of the corresponding charge rates which the policy states will be imposed in policy years two through 20 in determining the policy value.

The initial acquisition expense charges shall be the excess of the expense charges, other than service charges, actually made in the first policy year over the averaged administrative expense charges for that year. Additional acquisition expense charges shall be the excess of the expense charges, other than service charges, actually made in an insurance-

increase year over the averaged administrative expense charges for that year. An insurance-increase year shall be the year beginning on the date of increase in the amount of insurance by policyowner request (or by the terms of the policy).

Service charges shall include charges permitted by the policy to be imposed as the result of a policyowner's request for a service by the insurer (such as the furnishing of future benefit illustrations) or of special transactions.

The initial expense allowance shall be the allowance provided by [insert reference to Section 5 or 5cA of the Standard Nonforfeiture Law for Life Insurance] for a fixed premium, fixed benefit endowment policy with a face amount equal to the initial face amount of the flexible premium universal life insurance policy, with level premiums paid annually until the highest attained age at which a premium may be paid under the flexible premium universal life insurance policy, and maturing on the latest maturity date permitted under the policy, if any, otherwise at the highest age in the valuation mortality table. The unused initial expense allowance shall be the excess, if any, of the initial expense allowance over the initial acquisition expense charges as defined above.

If the amount of insurance is subsequently increased upon request of the policyowner (or by the terms of the policy), an additional expense allowance and an unused additional expense allowance shall be determined on a basis consistent with the above and with [Section 5cE of the Standard Nonforfeiture Law for Life Insurance], using the face amount and the latest maturity date permitted at that time under the policy.

The unamortized unused initial expense allowance during the policy year beginning on the policy anniversary at age $x+t$ (where "x" is the same issue age) shall be the unused initial expense allowance multiplied by $\frac{a_{x+t}}{a_x}$ where a_{x+t} and a_x are

present values of an annuity of one per year payable on policy anniversaries beginning at ages $x+t$ and x , respectively, and continuing until the highest attained age at which a premium may be paid under the policy, both on the mortality and interest bases guaranteed in the policy. An unamortized unused additional expense allowance shall be the unused additional expense allowance multiplied by a similar ratio of annuities, with a_x replaced by an annuity beginning on the date as of which the additional expense allowance was determined.

Drafting Note: The drafters chose a whole life initial expense allowance for several reasons. Although highly flexible, universal life insurance is generally considered a permanent life insurance plan. Most companies encourage a premium level which will provide lifetime insurance protection. Every universal life insurance policy of which the drafters are aware has a "net level premium" that could be computed which would guarantee permanent protection. As a result, it is expected that most universal life insurance policies will be sold as permanent plans.

Traditional whole life insurance, which is accorded a permanent plan expense allowance by the Standard Nonforfeiture Law (SNFL), is much more flexible than is often realized. Premiums may be stopped with term coverage resulting, policy loans can result in "stop and go" premiums, or a vanishing premium arrangement can be effected, all without the permanent plan expense allowance being affected. The SNFL does not require cash values for many forms of term insurance. All other permanent plans develop an expense allowance greater than that for whole life insurance under the SNFL.

The alternative of basing the initial expense allowance on a policyowner's "planned premium" was considered but rejected as artificial and subject to substantial manipulation by agents and/or insurers.

B. Minimum Cash Surrender Values for Fixed Premium Universal Life Insurance Policies

For fixed premium universal life insurance policies, the minimum cash surrender values shall be determined separately for the basic policy and any benefits and riders for which premiums are paid separately. The following requirements pertain to a basic policy and any benefits and riders for which premiums are not paid separately.

The minimum cash surrender value (before adjustment for indebtedness and dividend credits) available on a date as of which interest is credited to the policy shall be equal to $[(A)-(B)-(C)-(D)]$, where:

(A) is the present value of all future guaranteed benefits.

(B) is the present value of future adjusted premiums. The adjusted premiums are calculated as described in [Sections 5 and 5-a or in paragraph (1) of Section 5-c], as applicable, of [the Standard Nonforfeiture Law for Life Insurance, as amended in 1980]. If Section 5-c, paragraph (1) is applicable, the nonforfeiture net level premium is equal to the quantity $\frac{PVFB}{a_x}$.

a_x

where PVFB is the present value of all benefits guaranteed at issue assuming future premiums are paid by the policyowner and all guarantees contained in the policy or declared by the insurer.

a_x is the present value of an annuity of one per year payable on policy anniversaries beginning at age x and continuing until the highest attained age at which a premium may be paid under the policy.

(C) is the present value of any quantities analogous to the nonforfeiture net level premium which arise because of guarantees declared by the insurer after the issue date of the policy. a_x shall be replaced by an annuity beginning on the date as of which the declaration became effective and payable until the end of the period covered by the declaration.

(D) is the sum of any quantities analogous to (B) which arise because of structural changes⁵ in the policy.

Future guaranteed benefits are determined by (1) projecting the policy value, taking into account future premiums, if any, and using all guarantees of interest, mortality, expense deductions, etc., contained in the policy or declared by the insurer; and (2) taking into account any benefits guaranteed in the policy or by declaration which do not depend on the policy value.

All present values shall be determined using (i) an interest rate (or rates) specified by [the Standard Nonforfeiture Law for Life Insurance, as amended in 1980] for policies issued in the same year and (ii) the mortality rates specified by [the Standard Nonforfeiture Law for Life Insurance, as amended in 1980] for policies issued in the same year or contained in such other table as may be approved by the Commissioner for this purpose.

Drafting Note: The types of quantities included in Subsection C are increased current interest rate credits guaranteed for a future period, decreased current mortality rate charges guaranteed for a future period, or decreased current expense charges guaranteed for a future period.

C. Minimum Paid-Up Nonforfeiture Benefits

If a universal life insurance policy provides for the optional election of a paid-up nonforfeiture benefit, it shall be such that its present value shall be at least equal to the cash surrender value provided for by the policy on the effective date of the election. The present value shall be based on mortality and interest standards at least as favorable to the policyowner as (1) in the case of a flexible premium universal life insurance policy, the mortality and interest basis guaranteed in the policy for determining the policy value, or (2) in the case of a fixed premium policy the mortality and interest standards permitted for paid-up nonforfeiture benefits by [the Standard Nonforfeiture Law for Life Insurance, as amended in 1980]. In lieu of the paid-up nonforfeiture benefit, the insurer may substitute, upon proper request not later than sixty (60) days after the due date of the premium in default, an actuarially equivalent alternative paid-up nonforfeiture benefit which provides a greater amount or longer period of death benefits, or, if applicable, a greater amount or earlier payment of endowment benefits.

Drafting Note: it is possible that policies will have secondary guarantees. Such guarantees should be taken into consideration when computing minimum paid-up nonforfeiture benefits.

To preserve equity between policies on a premium paying basis and on a paid-up basis, present values must comply with Section 6A for flexible premium universal life insurance policies and with Section 6B for fixed premium policies.

Ever since the adoption of the original Standard Nonforfeiture Law (SNFL) in 1942, provision has been made for nonforfeiture calculations on the basis of substandard mortality. (See Sections 5, 5-a, and 5-c of SNFL.) While this provision has been used infrequently in the past, it is anticipated that substandard mortality will be more frequently utilized in universal life insurance, given its flexible nature, to reflect the mortality classification assigned to the policy by the insurer.

A charge may be made at the surrender of the policy provided that the result after the deduction of the charge is not less than the minimum cash surrender value required by this section.

Section 7. Mandatory Policy Provisions

The policy shall provide the following:

A. Periodic Disclosure to Policyowner

The policy shall provide that the policyowner will be sent, without charge, at least annually, a report which will serve to keep such policyowner advised as to the status of the policy. The end of the current report period must be not more than three months previous to the date of the mailing of the report. Specific requirements of this report are detailed in Section 9.

Drafting Note: Fixed premium universal life insurance policies may be required to contain a table of cash surrender or nonforfeiture values, by law. Such a table of values is of little use for a flexible premium policy, since the premiums cannot be determined, and therefore, such table should not be required to be included in the policy. Periodic disclosure to the policyowner is designed to fulfill the purpose of such a table of values, which, because of the nature of universal life insurance, cannot be determined at issue for a flexible premium policy.

B. ~~Illustrative Reports~~Current Illustrations

~~The policy annual report shall provide for an illustrative report which will be sent to the policyowner upon request. Minimum requirements of such report are the same as those set forth in Section 8. The insurer may charge the~~

~~policyowner a reasonable fee for providing the report notice that the policyholder may request an illustration of current and future benefits and values based on the insurer's present illustrated scale.~~

C. Policy Guarantees

The policy shall provide guarantees of minimum interest credits and maximum mortality and expense charges. All values and data shown in the policy shall be based on guarantees. No figures based on nonguarantees shall be included in the policy.

Drafting Note: Minimum and maximum guarantees are in addition to any index guarantees. If "guaranteed" credits and/or charges are also the "current" credits and/or charges, such amounts may be included in the policy if clearly labeled. The maturity date is not considered a guarantee for purposes of this section.

D. Calculation of Cash Surrender Values

The policy shall contain at least a general description of the calculation of cash surrender values including the following information:

- (1) The guaranteed maximum expense charges and loads.
- (2) Any limitation on the crediting of additional interest. Interest credits shall not remain conditional for a period longer than 24 months.
- (3) The guaranteed minimum rate or rates of interest.
- (4) The guaranteed maximum mortality charges.
- (5) Any other guaranteed charges.
- (6) Any surrender or partial withdrawal charges.

E. Changes in Basic Coverage

If the policyowner has the right to change the basic coverage, any limitation on the amount or timing of such change shall be stated in the policy. If the policyowner has the right to increase the basic coverage, the policy shall state whether a new period of contestability and/or suicide is applicable to the additional coverage.

F. Grace Period and Lapse

The policy shall provide for written notice to be sent to the policyowner's last known address at least thirty (30) days prior to termination of coverage.

A flexible premium policy shall provide for a grace period of at least thirty (30) days (or as required by state statute) after lapse. Unless otherwise defined in the policy, lapse shall occur on that date on which the net cash surrender value first equals zero.

Drafting Note: Fixed premium policies shall contain a provision providing for a standard grace period as required by state law.

G. Misstatement of Age or Sex

If there is a misstatement of age or sex in the policy, the amount of the death benefit shall be that which would be purchased by the most recent mortality charge at the correct age or sex. The commissioner may approve other methods which are deemed satisfactory.

H. Maturity Date

If a policy provides for a "maturity date," "end date," or similar date, then the policy shall also contain a statement, in close proximity to that date, that it is possible that coverage may not continue to the maturity date even if scheduled premiums are paid in a timely manner, if such is the case.

Section 8. Disclosure Requirements

A. ~~Initial Disclosure~~

~~In connection with any advertising, solicitation or negotiation of a universal life insurance policy:~~

~~(1) Any statement of policy cost factors or benefits shall contain:~~

~~(a) The corresponding guaranteed policy cost factors or benefits, clearly identified.~~

~~(b) A statement explaining the nonguaranteed nature of any current interest rates, charges, or other fees applied to the policy, including the insurer's rights to alter any of these factors.~~

~~(c) Any limitations on the crediting of interest, including identification of those portions of the policy to which a specified interest rate shall be credited.~~

~~Drafting Note: Policy cost factors are those amounts which affect the price per thousand of life insurance coverage or other benefits. They include: interest, mortality, expense charges and fees, including any surrender or withdrawal charges, but not persistency assumptions.~~

~~(2) Any illustration of the policy value shall be accompanied by the corresponding net cash surrender value.~~

~~(3) Any statement regarding the crediting of a specific current interest rate shall also contain the frequency and timing by which such rate is determined.~~

~~(4) If any statement refers to the policy being interest-indexed, the index shall be described. In addition, a description shall be given of the frequency and timing of determining the interest rate and of any adjustments made to the index in arriving at the interest rate credited under the policy.~~

~~(5) Any illustrated benefits based upon nonguaranteed interest, mortality, or expense factors shall be accompanied by a statement indicating that these benefits are not guaranteed.~~

~~(6) If the guaranteed cost factors or initial policy cost factor assumptions would result in policy values becoming exhausted prior to the policy's maturity date, such fact shall be disclosed, including notice that coverage will terminate under such circumstances.~~

~~(7) These requirements may be met by the use of the disclosure statement defined in Section 8B below.~~

~~Drafting Note: It is not intended that this section conflict with or supersede the Unfair Trade Practices Act or model regulations on advertising and solicitation. This section supplements those models to the extent that they do not contemplate universal life insurance policy forms and covers those areas which appear to be most subject to misunderstandings by the public.~~

~~B. Disclosure at Time of Sale~~

~~At the time the agent takes an application for a policy, he shall furnish to the applicant a Statement of Policy Information for Applicant in substantially the format illustrated in Appendix A except as provided in the next paragraph. The illustration of policy premium, death benefit and cash value shall be shown for the current interest rate actually being paid on existing policies in force, and for the interest rate guaranteed in the policy. No interest rates other than these may be illustrated.~~

~~If the Policy Information for Applicant is not furnished at the time of application, it shall be delivered within fifteen (15) working days after application is taken, but at least five (5) days before delivery of the policy.~~

~~If the policy is delivered sooner than five (5) days after the Policy Information for Applicant, the free-look period shall be extended to fifteen (15) days. In the event the Statement of Policy Information for Applicant 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.~~

~~C. Direct Response Solicitation~~

~~In the case of direct response solicitation methods, the Statement of Policy Information for Applicant contained in Appendix A may be furnished at the time of delivery of the policy, so long as the purchaser is given an unconditional refund provision of at least ten (10) days.~~

~~Disclosure of information about the policy being applied for shall follow the standards in insert citation to state equivalent of the Life Insurance Illustrations Model Regulation.~~

Section 9. Periodic Disclosure to Policyowner

A. Requirements

The policy shall provide that the policyowner will be sent, without charge, at least annually, a report which will serve to keep such policyowner advised of the status of the policy. The end of the current report period shall be not more than three (3) months previous to the date of the mailing of the report.

B. The report shall include the following:

- (1) The beginning and end of the current report period;
- (2) The policy value at the end of the previous report period and at the end of the current report period;

- (3) The total amounts which have been credited or debited to the policy value during the current report period, identifying each by type (e.g., interest, mortality, expense and riders);
- (4) The current death benefit at the end of the current report period on each life covered by the policy;
- (5) The net cash surrender value of the policy as of the end of the current report period;
- (6) The amount of outstanding loans, if any, as of the end of the current report period;
- (7) For fixed premium policies:

If, assuming guaranteed interest, mortality and expense loads and continued scheduled premium payments, the policy's net cash surrender value is such that it would not maintain insurance in force until the end of the next reporting period, a notice to this effect shall be included in the report;

- (8) For flexible premium policies:

If, assuming guaranteed interest, mortality and expense loads, the policy's net cash surrender value will not maintain insurance in force until the end of the next reporting period unless further premium payments are made, a notice to this effect shall be included in the report.

Drafting Note: These are the same standards as required in the Life Insurance Illustrations Model Regulation. A state could refer to that regulation instead of including the standards here.

Section 10. Interest-Indexed Universal Life Insurance Policies

A. Initial Filing Requirements

The following information shall be submitted in connection with any filing of interest-indexed universal life insurance policies ("interest-indexed policies"). All such information received shall be treated confidentially to the extent permitted by law.

- (1) A description of how the interest credits are determined, including:
 - (a) A description of the index;
 - (b) The relationship between the value of the index and the actual interest rate to be credited;
 - (c) The frequency and timing of determining the interest rate; and
 - (d) The allocation of interest credits, if more than one rate of interest applies to different portions of the policy value;
- (2) The insurer's investment policy, which includes a description of the following:
 - (a) How the insurer addressed the reinvestment risks;
 - (b) How the insurer plans to address the risk of capital loss on cash outflows;
 - (c) How the insurer plans to address the risk that appropriate investments may not be available or not available in sufficient quantities;
 - (d) How the insurer plans to address the risk that the indexed interest rate may fall below the minimum contractual interest rate guaranteed in the policy;
 - (e) The amount and type of assets currently held for interest indexed policies;
 - (f) The amount and type of assets expected to be acquired in the future;
- (3) If policies are linked to an index for a specified period less than to the maturity date of the policy, a description of the method used (or currently contemplated) to determine interest credits upon the expiration of such period.
- (4) A description of any interest guarantee in addition to or in lieu of the index.
- (5) A description of any maximum premium limitations and the conditions under which they apply.

B. Additional Filing Requirements

- (1) Annually, every insurer shall submit a Statement of Actuarial Opinion by the insurer's actuary similar to the example contained in Section 10C.

(2) Annually, every insurer shall submit a description of the amount and type of assets currently held by the insurer with respect to its interest-indexed policies.

(3) Prior to implementation, every domestic insurer shall submit a description of any material change in the insurer's investment strategy or method of determining the interest credits. A change is considered to be material if it would affect the form or definition of the index (i.e., any change in the information supplied in Section A above) or if it would significantly change the amount or type of assets held for interest-indexed policies.

Drafting Note: Interest-indexed products present unique aspects which, due to the unknown future values of the index, are not precisely addressed by current valuation laws. The drafters have considered and rejected approaches to valuation which would require the setting of arbitrary reserves and/or the arbitrary dedication of specific amounts of surplus as being neither logical nor workable. In requiring the filing and evaluation of the above items, together with an annual actuarial opinion, the drafters have attempted to preserve the basic principle of the valuation laws, which is to maintain the ability of the insurer to meet its future contractual obligations.

It is assumed that the evaluation of the information provided in this Section together with the experience of insurers in writing indexed forms will lead to a more scientific approach to valuation in the future.

The drafters believe that by focusing attention on cash flows and the quality and quantity of assets supporting indexed policy liabilities, most of the risks associated with indexed products can be addressed by insurers and regulators in a manner which will provide adequate protection to the public while permitting experimentation and diversity in minimizing the uncertainty associated with the valuation of these products.

C. Statement of Actuarial Opinion for Interest-Indexed Universal Life Insurance Policies

I, _____, am _____ for the XYZ Life
(Name) (position or relationship to Insurer)

Insurance Company (The Insurer) in the state of _____
(State of Domicile of Insurer)

I am a member of the American Academy of Actuaries (or if not, state other qualifications to sign annual statement actuarial opinions).

I have examined the interest-indexed universal life insurance policies of the Insurer in force as of December 31, 19XX, encompassing _____ number of policies and \$_____ of insurance in force.

I have considered the provisions of the policies. I have considered any reinsurance agreements pertaining to such policies, the characteristics of the identified assets and the investment policy adopted by the Insurer as they affect future insurance and investment cash flows under such policies and related assets. My examination included such tests and calculations as I considered necessary to form an opinion concerning the insurance and investment cash flows arising from the policies and related assets.

I relied on the investment policy of the Insurer and on projected investment cash flows as provided by _____, Chief Investment Officer of the Insurer.⁶

The tests were conducted under various assumptions as to future interest rates, and particular attention was given to those provisions and characteristics that might cause future insurance and investment cash flows to vary with changes in the level of prevailing interest rates.

In my opinion, the anticipated insurance and investment cash flows referred to above make good and sufficient provision for the contractual obligations of the Insurer under these insurance policies.

Signature of Actuary

Drafting Note: The American Academy of Actuaries has offered to prepare appropriate guidelines which will delineate the various responsibilities of the actuary in signing the Statement of Actuarial Opinion included in this regulation. Upon publication, these guidelines will become a part of the body of actuarial literature which describes Generally Accepted Actuarial Principles and Practice.

If the actuary has not examined the underlying records, but has relied upon listings and summaries of policies in force, an appropriate statement of such reliance should be included here.

Endnotes:

1. The maturity amount shall be the initial death benefit where the death benefit is level over the lifetime of the policy except for the existence of a minimum-death-benefit corridor, or shall be the specified amount where the death benefit equals a specified amount plus the policy value or cash surrender value except for the existence of a minimum-death-benefit corridor.

2. The Guaranteed Maturity Premium for both flexible and fixed premium policies shall be adjusted for death benefit corridors provided by the policy. The Guaranteed Maturity Premium may be less than the premium necessary to pay all charges. This can especially happen in the first year for policies with large first-year expense charges.

3. Structural changes are those changes which are separate from the automatic workings of the policy. Such changes usually would be initiated by the policyholder and include changes in the guaranteed benefits, changes in latest maturity date, or changes in allowable premium payment period. For valuations on or after January 1, 1987, for fixed premium universal life policies with redetermination of all credits and charges no more frequently than annually, on policy anniversaries, structural changes also include changes in guaranteed benefits, or in fixed premiums, unanticipated by the guaranteed maturity premium for such policies at the date of issue, even if such changes arise from automatic workings of the policy. The recomputation of (B) above, for fixed premium universal life structural changes, shall exclude from PVFB, the present value of future guaranteed benefits, those guaranteed benefits which are funded by the excess of the insurer's declared guarantees of interest, mortality and expenses, over the guarantees contained in the policy at the date of issue.

4. Because this product is still developing, it is recommended that benefit charges not be restricted and regulatory treatment of cash values be limited to that contained in this section for several reasons. First, further restrictions would limit the development of the product. Second, added restrictions would discourage insurers from reducing non-guaranteed current benefit charges because such reductions could require reduced future benefit charges that could be financially unsound for the insurer. Third, market pressures will encourage insurers to limit benefit charges.

5. See footnote 3.

6. If the actuary does not choose to rely on an investment officer for the projected investment cash flows, this statement should be modified to show the extent of the actuary's reliance.

APPENDIX A

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

CHART B

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.

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	2	3	4 Cash Surrender Value at Year End	1*	2	3	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.

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 "Current 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 change.

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 change, — 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 18."

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 "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.

ATTACHMENT FOUR

Suitability Working Group
San Francisco, California
December 6, 1999

The Suitability Working Group of the Life Insurance and Annuities (A) Committee met in San Francisco, CA, on Dec. 6, 1999. Paul DeAngelo (NJ) chaired the meeting. The following working group members were present: Lester Dunlap, Vice Chair (LA); Mike Hessler for Robert Heisler (IL); Rosanne Mead (IA); Marilyn Burch (KS); Scott Borchert (MN); Cindy Amann (MO); Louis Belo for Tom Jacks (NC); John Pouliot (OH); Frank Stone for Joan Williams (OK); Joel Ario (OR); Randy Rohrbaugh for Greg Martino (PA); Rhonda Myron for Ted Becker (TX); and Tom Van Cooper (VT).

1. Consider Comments on Advertisement of Life Insurance and Annuities Model Regulation

Mr. DeAngelo said the working group received more comments on the draft of the Advertisement of Life Insurance and Annuities Model Regulation. Don Walters (American Council of Life Insurance—ACLI) summarized his comments on "branding" advertisements and said he views advertising that is designed to raise awareness of the company name as generic and is concerned about its being covered under the regulation. Riva Kinstlick (Prudential) said that these generic advertisements do not refer to specific products and should not be subjected to the advertising rules. She said some states then subject them to filing requirements and, for a national advertising campaign, a delay in approval by one state can affect the entire campaign. Mr. DeAngelo said this model has been around for a long time and there has not been an exception for these types of advertisements. He pointed out several sections of the model that would apply to this type of advertisement and expressed concern about exempting branding advertisements from Section 4B, 5Q, 5S and 5T(4). He said he is sympathetic to the industry's concerns about filing of advertising but the NAIC model regulation does not require filing. Mr. Ario said he agrees with that analysis. In addition he said that the definition suggested by the ACLI is too vague and would be difficult to enforce.

Mr. DeAngelo offered instead to include a drafting note that would raise the consciousness of states that do have a filing requirement for advertising. The drafting note could suggest that those states consider exempting this type of advertising from their requirements. Mr. Ario said the Electronic Commerce and Regulation (EX) Working Group is considering saying in its white paper that filing of advertising is probably not a good use of scarce resources. He asked how many states have a requirement for the filing of advertising. Ms. Kinstlick responded that it depends on the product and she did not have a definitive answer for that. She said that a drafting note would be helpful, but she was not sure it was sufficient. She said the Unfair Trade Practices Act still covers these types of advertisements, even if the advertising rule does not, so the company would have some limits.

Mr. VanCooper said that he did not think it was very constructive to have to argue about what would fit under an exemption for a generic advertisement. He agreed with the idea of a drafting note but expressed concerns that it not be worded too strongly. Anda Olsen (ING) said this is an important issue to companies. There is a fundamental shift in how companies want to present themselves in advertising. Mr. VanCooper responded that the problem the industry is describing is a filing problem not a problem with the NAIC's model. Kevin Hennosey (Spread the Risk) opined that branding advertisements on television are the most misleading type of ads, and are simply designed to give a warm and fuzzy feeling about the company. Mr. DeAngelo asked if any working group members were in favor of the amendment and no one responded. He asked if the working group members were in favor of inserting a drafting note. Ms. Mead suggested that the group should send a strong message about how the regulators feel about filing of advertising. She said if the working group has a consensus, it should raise that issue. Mr. VanCooper said he did not think it was relevant to include that issue in the model and suggested it would be better to write a letter to the Electronic Commerce and Regulation Working Group. Ms. Olsen suggested wording for a drafting note, which was accepted by the working group for inclusion in Section 9.

Mr. DeAngelo said the second issue to be resolved by the working group relates to use of financial planner designations. Michael Herndon (Certified Financial Planner Board of Standards) said he agrees that a financial planner designation should not imply that someone is offering financial planning services if he or she is only selling insurance. He said his organization's concern is that a person with a properly obtained designation should not be precluded from using it on his stationary or business cards. Jim McIntyre (International Association for Financial Planning) said he would like to see the group go a little further. He expressed concern that three different models talk about financial planners and each chooses a different approach.

He pointed out that the Unfair Trade Practices Act language is different from that in the advertising model and from that in the Life Disclosure Model Regulation. He said there are ambiguities created by three different approaches. He suggested taking out the provision in this model and relying on the Unfair Trade Practices Act. Mr. DeAngelo said the Life Disclosure Working Group made amendments to the Life Disclosure Model Regulation to insert the same language Mr. Herndon asks the Suitability Working Group to consider. He said the Unfair Trade Practices Act creates more of a problem because, in his opinion, the drafting note undoes the provision. He suggested the Suitability Working Group use the same approach as the Life Disclosure Working Group. Mr. Walters suggested incorporating the substance of the drafting note into the regulation and the working group agreed with that approach.

Dennis Herchel (MassMutual) suggested adding a sentence at the end of Section 6A to clarify that, if an advertisement identifies the issuing insurers, the ratings need not be stated. The working group agreed to that addition. Mr. Ario moved and Mr. VanCooper seconded a motion to adopt the Advertisements of Life Insurance and Annuities Model Regulation (Attachment Four-A). The motion passed.

2. Discuss Suitability White Paper

The working group reviewed the white paper (Attachment Four-B) and the comments that Mr. Walters submitted for the ACLI. He suggested that the description of the state standards found in Section III were pejorative and argumentative and asked that those three pages be deleted. Mr. Ario said that the white paper cannot demonstrate that current laws do not do the job adequately without talking about them. Mr. DeAngelo responded that he found the examples very instructive. Ms. Mead said that she did not intend to paint a dark picture about the industry, but opined that this section is needed to give instruction to regulators. Mr. Ario said that the examples could be moved into an appendix, as was done in another white paper drafted at the NAIC. Mr. Walters suggested describing the problems in a more generic fashion instead of giving specific examples from the state files. Mr. VanCooper said the examples are a good way to show that suitability standards are a useful tool. Mr. Ario suggested that the working group keep the examples but hear comments on specific phrasing that is pejorative. Mr. DeAngelo said the working group could leave these examples and add an appendix with more, it could lift these examples and put them into an appendix with others, or the paper could include no examples. The working group decided to leave the examples currently in the draft white paper, but not to include further examples in an appendix.

Mr. Walters suggested that Section IV.D on National Association of Securities Dealers Suitability Requirements was not applicable and should be deleted. Mr. DeAngelo responded that the working group should not just take the standards for securities and apply them, but it is instructive. He also referred to a report issued by the New York Insurance Department and said it was a good idea to reference that report in the conclusions. Interested parties also provided other suggestions for wording changes. Mr. DeAngelo asked that all comments be submitted in writing for the working group to consider. He committed to producing a revised draft by the end of January so that comments could be received by the third week in February. He said the working group would hold a conference call at the end of February.

Mr. DeAngelo offered to draft the section of the white paper on conclusions and recommendations. He said he sensed from the discussion that there is compelling evidence that the NAIC should develop a model with suitability standards for life insurance and annuities. He asked if anyone felt that the group should reach a different conclusion. There was no disagreement with that analysis.

3. Adopt Minutes of Nov. 8, 1999, Conference Call

Mr. VanCooper moved and Mr. Hessler seconded a motion to adopt the minutes of the Nov. 8, 1999, conference call (Attachment Four-C). The motion passed.

Having no further business, the Suitability Working Group adjourned.

ATTACHMENT FOUR-A

Rules Governing the Advertisements of Life Insurance and Annuities Model Regulation (#570) Draft: December 6, 1999

Table of Contents

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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 a n 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.

E.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.

~~E.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. "Nonguaranteed elements" means 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 nonguaranteed if any of the underlying nonguaranteed elements are used in its calculation.

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 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. 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 most serious consequence 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~~ 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 or annuity contract'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. This provision is not intended to preclude persons who hold some form of formal recognized financial planning or consultant designation from using this designation when they are only selling insurance. This does not permit persons to charge an additional fee for services that are customarily associated with the solicitation, negotiation or servicing 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 Regulationl, 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.

Drafting Note: A state that has not adopted the Life Insurance Illustrations Model Regulation should delete the phrase referencing it.

(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 elements shall set forth, with equal prominence comparable illustrations or statements containing or based upon the guaranteed policy elements.

Drafting Note: A state that has not adopted the Life Insurance Illustrations Model Regulation should delete the phrase referencing it.

(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 a life insurance policy or annuity contract is ~~involved or 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. However, ~~if an advertisement contains a listing of rates or features that is a composite of several different policies or contracts of different insurers, the advertisement shall so state, shall indicate, if applicable, that not all policies or contracts on which the composite is based may be available in all states, and shall provide a rating of the lowest rated insurer and reference the rating agency, but need not identify each insurer. If an advertisement identifies the issuing insurers, insurance issuer ratings need not be stated.~~

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.~~

Drafting Note: In furtherance of efficient and effective use of scarce regulatory resources, the drafters recommend that any state requirements for review and pre-approval of life insurance and annuity advertisements be carefully examined and reconsidered. In particular it seems appropriate that generic or branding advertisements that are designed to create public interest in life insurance or annuities or in an insurer be exempt from such requirements.

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.

ATTACHMENT FOUR-B

Suitability of Sales of Life Insurance and Annuities White Paper
NAIC Suitability (A) Working Group
Draft: December 6, 1999

I. 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.

II. 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.

III. State Suitability Statutes and Standards

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

A. States with Broad Suitability Standards

1. Iowa

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

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

The Iowa rule was adopted, with a February 1997 effective date, to respond to cases in which consumers complained about sales that were not to their benefit, but could not prove misrepresentation or any other violation of law in the sales process. The Iowa Department decided that an additional enforcement tool was necessary and has found its suitability rule to be effective in cases where transactions do not appear appropriate, but there is no particular evidence of misrepresentation and the paperwork on file with the company would indicate that the transaction was done with the consumer's consent.

The rule has been used both in resolving consumer complaints and in enforcement actions. Here are examples:

- An 85-year-old woman, with a \$12,000 annual income, was sold an annuity for \$16,000 and life insurance with total face amounts of \$17,000 and annual premiums of \$3,900. The consumer, who was alleged to suffer from Alzheimer's disease, was left with current income insufficient to pay premiums and high surrender charges on withdrawals from her annuity. After hearing, the sales were found unsuitable and a civil penalty was assessed against the agent.
- A 69-year-old consumer with a terminal illness was sold a replacement annuity that had to be held at least 2.5 years to break even on the surrender charge. The two companies involved agreed to reinstate the original annuity and give a refund on the new one. The agent stipulated to a civil penalty and two years of probation.
- A husband and wife in their fifties were convinced to surrender two life insurance policies in a 1035 exchange and replace them with a new policy that had \$16,000 in surrender charges on the first \$25,000 in premium. The new policy also paid less interest and had other unfavorable features compared to original policies. The agent stipulated to a civil penalty and two years probation, and the company agreed to a new contract that made the couple whole.

Based on these cases, the Iowa Department describes its suitability rule as "an additional and valuable tool to use to assist consumers in receiving fair treatment from insurers and insurance producers." The Department also points out that company oversight alone is not sufficient to detect whether single policies are unsuitable given the potential for agents to sell policies from multiple companies in order to avoid detection. This makes it important for a suitability standard to be applicable against both companies and agents.

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."

One of the many tools at the disposal of the Kansas Insurance Department to curb deceptive practices in the sale of insurance and annuity products is the suitability standard. It is contained in Kansas regulation § 40-2-14 (c)(5). Deemed as an unfair or deceptive practice under the unfair trade practices act is any recommendation to purchase or replace a policy that an agent believes is "unsuitable for the applicant based on information furnished by this person, or otherwise obtained." This is one of many prohibitions on the Kansas regulations including misrepresentation, false, deceptive or misleading statements and fraud. These along with the suitability standard are what Kansas uses to judge the treatment of insurance consumers by agents and companies.

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."

The Minnesota Department describes its suitability standard as "an important regulatory tool" and emphasizes that it should not be used simply as a deterrent, but also to clarify guidelines and expectations for insurers and agents. The Department also points out that the ongoing melding of the financial services industry, which is blurring the distinctions between the banking, securities, and insurance industries, makes a suitability standard appropriate in the regulation of sales conduct whether the product is a stock, insurance policy, or loan.

Minnesota has found its suitability standard to be especially helpful with Medicare supplement policies when the Department had a number of problems with the unscrupulous sale of multiple policies to the elderly in the 1980s, as well as with replacement policies, where the consumer may be giving up important benefits such as the two-year limit on contestability.

Another example where a suitability standard encourages agents to scrutinize advantages and disadvantages involves the comparison of surrender charges on the existing and new policies.

4. Wisconsin

Wisconsin has an administrative rule (Ins. 2.16(6)) 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 regulation 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."

Wisconsin has found its suitability rule to be particularly helpful in resolving consumer complaints. The rule provides helpful leverage when the Department is working with agents and companies to resolve cases where a sale arguably didn't take proper account of the consumer's circumstances. The Department has not exercised its sanctioning authority against single acts of unsuitable sales, but has penalized agents for the general business practice of engaging in unsuitable sales. The Department has found its suitability standard to be more readily applicable to Medicare supplement and long-term care policies than life and annuity products.

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.

The inclusion of a suitability standard in Vermont's Insurance Trade Practices Act is considered an important and useful regulatory tool by Vermont regulators. The Vermont department has applied this standard in a variety of areas including market conduct and consumer services. It has not been a controversial standard to apply, according to the department.

The Vermont Consumer Service section has received 68 complaints that related to misrepresentation by an agent in the sale of life insurance products since Jan. 1, 1997. These types of complaints are generally difficult to resolve because of factual disputes regarding statements that may have been made at the point of sale. Nonetheless, the section will analyze the transaction to determine the needs of the applicant and whether the producer provided a policy that met those needs. In some cases, the insurer has reversed transactions as a result of determining that the producer did not provide the type of policy that the applicant needed or wanted. The basis for evaluating the sale in these instances is the suitability provision in the Insurance Trade Practices Act.

Examples include:

- Complainants were sold a whole life policy that locked their money up for a long period of time. They were in their sixties at the time that the policy was sold. Their purpose for the policy was to provide an income stream upon retirement. The whole life product did not meet these needs and the department was able to reverse the transaction.
- A 68-year-old farmer was sold an annuity that would not begin to pay out until he was 88. His money would be tied up with him only being allowed to withdraw a small portion of his funds until he reached the age of 88. He was looking for a retirement income policy. This did not meet that need and the department was able to reverse the transaction.

In both of the above examples, the department was able to negotiate a resolution with the company as a result of imposing the suitability provision of the Insurance Trade Practices Act. In both instances the company agreed to rescind the contracts and refund all premiums paid with interest to the policyholders. The policyholders were then able to purchase the type of policy that met their needs. Without utilizing this provision the insureds would have either been required to keep policies that was not in their best interest, surrender the policies and suffer severe financial penalties or go through the expense of beginning legal procedures against the agents and companies regarding misrepresentation on the part of the agents. After exploring these complaints with the companies, they agreed with the department's analysis that the policies were not suitable.

B. Other States with Some Suitability Standards

1. 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.

2. 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."

3. South Dakota

South Dakota has a statute (§ 58-17-87) authorizing rules on the "suitability and appropriateness" of individual health insurance policies, and a second statute (§ 58-18B-35) authorizing rules on the "suitability and eligibility for coverage of insureds" for stop loss, multiple employer trusts, and multiple employer welfare arrangements (MEWAs). One administrative rule (§ 20:06:13) has been promulgated for Medicare supplement insurance that tracks the Minnesota statute in judging suitability on the basis of the prospective insured's financial condition, need for insurance, and existing insurance in comparison to the recommended insurance.

4. Utah

Utah has a statute (§31A-23-303) that authorizes the commissioner to find certain products "inherently unsuitable." This power has not been exercised.

IV. 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."

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

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

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

D. NASD Suitability Requirements

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

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

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

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

- (b) Prior to the execution of a transaction recommended to a non-institutional customer, other than transactions with customers where investments are limited to money market mutual funds, a member shall make reasonable efforts to obtain information concerning:

- (1) the customer's financial status;
- (2) the customer's tax status;
- (3) the customer's investment objectives; and
- (4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

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

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

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

In May 1999, NASD Notice to Members 99-35 was issued, reminding members of their responsibilities regarding the sale of variable annuities. The notice provided recommended guidelines for establishing procedures for the sale of variable annuities that would assist in assuring compliance with both regulatory and legal requirements. Included in the guidelines were such items as making reasonable efforts to obtain comprehensive information about the customer including age, income, risk tolerance, tax status and investment objectives; discussing liquidity issues such as fees, penalty charges, taxes and administrative charges; making sure the registered representative has a thorough knowledge of the recommended variable annuity including the death benefits, tax treatment and subaccount choices; and providing whenever practical, a current prospectus on the variable annuity to the customer. The notice also cautions members that in most cases variable annuities are not suitable for customers with short-term investment objectives, and that in some cases, those of advanced age may not be suitable for a variable annuity.

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 twenty-five 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 has no interest in life insurance since he already had sufficient coverage. He was looking for an investment vehicle to save money for his retirement. In this case, given the stated investment objectives, the committee found the policy to be unsuitable. Each of the nine sales was reviewed in this manner and the representative was fined, received a censure and was required to requalify as an investment company and variable contracts representative.

Although misrepresentation is a separate violation of the Rules of Conduct, it is not uncommon for a representative to misrepresent a product that is not suitable for the stated investment objectives. In the *Cruz* case, when the customers indicated their objectives were to invest money for short time periods and that they had no interest in insurance, 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. 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.

V. 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 the NASD rule that commonly is called the "know your customer" rule.

The suitability rule is just one 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.

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, et al. v. E. F. Hutton Group, Inc.*, 991 F.2d 1020, 1031 (2d Cir. 1993)(*citations omitted*). 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." *Ernest & Ernest v. Hochfelder*, 425 U.S. 185, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976).

The elements necessary for a plaintiff to succeed in a Section 10(b) 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 10(b):

- (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).

While these cases provide some guidance on court decisions interpreting suitability, the specific discussion of the fraud elements required in a securities case may not be relevant in the insurance context. However, the discussion of Section 10(b)(5) cases is included as the information specific to suitability may be instructive in the drafting of a model law or regulation regarding suitability.

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.

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 Litigation and Practice Under Rule 10b-5, § 211.03, 9-12 and 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. Ct. 88 (1979)).
- " 'Suitable' is defined as appropriate and fitting." (*Id.*, at 96, citing *Morgan v. Morgan*, 366 N.Y.S.2d 977, 981, 81 Misc.2d 616 (1975)).

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 Litigation and Practice Under Rule 10b-5, *supra*, at Section 211.01, p.9-23.

Under the "reasonable basis" rule, a broker-dealer has a burden and has certain duties. The burden has been stated as follows: "The SEC rules on reasonable basis place a burden on the broker-dealer to disclose all relevant facts, to make a reasonable investigation into the product recommended and, if the agent lacks knowledge, to disclose the lack of knowledge and caution customers as to the risk." 5C Litigation & Practice, *supra*, § 211.01[a], 9-26. The duties have been defined as follows:

[t]he law implies three 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.

5C Litigation & Practice, *supra*, § 211.01[a], 9-55.

A reasonable basis is not always required. "[A] broker has no reasonable basis duties when a customer places an unsolicited order." 5C Litigation & Practice, *supra*, § 211.01[a], 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. The *Hanly* court also 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). The courts have also ruled the investor cannot 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).

However, the suitability standard is not wholly unreasonable. It is important to note that the imposition of a 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 5C Litigation & Practice, *supra*, § 211.01[b], 9-63, 64. 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).

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.

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.*

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

stated “any insurance agent who would sell a man with ... limited income and prospects an insurance program that involved saddling him with a bank indebtedness of \$125,000, an essentially term insurance type of protection, and dissipation of the accumulated cash values of his old insurance, must have known that he was not acting honestly in making the sale.” *Anderson v. Knox*, 297 F.2d 702, 727-28 (9th Cir. 1961) *cert. denied*, 370 U.S. 915 (1962).

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

VI. Voluntary Suitability Standards

A. Insurance Marketplace Standards Association (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.”¹

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.”²

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.”³ 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.

Also during this time period, the American Council of Life Insurance (ACLI) Task Force on Market Conduct, comprised of 16 life insurance company chief executive officers, 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.

¹ Dan Lonkevich, “ACLI Conduct Code Nears Completion; Proposal Drops Compliance Certification,” *BestWeek* * L/H, Release 41, Oct. 9, 1995, 1.

² March 5, 1996, letter from Commissioner Glenn Pomeroy to interested parties

³ Oct. 23, 1995, Working Group’s charge

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."⁴

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

VII. Current Consumer Protection Tools

A. Standards for Informing and Educating Consumers

1998 NAIC Model Life Insurance and Annuities Replacement Model Regulation

In September of 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. I would anticipate that many of these same states will be revising their current regulation to comport with the 1998 version.

NAIC Life Insurance Illustrations Model Regulation

During 1996 and 1997 the NAIC Life Disclosure Working Group developed the Life Insurance Illustrations Model Regulation. The goals of the regulation are to ensure that illustrations do not mislead purchasers of life insurance as well as to make life illustrations more understandable. Thirty-three (33) states have adopted the model. The Working Group continues to develop a model illustration regulation for variable life products, with the goal of each being to provide consumers accurate and comprehensive information prior to and during the insurance sales process.

Model Advertising Rules

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

Life Insurance Disclosure Model Regulation

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

⁴ Insurance Marketplace Standards Association, (visited Aug. 2, 1999). (www.imsaethics.org)

Annuity Disclosure Model Regulation

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

Buyer's Guides

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

Unfair Trade Practices Act

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

NAIC's Market Conduct Examiners Handbook

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

Long-Term Care Insurance Model Act

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

Life Insurance and Annuities Replacement Model Regulation

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

VIII. Comparison of the Insurance and Securities Industries

In analyzing whether suitability standards should be applied to the marketing of non-registered insurance products, it has been suggested that there are significant differences between the marketing of such products and the sale of securities. One important difference is that with securities (which include registered insurance products) the investor's principle is at risk while with non-registered insurance products it is not. There are, however, other aspects of the marketing of these two financial products that should also be examined before reaching any conclusions as to the appropriateness of suitability standards. Below is an analysis of the various parties and elements involved in sales of registered securities and non-registered insurance products including the products; the issuers; the sales representatives; and, finally, the customer.

A. The Products

Securities include stocks, bonds, variable life and annuity and mutual funds. Non-registered life insurance and annuity products include traditional whole life and term life insurance, some of which pay dividends; interest sensitive life insurance; fixed dollar annuities, both immediate and deferred, single and flexible premium; and, equity indexed life insurance and annuity contracts.

As indicated previously, the most significant difference between registered and non-registered financial products is principle risk. With registered products, an investor could experience a loss of principle. This is generally not true of non-registered products, although there are instances where such "losses" could occur. For example, the surrender of a life insurance policy in the early years of the policy, particularly the first two years, would result in the loss of all or most of the premiums paid in an amount far greater than the cost of insurance. Similarly, the surrender of an annuity contract, which often have seven years of surrender charges and/or front end loads, can result in the loss of a considerable portion of the contributions made.

Notwithstanding that certain registered products have always included an element of life insurance protection, securities were historically clearly distinguishable from non-registered life insurance policies. Beginning in the late '70s, the life insurance industry introduced a new generation of life insurance products. This new generation of products have blurred the differences that once were clear. Their investment component promised the potential of far greater returns in the form of excess interest credits. The products were designed to appeal to a marketplace that had begun to eschew the traditional life insurance products which offered modest equity development in favor of individual retirement accounts, money markets and mutual funds. The promise of excess interest credits as an avenue to share in the high interest returns insurers were experiencing, coupled with the annual resetting of the mortality costs, served to highlight the investment features and minimize the costs of insurance

protection. As interest rates have declined and the stock market has flourished, equity indexed products have been introduced. These products offer an opportunity to participate in the insurer's returns on equity investments, again appealing to a marketplace that is frequently turning to registered products rather than life insurance to fund its future financial security. Equity indexed products provide purchasers the opportunity to participate in at least a portion of the insurer's equity investment returns by linking the growth of contributions to a particular stock market index.

B. The Issuers

Securities were traditionally not sold by life insurance companies. Insurers sold almost exclusively, traditional life insurance products offering protection against financial loss due to premature death. Cash values available upon surrender and nonforfeiture options triggered if the policies lapsed with value were included because insurers were required to do so. They sold life insurance not investments.

Today many life insurers also sell mutual funds and variable life insurance policies and annuity contracts in addition to the traditional life insurance and fixed dollar annuity products. These registered and non-registered products are available from a single source. Similarly, banks and other financial institutions have begun to sell insurance products including non-registered life insurance and annuity contracts. An individual that visits a local bank with the intention of purchasing a certificate of deposit or opening an individual retirement account can find themselves referred to the insurance desk and offered a fixed dollar or equity indexed annuity. It is also true that someone who contacts a broker to purchase a mutual fund, stock or other security might be offered the same non-registered products.

C. The Sales Representatives

Like the products sold in years past, investment brokers and advisers were distinct from the life insurance agent. The investment brokers did not sell life insurance and the life insurance agent did not advise or broker stocks or other securities. Today it is common for brokers to be licensed to sell life insurance and annuities.

Life insurance, once sold door to door, is now made available at the same locations as such other investment vehicles are available, including investment houses and banks. And, as indicated previously, life insurance agents now bring registered products in the forms of mutual funds, variable life insurance and variable annuity contracts to the same kitchen tables where previously only traditional life insurance and fixed dollar annuities were sold.

While registration and licensure may be present, one might question whether these multi disciplined sales representatives bring the same depth of expertise to the table that was once available from the representatives that specialized in life insurance or securities. Common to both the registered broker and the licensed insurance agent is the method of compensation. Both are compensated through commissions, amounts that are contingent upon the sale of a product, usually a percentage of the cost and not dependent upon the performance of what was recommended.

D. The Customer

Although life insurance was sold to people of every walk of life, rich and not so rich, educated and uneducated, sophisticated and unsophisticated, securities were once reserved for the wealthy, educated and sophisticated. Others did not have the means to invest and did not understand the complexities of the stock market. For these individuals, who did not have assets to protect themselves and their dependents from financial loss or to leave upon their untimely death, life insurance provided "security." What meager additional funds they had available after paying weekly or monthly premiums were placed in safe investments which were simple to understand such as bank accounts, certificates of deposit or government bonds.

Today, more people have the wherewithal to invest as is evidenced by the popularity of mutual funds. Such vehicles give even the small investor the opportunity to experience the type of returns previously reserved for the large investor. The sellers of life insurance no longer have a captive market and now must compete with the securities industry for investment dollars. To do so, they have developed products that offer potential returns that can be compared with securities. In so doing, the products have become more complex but are marketed to that same segment of customers that previously limited their purchases to the traditional, uncomplicated life insurance products.

XI. Industry Viewpoint

X. Conclusions and Recommendations

A. Life Products

B. Annuity Contracts

ATTACHMENT FOUR-C

Suitability Working Group
Conference Call
November 8, 1999

The Suitability Working Group of the Life Insurance and Annuities (A) Committee met by conference call on Nov. 8, 1999. Paul DeAngelo (NJ) chaired the meeting. The following working group members participated: Lester Dunlap, Vice Chair (LA); Rosanne Mead (IA); Dick Rose for Linda Ruthardt (MA); Scott Borchert (MN); Delora Schafer (OK); Joel Ario (OR); Ted Becker (TX); and Tom Van Cooper (VT).

Mr. DeAngelo said the purpose of the conference call was to resolve remaining issues with regard to the Advertisements of Life Insurance and Annuities Model Regulation. He said it was his hope to finalize the regulation so that it could be adopted by the working group at the Winter National Meeting.

The first comment considered by the working group was a suggestion from the American Council of Life Insurance (ACLI) to revise Section 2A(2). Don Walters (ACLI) said that, with the financial market changes resulting from the passage of the federal financial services modernization legislation, the NAIC's model regulation should reflect the reality of today's marketplace. Mr. DeAngelo said that regulators do not yet know what that marketplace will look like and expressed discomfort with changing the model before regulators have any experience. He asked what parts of this rule would be a problem under the possible scenarios created by financial services modernization. Mr. Walters responded that filing of advertising for "branding" communications could create a problem. Mr. DeAngelo noted that the NAIC's model does not require filing of advertising and asked if an exclusion in the model for advertisements that do not reference specific products was appropriate. Mr. Van Cooper said he could foresee confusion about what is included or excluded and suggested that a state with a filing requirement should review to see if branding advertisements should be included. Ron Panneton (National Association of Insurance Financial Advisers—NAIFA) said his organization tries to raise awareness of the value of life insurance. It does not mention any particular company. He opined that the model is not designed to cover that type of situation. Mr. DeAngelo confirmed that an organization not licensed as an insurer is not covered by the regulation. Mr. DeAngelo suggested interested parties provide sample advertisements to the working group that would be affected adversely by the new regulation language. Mr. Ario said the proposed language from the ACLI is not clear. Mr. Van Cooper agreed that the interested parties should clearly identify what interference would be caused by the language in the model regulation.

The ACLI suggested that Section 2F be replaced with the definition of nonguaranteed elements currently found in the NAIC Annuity Disclosure Model Regulation. The working group agreed to that suggestion.

Mr. Dunlap expressed concern about the definition of preneed funeral contract or prearrangement. He said most state insurance departments do not regulate preneed funeral contracts. Carolyn Johnson (NAIC) said the only place the model uses this definition is in Section 5Y, where regulation of life insurance policies used to fund preneed funeral contracts is discussed. The working group agreed that was appropriate insurance regulation.

Another proposal in the ACLI letter was a suggestion that when a producer uses advertising that has not been approved by the insurer, the insurer is not liable. Mr. DeAngelo said he was not in favor of the changes proposed to Section 3B. He said he did not believe the model should absolve the insurer; the regulator should be free to take into consideration the circumstances of the situation. In addition, the ACLI suggested changing the last two lines of Section 3B to say that the notice will state that there are consequences of not obtaining the required approval. Mr. DeAngelo said he did not think that would be very effective. He suggested telling the producer the most dire consequences that could occur, rather than the least. Simply saying there are consequences is not effective. David Nelson (Northwestern Mutual) suggested that notices could be found not to be in compliance in that case. If none of those failing to comply were terminated, the insurer would not be in compliance. Mr. DeAngelo said he did not agree with that interpretation. He would ask the insurer what steps it did take.

Mr. DeAngelo reminded the working group that New Hampshire had raised a concern at the Fall National Meeting about Section 5J. David Sky (NH) had suggested a parallel section referring to annuity contracts. Mr. DeAngelo suggested instead adding reference to annuity contracts in Subsection J and the working group agreed to that approach.

The working group discussed Section 5N and the revisions made after the last comment period. The ACLI suggested adding a drafting note that sought to limit the application of that section. The working group members considered that approach and decided to return to the original language of Subsection N rather than the amended language proposed at the Fall National Meeting.

The working group next considered a suggestion from the ACLI for amendments to Section 6A. The working group agreed to all of the changes except decided to delete the phrase "if appropriate." Dennis Herschel (MassMutual) asked if this section meant insurers were required to show the ratings. Mr. DeAngelo confirmed that, in a composite where companies are not identified, the ratings must be shown. Mr. Herschel commented that the composite advertisements he had seen were pretty tight for space. Mr. DeAngelo said that this is not required in other advertising because they identify the insurer so a person can look up the company for himself. Here all the companies do not have to be identified, but the rating of the lowest insurer does need to be stated. Mr. Nelson asked about the procedure when there are different ratings from different agencies. Mr. DeAngelo said that if the company chooses to use the Best ratings, for example, than it will go by the lowest on that scale.

Having no further business, the Suitability Working Group adjourned.

ATTACHMENT FIVE

2000 Charges

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

1. Develop a handbook to assist regulators in interpretation of viatical settlement data submitted by companies to determine reasonableness of payments by Winter National Meeting.
2. Develop an NAIC model covering life insurance sales by healthy individuals by the Winter National Meeting.
3. ~~Develop continuing education requirements for viatical settlement representatives and brokers.~~
3. Consider appropriate regulatory response to issues related to investments in viatical and life settlements. Make recommendations by the Winter National Meeting.
4. Consider issues related to insurable interest, fraud and the impact on the traditional role of life insurance to address practices related to soliciting individuals to purchase insurance with the purpose of viaticating the policy. Report by the Winter National Meeting.
5. Complete drafting of a white paper discussing issues related to suitability of sales of life insurance and annuities. Implement recommendation to develop a model law, or take other steps recommended, if necessary.
6. Consider changes to the NAIC Life Insurance and Annuities Replacement Model Regulation to address issues identified by states that have adopted or are actively pursuing adoption of a replacement regulation based on the NAIC model. Report back by March 2000 meeting.
7. Complete revisions to Advertisements of Life Insurance and Annuities Model Regulation by Spring National Meeting.
6. ~~Review Annuity Disclosure Model Regulation to determine if technical changes are needed, or if illustration requirements should be developed.~~
8. Solicit opinions from state regulators in regard to the equity indexed product checklist and update as required.
9. Review other NAIC model laws for potential conflicts with the Annuities Disclosure Model Regulation and revise as necessary.
10. Review Universal Life Model Regulation and revise as necessary.
11. Establish model requirements for policy illustrations or ledger information disclosed or made available to consumers of variable life insurance and variable annuities by the Winter National Meeting, subject to coordination with regulatory initiatives of the Securities and Exchange Commission and the National Association of Securities Dealers.
12. Continue revisions to the Life Disclosure Model Regulation to remove conflicts with the Life Insurance Illustrations Model Regulation. Review and update entire model. Complete revised draft by Fall National Meeting.
13. Support and monitor work of Health Law Policy Institute and its research project on genetics and life insurance.
14. Oversee changes and provide technical assistance as appropriate for the production of the *Market Share Reports for the Top 125 Life and Fraternal Insurance Groups and Companies by State*. This is an on-going charge.

ATTACHMENT SIX

Adopted by Plenary: December 6, 1999

Life Insurance and Annuities (A) Committee
Conference Call
October 27, 1999

The Life Insurance and Annuities (A) Committee met by conference call on Oct. 27, 1999. Commissioner Terri Vaughan (IA) chaired the meeting. The following committee members participated: Greg Martino representing Diane Koken, Vice Chair (PA); Marlyn Burch representing Kathleen Sebelius (KS); Lester Dunlap representing James H. Brown (LA); Michael Batte representing Don Letherer (NM); and Dalora Schafer and Frank Stone representing Carroll Fisher (OK).

1. Consider Charge on Structured Settlements

Commissioner Vaughan said the committee began to respond to its charge to discuss structured settlements with a hearing at the Summer National Meeting. At the end of that meeting, the committee decided to analyze state laws already in place and asked staff to prepare a summary of those laws. Commissioner Vaughan said her awareness was raised by the useful information at the hearing about the problems and appropriate protections for consumers. She also noted that the chart prepared by NAIC staff provides good information on how states have addressed these issues. She asked whether the regulators thought it would be useful at this time to develop an NAIC recommendation on this topic. She suggested it may be enough to reflect in the minutes that the regulators have studied the issue and agree that legislation is appropriate to protect consumers. The regulators have information about alternative approaches to address those concerns. The members of the Life Insurance and Annuities (A) Committee agreed to that approach.

2. Consider Adoption of Equity Indexed Products Checklist

Mr. Dunlap said the checklist created by the Equity Indexed Products Working Group (Attachment Six-A) is designed to provide information to contract analysts on appropriate items to review. He said it is important to keep this document relevant and suggested that the Life Disclosure Working Group be assigned a charge to revisit the document from time to time. Commissioner Vaughan asked if it was his intent to send this document out in its current form. Mr. Dunlap responded that the working group would like to see it mailed out to state regulators but there were some concerns about the proper procedure for this. Commissioner Vaughan remarked that the viatical advisory package was sent to states after it was adopted by the Plenary. Mr. Batte told of receiving a recent e-mail asking for this information. He noted that the Life and Health Actuarial Task Force sent a letter about guaranteed investment contract (GICs) with bailouts after it was adopted by the A Committee. He suggested doing something similar in this instance.

Commissioner Vaughan asked if any of the regulators participating in the conference call had comments on the checklist. She said the NAIC had earlier sent a letter to the Securities and Exchange Commission (SEC) saying that state regulators were able to address issues on equity indexed products, and thus regulation by the SEC was not necessary. She asked regulators to consider whether the items on the checklist give adequate guidance. She questioned particularly the issue of agent training. She asked if the points under No. 8 were enough for regulators to feel confident that agents were receiving adequate training. She asked if it would include information about how agents were trained and how long the training took. Mr. Batte said that the Equity Indexed Products Working Group looked specifically at the agent training issue. The group was unable to reach consensus on what kind of training to require. Some regulators thought a special examination on equity indexed products is necessary while regulators on the other end of the continuum thought that no additional training is necessary. Commissioner Vaughan said she was concerned that agents should know what they were doing when they sold these type of products and she expressed the hope that the Life Disclosure Working Group would think more about this issue to decide if question No. 8 covers this adequately.

Mr. Batte moved and Mr. Dunlap seconded a motion to adopt the equity indexed product checklist and to transfer responsibility for its maintenance to the Life Disclosure Working Group, and to disband the Equity Indexed Products Working Group. The motion passed.

Commissioner Vaughan said there was one remaining issue; whether to send the checklist to state regulators now or wait until final adoption by the Plenary. She noted that it was only slightly more than a month until the NAIC meeting and suggested that the regulators wait until final approval by the Plenary in December before mailing a copy of this checklist to the contract analysts. The members of the committee agreed with that approach.

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

ATTACHMENT SIX-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 XXXV?
 - 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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