

the digits method. The latter sub-program is extremely useful in making refunds to debtors who become entitled to return premiums. Thus the information can be provided at no real additional cost.

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### Fraternal Insurance (E3) Subcommittee

(Mtg. 23)

The meeting of the Fraternal Insurance (E3) Subcommittee met in the Grand Ballroom of the Roosevelt Hotel, New Orleans, Louisiana on December 2, 1969 at 10:30 A.M.

Presiding at the meeting was the Chairman of the Subcommittee, the Honorable Pedro J. Fernandez Badillo, Insurance Commissioner of Puerto Rico.

He opened the meeting reading the agenda:

- (1) Taxation of activities of Fraternal Insurance Societies in the writing of life, accident and health insurance.
- (2) The registration and licensing of agents of fraternal societies writing life, accident and health insurance.
- (3) Any other matter submitted for consideration.

Chairman Badillo informed those present that he sent a letter to all the Commissioners of NAIC asking if they had anything to place on the agenda of the Fraternal Insurance (E3) Subcommittee.

The following Commissioners replied:

- (1) Newton I. Steers, Jr., of Maryland
- (2) Broward Williams of Florida
- (3) Robert A. Short of Delaware
- (4) Dudley A. Guglielmo of Louisiana
- (5) Milton P. Rice of Tennessee
- (6) George F. Reed of Pennsylvania
- (7) J. Richard Barnes of Colorado

All of them advised that they had nothing to place on the agenda; however, Commissioner Barnes suggested that he write to Mr. B. C. Hallum, Independent Order of Foresters, who he believed was the current President of the National Fraternal Congress, asking if he had

any remarks as to what effects the proposed 48% taxation of unrelated business income of fraternal beneficiary societies will have on the continued operation of Fraternal Benefit Societies.

Commissioner Barnes enclosed a copy of an item on this tax subject from the Rocky Mountain News, Wednesday, October 29, 1969.

The Chairman of the Subcommittee introduced Mr. B. C. Hallum from the Independent Order of Foresters to whom he wrote the letter. He then introduced Cyrus Rachie, Chairman of the Law Committee for the National Fraternal Congress of America, who expressed the following views:

This Fraternal Insurance Subcommittee last met in the Bellevue Stratford Hotel on June 16, 1969. Attached to the report of this Subcommittee was a paper that I gave in behalf of the National Fraternal Congress of America. A portion of the last page of this paper read as follows:

"The National Fraternal Congress of America is ready and willing to fully cooperate with and render all possible assistance to the National Association of Insurance Commissioners as it has always done in the past. If this Subcommittee concludes to further consider these Agenda Items or either of them and will inform us of its object in so doing, we shall be glad to furnish any additional information requested and to appoint a Subcommittee of the National Fraternal Congress of America to cooperate and work with or to meet with the Subcommittee at any mutually convenient time and place."

To date, the National Fraternal Congress of America has not received any communication from this Subcommittee in accepting our offer made last June. The only communication of any sort was a letter dated November 10, 1969, from the Honorable Pedro J. Fernandez Badillo, the present Chairman of this Committee, addressed to Mr. B. C. Hallum, Independent Order of Foresters. It is to this letter that I am addressing my remarks at this time. Mr. Fernandez-Badillo's letter read as follows:

"The National Association of Insurance Commissioners Fraternal Insurance (E3) Subcommittee is meeting in New Orleans, December 2, 1969.

We would be very pleased to hear your remarks as to what effect the 48% taxation provision, approved by the House of Representatives and recommended by the Senate Finance Committee, will have on the continued operation of Fraternal Benefit Societies.

Your comments on this matter will be deeply appreciated."

The answer to Mr. Badillo's letter is that the premise of his question is incorrect as to the facts. There is nothing in the Tax Reform Bill of 1969, also known as H. R. 13270 as passed by the House of Representatives and as published in the report of the Senate Finance Committee that would tax fraternal benefit societies as such. The only effect the H. R. 13270, as now worded, will have upon fraternal benefit societies is to tax at regular corporate rates any unrelated business. In this respect, fraternal benefit societies will be treated the same as charitable, educational, religious organizations and churches. The Law Committee of the National Fraternal Congress of America concurs in this proposed change in the federal income tax law. If a Fraternal Benefit Society enters into a trade or business regularly carried on and not substantially related to the exempt function of fraternal benefit societies, such a society should be taxed.

The conclusions of both the House Ways and Means Committee and the Senate Finance Committee, after complete investigation by their staffs, were that, because of the outstanding job being done by most fraternal benefit societies in their benevolent and charitable work, they should not be taxed unless they engage in an unrelated business.

By the same token, fraternal benefit societies should not be taxed on a state level as the same facts as taken into consideration by the House and Senate Committee

would have to rightfully be taken into consideration on a state level. Both the federal and state governments are in need of finances. Up to now, however, neither has insisted on the receipt of finances when either people or organizations are actually doing good to society and their fellow man.

If a fraternal benefit society in a given state is not active and doing business as they should, the Insurance Commissioner of the state of domicile should utilize that portion of the Fraternal Benevolent Society Code to make such a society change to a mutual insurance company.

In conclusion and in answer to the question as stated in Commissioner Badillo's letter of November 10, 1969, addressed to Mr. B. C. Hallum, please be advised that the Tax Reform Bill of 1969 as approved by the House of Representatives and recommended by the Senate Finance Committee will have no effect whatsoever on the continued operation of Fraternal Benefit Societies.

Respectfully submitted,

Cyrus Rachie

When Mr. Rachie finished, the Chairman expressed his thanks for the opinions and for his information about the taxation of activities of fraternal societies.

Chairman Badillo then stated that he wrote that letter to Mr. B. C. Hallum according to the article which appeared in the Rocky Mountain News, Denver, Colorado on Wednesday, October 29, 1969 and which stated in one of its paragraphs "Adopt the House provision to tax at a regular corporate rate of 48% the unrelated business income of churches, social clubs, *fraternal beneficiary societies* and similar tax-exempt groups which operate factories, restaurants and other enterprises. The revenue increase was estimated at \$20 million a year." There was no further discussion on this item.

There being no views or comments expressed with relation to the second and third items on the agenda, the Chairman then adjourned the meeting.

HON. PEDRO J. FERNANDEZ BADILLO, CHM., P. R.;  
HON. RALPH APODACA, V. CHM., N. MEXICO; Hon. Albert F.  
Jordan, D. C.; Hon. Frank Sullivan, Kansas; Hon. William Y. McCaskill, Mo.; Hon. Stanley DuRose, Wisconsin; Hon. William G. Walton, Wyom.

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#### Life Insurance (E4) Subcommittee

(Mt. 19)

The Life Insurance (E4) Subcommittee convened at 9:00 a.m. in the International Room of the Roosevelt Hotel on Tuesday, December 2. Every member of the Committee was present.

Mr. Larry Gilbertson of Participating Annuity Life Insurance Com-

pany indicated that it was his feeling that the subject of separate accounts and other financial aspects of variable contracts other than annuities was of sufficient concern that it should be included in the proposed draft of model laws of regulations being prepared by the Variable Annuities and Other Contracts (E6) Subcommittee. In executive session the subcommittee unanimously voted to so recommend.

Extensive discussion was held on replacement regulations. Mr. Jim Douds, Vice Chairman of the Industry Advisory Committee, submitted a majority report recommending adoption of the Industry Committee's recommended replacement regulation as submitted to the subcommittee on Nov. 7, with some minor changes. This proposal does not include reference to variable annuities or other equity investments.

Harold Baird, the chairman of the Industry Committee, submitted a minority report in which he strongly urged inclusion of variable annuities and equity products in the regulation.

Mr. Robert J. Demichelis, speaking on behalf of ALC and LIAA, gave general endorsement to the industry majority report, but recommended an exclusion for small policies and some changes in the reference to dividends in the comparison statement.

Mr. Joe Mintz, an independent agent from Dallas, Texas, made a lengthy presentation recommending that regulations be issued pertaining to full disclosure at the time of the sale of life insurance as well as at the time of retirement or death benefits, in addition to disclosure at the time of recommending replacements.

Mr. James H. Banks of the Presidential Life indicated his company's support to the basic concept of replacement regulations. However, he expressed concern over the possible misrepresentation by the defending or replaced company and agent. He recommended inclusion of wording which would prohibit "reverse twisting" in an effort to conserve business.

Mr. Murray Krowitz gave a report of the drafting work and recommendations of himself and George McDonald who have put in countless hours of staff work in the initial and revised drafts. He indicated that they felt that the complications of comparison with variable annuities would make it advisable to temporarily eliminate reference to variable annuities from the regulation in order to get an initial regulation out and then later amend it by adding reference to variable annuities or other situations as they develop in the future.

A letter from Walter Young of the New Jersey Department was read indicating their concern with combination proposals which involve

financing or new insurance through borrowing on existing life insurance and mutual fund shares.

In executive session it was unanimously voted to make certain amendments to the various working drafts and recommend to the parent committee the adoption of a model replacement regulation as per the draft attached to and made a part of this report.

HON. J. RICHARD BARNES, CHM., COLORADO; HON. BROWARD WILLIAMS, V. CHM., FLORIDA; Hon. James L. Bentley, Georgia; Hon. James Baylor, Illinois; Hon. Frank M. Hogerty, Maine; Hon. Thomas C. Hunt, Minnesota; Hon. Richard E. Stewart, New York; Hon. Cornelius Bateson, Oregon; Hon. George Reed, Pennsylvania; Hon. Durwood Manford, Texas; Hon. C. N. Ottosen, Utah; Hon. Everette Francis, Virginia.

### Model Life Insurance Replacement Regulation

#### Section 1. Statutory Authority

This Regulation is promulgated by the Insurance \_\_\_\_\_ pursuant to Section \_\_\_\_\_ of the Insurance Laws of \_\_\_\_\_ which authorizes the Insurance \_\_\_\_\_ to make all reasonable rules and regulations to administer the Insurance Laws of \_\_\_\_\_

#### Section 2. Purpose

The purpose of this Regulation is:

- 1) To implement the Insurance Laws of \_\_\_\_\_ by regulating the acts and practices of insurers and agents with respect to life insurance replacing life insurance under Sections \_\_\_\_\_ and \_\_\_\_\_ of the Insurance Laws of \_\_\_\_\_
- 2) To protect the interests of the life insurance public by establishing minimum standards of conduct to be observed in the replacement or proposed replacement of life insurance policies; by making available full and clear information on which an applicant for life insurance can make a decision in his own best interest; by reducing the opportunity for misrepresentation and incomplete comparison in replacement situations; and by precluding unfair methods of competition and unfair practices.

#### Section 3. Replacement of Life Insurance Defined

The replacement of life insurance which, as used in this Regulation includes annuity contracts, is defined as any transaction, not exempted in Section 4, below,

- (A) Wherein new life insurance is to be purchased and it is known to the agent that, as part of the transaction, existing life insurance has been or is to be;
- (B) Or it is known to the agent that, as part of the transaction, existing life insurance has been or is to be:
  - 1) Lapsed or surrendered;
  - 2) Converted into paid up insurance, continued as extended term insurance or under another form of non-forfeiture benefit;
  - 3) Converted otherwise so as to effect a reduction either in the amount of the existing life insurance or in the period of time the existing life insurance will continue in force;

- 4) Reissued with a reduction in amount such that substantial cash values are released. ("Substantial cash values" include all transactions wherein an amount in excess of 50% of the tabular cash value is to be released on one or more of the existing policies.), or
- 5) Assigned as collateral for a loan or subjected to substantial borrowing of the loan values whether in a single loan or under a schedule of borrowing over a period of time. "Substantial borrowings" includes all transactions wherein an amount in excess of 50% of the tabular cash value is to be borrowed on one or more existing policies.

#### Section 4. Exemptions

This Regulation shall not apply when:

- 1) The application for the new life insurance is made to the same insurer that issued the existing life insurance and a contractual policy change or conversion privilege is being exercised;
- 2) The new life insurance is provided under (i) a group life insurance policy; (ii) a policy whose cost is borne in whole or in part by the insured's employer or by an association of which the insured is a member; (iii) policies covering employees of an employer, debtors of a creditor, or members of an association, which are distributed on a mass merchandising basis and administered by group-type methods; or (iv) life insurance policies issued in connection with a pension, profit-sharing or other benefit plan qualifying for tax-deductibility of premiums; provided, however, that as to any plan described in this subsection, full and complete disclosure of all material facts shall be given to the administrator of any plan to be replaced;
- 3) The existing life insurance is a non-convertible term policy with five years or less to expire and which cannot be renewed.

#### Section 5. Duties of Agent

Each life insurance agent shall:

- 1) Obtain with or as a part of each application for life insurance a statement signed by the applicant as to whether such insurance will replace existing life insurance;
- 2) Submit to the insurer in connection with each application for life insurance a statement as to whether, to the best of his knowledge, replacement is involved in the transaction;
- 3) Where a replacement is involved:
  - a) obtain with or as a part of each application a list of all existing life insurance policies proposed to be replaced;
  - b) present to the applicant, not later than at the time of taking the application, a completed "Comparison Statement" signed by the agent and a "Notice to Applicants Regarding Replacement of Life Insurance" in form substantially as described in Exhibits A and B and leave such forms with the applicant for his records;
  - c) submit with the application to the insurer a copy of any proposal used and the completed "Comparison Statement" and the name of each insurer which issued any insurance being replaced;
  - d) have the applicant acknowledge receipt of the completed "Comparison Statement" and the "Notice to Applicants Regarding Replacement of Life Insurance."

#### Section 6. Duties of Insurers

Each insurer shall:

- 1) Inform its field representatives of the requirements of this Regulation;

- 2) Require with or as a part of each application for life insurance a statement signed by the applicant as to whether such insurance will replace existing life insurance;
- 3) Require in connection with each application for life insurance a statement signed by the agent as to whether, to the best of his knowledge, replacement is involved in the transaction;
- 4) Where a replacement is involved:
  - a) require with or as a part of each application a list prepared by the agent representing, to the best of his knowledge, all of the existing life insurance policies proposed to be replaced;
  - b) obtain a copy of any proposal used, the completed "Comparison Statement," proof of the receipt by the applicant of the "Notice to Applicants Regarding Replacement of Life Insurance" and the name of each insurer whose insurance is being replaced;
  - c) immediately notify any insurer whose insurance is being replaced and upon request promptly furnish a copy of any proposal used and the completed "Comparison Statement";
  - d) examine any proposal used and the completed "Comparison Statement" and ascertain that the latter meets the requirements of this Regulation;
  - e) maintain copies of any proposal used, the completed "Comparison Statement", proof of receipt by the applicant of the "Notice to Applicants Regarding Replacement of Life Insurance" and the applicant's signed statement with respect to replacement in its home office for at least three years or until the conclusion of the next succeeding regular examination by the Insurance Department of its state of domicile, whichever is later.

Any insurer which receives notice that its existing insurance may be replaced shall maintain copies of such notification on its premises, indexed by insurer notifying it of such replacement, for three years or until the conclusion of the next regular examination conducted by the Insurance Department of its state of domicile, whichever is later.

#### Section 7. Penalties

- 1) Any insurer, agent, representative, officer or employee of such insurer failing to comply with the requirements of this Regulation shall be subject to such penalties as may be appropriate under the Insurance Laws of \_\_\_\_\_.
- 2) Policyholders have the right to replace existing life insurance after indicating in or as a part of applications for new life insurance that such is not their intention; however, patterns of such action by policyholders of the same agent shall be deemed prima facie evidence of the agent's knowledge that replacement was intended in connection with such transactions, and such patterns of action shall be deemed prima facie evidence of the agent's intent to violate this regulation.

#### Section 8. Exhibits

- 1) The forms set forth in the following Exhibits A and B are hereby approved for use as specified in this Regulation. Substantially equivalent forms may be adopted with the prior approval of the Insurance \_\_\_\_\_. To the extent that the forms in Exhibit A and B are not entirely appropriate for replacements involving annuity contracts, the company shall have the responsibility of adapting these forms to fit annuity cases when they arise.

#### Section 9. Effective Date

This Regulation shall become effective on \_\_\_\_\_.

**EXHIBIT A**  
**COMPARISON STATEMENT**

Name of Applicant \_\_\_\_\_

Address \_\_\_\_\_  
Street City State Zip Code

Name of Insured if Other Than Applicant \_\_\_\_\_

Date of Birth of Insured \_\_\_\_\_

**1. COMPARATIVE INFORMATION**

<u>Item</u>	<u>+ Existing Life Insurance</u>	<u>Proposed Life Insurance</u>
	X	X X X X X X X X
Policy Number	_____	_____
Insurance company	_____	_____
Amount of Basic Insurance:		
Currently	\$ _____	\$ _____
10 Years Hence	\$ _____	\$ _____
20 Years Hence	\$ _____	\$ _____
At Age 65	\$ _____	\$ _____
Basic Plan of Insurance	_____	_____
Present Amount	_____	_____
of Term Rider(s)	\$ _____	_____
Issue Age	_____	_____
Issue Date	_____	X X X X X X X X

  

<i>Premium For:</i>	Prem.	Yr. Prem. Payable to	Year Coverage Ceases	Prem.	Yr. Prem. Payable to	Year Cover. Ceases
Basic Policy	\$ _____	_____	_____	\$ _____	_____	_____
*Accidental	_____	_____	_____	_____	_____	_____
Death Benefit	_____	_____	_____	_____	_____	_____
*Waiver of Premium	_____	_____	_____	_____	_____	_____
Benefit	_____	_____	_____	_____	_____	_____
*Disability Income	_____	_____	_____	_____	_____	_____
Benefit	_____	_____	_____	_____	_____	_____
Family Income or	_____	_____	_____	_____	_____	_____
Increased	_____	_____	_____	_____	_____	_____
Protection Rider	_____	_____	_____	_____	_____	_____
Option to Purchase	_____	_____	_____	_____	_____	_____
Additional Insurance	_____	_____	_____	_____	_____	_____
Other Benefits	_____	_____	_____	_____	_____	_____
(Explain)	_____	_____	_____	_____	_____	_____
Total Current	_____	_____	_____	_____	_____	_____
Premium	\$ _____	_____	_____	\$ _____	_____	_____
Frequency of Premium Payment	_____	_____	_____	_____	_____	_____

\*If Premium For Benefits: (A) is not separable from basic policy premium, insert "Included in Basic Policy Premium," or (B) is an aggregate premium, show the aggregate premium.

+ If more than one existing life insurance policy is to be affected by a transaction included within the definition of a replacement contained in Section 3 of the Regulation, (1) the existing life insurance column of a separate signed Comparison Statement form must be completed for each such policy providing the information required by the form with respect to existing policies and (2) a separate signed Comparison Statement form must be completed for the proposed policy. The latter form must summarize, to the extent possible, the information concerning the existing policies set forth on the separate forms, and must include the information required in Sections 2 through 3 of the Comparison Statement.



<i>Tabular Cash Values:</i>	+ Existing Life Insurance	Proposed Life Insurance
At Present	\$ _____	\$ _____
1 Year Hence	_____	_____
5 Years Hence	_____	_____
10 Years Hence	_____	_____
At age _____ (Highest age shown in Cash Value Table of existing policy)	\$ _____	\$ _____
Cash Value of any existing Dividend Additions or Accumulations (if avail- able from applicant)	\$ _____	\$ _____
Amount of Loan Now Outstanding, if any	\$ _____	\$ _____
Amount of Annual Loan Interest	\$ _____	\$ _____
Date Contestable Period Expires	_____	_____
Date Suicide Clause Expires	_____	_____
<b>Dividends**</b>		
Is Policy Participating?	_____	_____
Annual Dividend (current scale)	_____	_____
1 year hence	_____	_____
2 years hence	_____	_____
5 years hence	_____	_____
10 years hence	_____	_____
Total 10 years	\$ _____	\$ _____

**2. Advantages of Continuing the Existing Life Insurance:**

(Provide Additional Space)

**3. Advantages of the Proposed Replacement of the Existing Life Insurance:**

**4. Additional Information:**

(A) The Existing Life Insurance Cannot Fulfill Your Intended Objectives for the Following Reason(s):

(B) Under the Proposal, the Existing Life Insurance Policy Will Be Treated as Follows:

**5. The Primary Reason for the Proposed Replacement of the Existing Life Insurance by New Insurance is as Follows:**

Date

Signature of Agent

Address

\*\*Dividends are based on the 10\_\_\_\_ dividend scale. The dividends shown are not to be construed as guarantees or estimates of dividends to be paid in the future. Dividends depend on mortality experience, investment earnings and other factors, and are determined each year in the sole discretion of the Company's board of directors.

The Agent is responsible for furnishing required dividend information. It is recommended that he obtain this for the policy being replaced from the Company issuing the original insurance. As an alternative, however, he may show dividends on closest comparable policy, amount, age and duration from current statistical manuals (interpolating where necessary). It is to be recognized that dividend information under this alternative method, with respect to existing insurance is not likely to be as accurate as dividend information obtained directly from the Company issuing the original insurance.

Source of dividend information used: \_\_\_\_\_

I hereby acknowledge that I received the above "Comparison Statement" and the "Notice to Applicants Regarding Replacement of Life Insurance" before I signed the application for the proposed new insurance.

---

Date

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Signature of Applicant

EXHIBIT B

NOTICE TO APPLICANTS REGARDING REPLACEMENT OF LIFE INSURANCE

THIS NOTICE IS FOR YOUR BENEFIT AND IS REQUIRED BY REGULATION

1. If you are urged to purchase life insurance and to surrender, lapse or in any other way change the status of existing life insurance, the agent is required to give you this Notice and a written signed Comparison Statement. This Statement must set forth the pertinent facts of the proposal and the advantages and disadvantages to you of making the change.
2. It is to your advantage to receive the advice of the present life insurance company regarding the proposed replacement or change of existing policies. The life insurance company to whom you are applying for the new policy is required by regulation to advise the home office of the company or companies which sold the existing policy or policies of the proposed replacement.
3. As a general rule, it is not advantageous to drop or change existing life insurance in favor of new life insurance, whether issued by the same or a different insurance company. Some of the reasons it may be disadvantageous are:
  - (a) The amount of the annual premium under an existing policy may be lower than that called for by a new policy having the same or similar benefits. Any replacement of the same type of policy will normally be at a higher premium rate based upon the insured's then attained age.
  - (b) Since the initial costs of life insurance policies are charged against the cash value increases in the earlier policy years, the replacement of an old policy by a new one results in the policyholder sustaining the burden of these costs twice.
  - (c) The incontestable and suicide clauses begin anew in a new policy. This could result in a claim under a new policy being denied by the company which would have been paid under the policy which was replaced.
  - (d) Existing policies often have more favorable provisions than new policies in such areas as settlement options and disability benefits.
  - (e) In addition to any cash value, an existing policy may have a reserve value which may be of some benefit.
  - (f) The present insurance company can often make a desired change on terms which would be more favorable than if you replaced existing insurance with new insurance.
4. For the same reasons, it is generally not advantageous to change an existing policy to reduced paid-up or extended term insurance or to borrow against its loan value beyond your expected ability or intention to repay in order to obtain funds for premiums on a new policy.
5. There may be a situation when a replacement is advantageous. However, for your protection you should receive the comments of the present insurance company before arriving at a decision in this important financial matter.
6. If, in the negotiation to replace existing insurance, it is suggested by an agent or employee of the present company that the existing insurance not be replaced, you are entitled to request in writing and receive directly from the person making the suggestion a written statement setting forth all the pertinent facts bearing on the advantages of the suggestion.