LIFE COST DISCLOSURE (A) TASK FORCE

Reference:
1984 Proc. I p. 495
1984 Proc. II p. 531

Margurite C. Stokes, Chairman--D.C.
Thomas P. Fox, Vice-Chairman--Wis.

CONTENTS

AGENDA

1. Report of Advisory Committee on Yield Index
2. Consider Continuation of Task Force
3. Any Other Matters Brought Before the Task Force

The Life Cost Disclosure (A) Task Force met in the Monroe Room of the Washington Hilton in Washington, D.C., at 9 a.m. on Dec. 11, 1984. A quorum was present and Margurite C. Stokes chaired the meeting. The following task force members or their representatives were present: Margurite C. Stokes, Chairperson (D.C.), Thomas P. Fox, Vice-Chairman (Wis.), Bruce A. Bunner (Calif.), David H. Elliott (Del.), Gil McCarty (Ky.), Sherman A. Bernard (La.), E.V. "Sonny" Omholt (Mont.), Kenneth D. Merin (N.J.), William P. Daves, Jr. (Texas) and Julio A. Brady (Virgin Islands).

Report of the Advisory Committee

James Jackson presented the report of the advisory committee. He noted Walter Miller, chair of the advisory committee, had been working diligently on the charge of the task force. (See Attachment One.) Mr. Jackson reported the advisory committee met in Chicago, Ill., on Oct. 4, 1984, in Indianapolis, Ind., on Nov. 15, 1984, and is scheduled to meet in Boston, Mass., on Dec. 18, 1984.

Mr. Jackson reported the committee agreed it was not appropriate to recommend a yield index without first addressing the issue associated with the use of such an index. The advisory committee is planning to offer its final report for consideration in June, 1985. Superintendent Stokes urged the advisory committee to comply with the June 1985 deadline. John Montgomery noted the issue of funding travel for consumer participation had been raised by the advisory committee. Mr. Montgomery stated he has presented a proposal to the Executive Committee which would establish a funding mechanism for consumer and staff travel to participate in NAIC activities.

Continuation of Task Force

Upon motion duly made and seconded the members voted to recommend that the task force be continued.

Any Other Matters

John Montgomery (Calif.) proposed that the recommendations being prepared by the American Academy of Actuaries regarding disclosure practices with respect to dividends on participating policies issued by stock life insurance companies and to non-guaranteed elements of life insurance policies would be submitted to the Blanks Task Force.

The task force, upon motion duly made and seconded, approved that action.

There being no further business, the task force adjourned at 9:30 a.m.

Margurite C. Stokes, Chairman, D.C.; Thomas P. Fox, Vice-Chairman, Wis.; Bruce A. Bunner, Calif.; David H. Elliott, Del.; Gil McCarty, Ky.; Sherman A. Bernard, La.; E.V. "Sonny" Omholt, Mont.; Kenneth D. Merin, N.J.; William P. Daves, Jr., Texas; Julio A. Brady, Virgin Islands.

ATTACHMENT ONE

OFFICE MEMORANDUM

Date: December 5, 1984
To: NAIC Life Cost Disclosure Task Force
Subject: Advisory Committee on Yield Indexes - Progress Report
From: Walter N. Miller

Our committee met in Chicago on Oct. 4 and in Indianapolis on Nov. 15. Our next meeting is scheduled in Boston on Dec. 18. The meetings have been attended not only by committee members but also by several observers whose presence has been welcomed and has been constructive.

At the outset, the committee agreed that it was not appropriate to recommend a yield index (i.e., a particular formula or methodology) without also addressing the inter-related issues associated with the use of such an index.

Because of such inter-relation, the approach we have followed has been to get all of the appropriate issues on the table for preliminary discussion and research where necessary, rather than to set a specific schedule of the "after addressing question A we will then go on question B" variety.

For this reason, we are not in a position to report any conclusions at this time although our meetings have been productive and we are making good progress.

We presently expect to have a report discussing our recommendation of a yield index completed in time for dissemination and discussion prior to the June, 1985 meeting.

Respectfully submitted,

Walter N. Miller
Chairman, Advisory Committee on Yield Indexes

UNIVERSAL AND OTHER NEW PLANS (A) TASK FORCE

Reference:
1984 Proc. I p. 513
1984 Proc. II p. 533

Michael J. Dugan, Chairman--Neb.
Linda N. Garner, Vice-Chairman--Ark.

CONTENTS

AGENDA

1. Adopt Minutes of Omaha Meeting
2. Discussion of the Nonforfeiture and Valuation Sections of the Universal Life Model Regulation
3. Report of the Advisory Committee
4. Consider Continuation of Task Force
5. Any Other Matters Brought Before the Task Force

The Universal and Other New Plans (A) Task Force met in the Lincoln Room of the Washington Hilton in Washington, D.C., at 1:10 p.m. on Dec. 10, 1984. A quorum was present and Director Michael Dugan (Neb.) chaired the meeting. The following task force members or their representatives were present: Linda N. Garner (Ark.), John Washburn (Ill.), Gil McCarty (Ky.), Sherman A. Bernard (La.), James P. Corcoran (N.Y.), Gerald Grimes (Okla.), Carole Keeton Rylander (Texas) and James M. Thomson (Va.).

1. Minutes of Previous Meeting

Upon motion duly made and seconded, the task force adopted the minutes of the Omaha meeting. (Attachment Four).

2. Report of the Advisory Committee

James Jackson, chairman of the advisory committee, presented the advisory committee report (Attachment One). Mr. Jackson stated that by letter of Oct. 5, 1984, the Actuarial Task Force had addressed 18 questions regarding the Universal Life Model to the Advisory Committee (Attachment Two). Mr. Jackson noted the advisory committee had been unable to meet prior to Dec. 9, 1984 and, therefore, was not presently prepared to respond to the inquiries. He noted that the advisory committee would respond by June 1985. Mr. Jackson also reported that the advisory committee was recommending that states adopting the Universal Life Model Regulation grant a one-year extension for companies to bring their products into compliance.

He noted the advisory committee is drafting a proposed footnote to the model regulation to address a decrease in reserves when unscheduled premiums are allowed under certain plans.

John Montgomery (Calif.) also noted that some states are considering adoption of the Universal Life Model and the advisory committee should consider that possibility in their deliberation.

Ted Becker (Texas) noted that of the 18 issues to the advisory committee, four of these were denoted as urgent and should be addressed immediately.

Director Dugan and other task force members urged the advisory committee members to complete their work by the Williamsburg, Va., meeting if possible. Upon motion duly made and seconded, the advisory committee report was received.

3. Continuation of Task Force

Noting the issues to be addressed by the advisory committee and the task force, the task force upon motion duly made and seconded, voted to recommend that the task force be continued.

The task force also asked the advisory committee to serve for another year.

4. Advisory Committee

John Montgomery asked the task force to establish an advisory committee on Indexed Products other than Universal Life products to assist the task force and the Actuarial Task Force . Upon motion duly made and seconded, the advisory committee was established. (Attachment Three)

Having no further business, the task force adjourned at 2 p.m.

Michael J. Dugan, Chairman, Neb.; Linda N. Garner, Vice-Chairman, Ark.; Dave J. Santos, Guam; John E. Washburn, Ill.; Gil McCarty, Ky.; Sherman A. Bernard, La.; James P. Corcoran, N.Y.; Gerald Grimes, Okla.; Rogers T. Smith, S.C.; Carole Keeton Rylander, Texas; James M. Thomson, Va.

ATTACHMENT ONE

REPORT OF THE ADVISORY COMMITTEE TO THE
UNIVERSAL AND OTHER NEW PLANS TASK FORCE

The advisory committee to the Universal and Other New Plans Task Force met on Sunday, Dec. 9, 1984, at the Washington Hilton. Fourteen people representing the committee were present. The advisory committee's present membership for 1984 is Attachment One-A to this report, for reference.

The advisory committee met to discuss three primary items on its agenda. The first item discussed was the determination of the committee's position regarding the extension of time, after adoption by a state of the Model Regulation on Universal Life Insurance, for insurers with previously approved universal life product forms to bring such forms into compliance with the Model Regulation.

A particular company and the insurance department directly involved had approached the committee for its position on such extension of time; however, the American Council on Life Insurance reported that a number of companies had also brought up the need for such extension.

The advisory committee determined, after discussion, that the issue of granting such extension had not been specifically addressed in the Model Regulation and that an extension of time for companies to phase their products into compliance was reasonable.

It is hereby recommended by the advisory committee that states adopting the Model Regulation grant a one year extension to those insurers to bring previously approved policy forms into compliance with the new Model Regulation. The period of one year was determined by the committee to be reasonable because of the lead time usually required to get computer systems work completed. It is the committee's understanding that North Dakota is one state which grants such an extension. The committee did not address whether this extension of time applies to new product forms filed with the insurance department after the effective date of the model regulation.

The committee then discussed an issue which has arisen and requires clarification, in the form of a footnote to the Model Regulation. The issue, stated in very general terms, involves policies which under the Model Regulation would be fixed term universal life plans but for the fact that they allow additional amounts over the planned premiums to be submitted to the insurer during the policy year. This additional policy benefit of allowing unscheduled premiums results in reserves actually decreasing. This was not an intended result under the Model Regulations.

Therefore, the advisory committee is in the process of drafting a footnote which will accomplish the proper results under the Model Regulation. One proposal, submitted by a person who is not a member of the committee is submitted to this task force for its review and comments. The committee also seeks responses to this submitted language from all interested persons.

The third major item on the agenda Sunday was the discussion of the letter of Oct. 18 to Jim M. Jackson from Ted Becker on behalf of the NAIC Life and Health Actuarial Task Force. The task force has previously received copies of this letter. In this letter, Mr. Becker requested that the advisory committee respond to 18 questions raised by Mr. Becker's group.

The committee analyzed, on a preliminary basis, each of these questions and determined that much work would be required to respond to some of them. The committee, therefore, determined that it will have various of its members be assigned to handle individual questions, and have follow-up committee meetings between now and June of 1985 to complete its analysis.

It is anticipated that in June of 1985, subject to this advisory committee remaining in existence as presently constituted, that responses to Mr. Becker's group shall be presented at the NAIC meeting in Kansas City.

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ATTACHMENT ONE-A

UNIVERSAL LIFE INSURANCE TASK FORCE ADVISORY COMMITTEE
1984

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ATTACHMENT TWO

Questions Regarding the Universal Life Model

October 5, 1984

Mr. Jim Jackson
Transamerica Occidental Life Insurance Company
Transamerica Center
1150 South Olive
Los Angeles, California 90015

Dear Jim:

Bill Tozer and I have been discussing the wording for the footnote in the Universal Life Model Regulation. In addition, Bill has been talking to Tony Spano about this matter. The following wording is satisfactory to the three of us:

"If a flexible premium Universal Life policy provides guaranteed benefits and requires a minimum premium that is required on every due date, then the minimum reserve would be the greater of:

a. the CRVM reserve defined in the Universal Life Model Regulation, or
b. the CRVM reserve defined in the Standard Valuation Law in effect at the time of issue."

Bill has suggested that the best approach for accomplishing the inclusion of this language in the regulation would be to work with you and the NAIC's Cost Disclosure Committee. I will be available to help you in any manner that you think is appropriate. Please feel free to call upon me.

Sincerely yours,

James B. Smith, Jr.

cc: Mr. Anthony Spano
Mr. William T. Tozer
Ms. Diana Marchesi

October 5, 1984

Mr. James M. Jackson
Transamerica Occidental Life Insurance Company
Box 2101, Terminal Annex
Los Angeles, California 90051

Dear Jim:

Enclosed is a letter on behalf of our NAIC Actuarial Task Force, containing a list of questions on universal life insurance plans.

I am sorry that the questions are so long, complex and difficult. This seems to be a necessary consequence, resulting from efforts to properly regulate a relatively new type of life insurance which has rapidly gained a significant part of the marketplace and which has already evolved in many different directions.

As matters now stand, I understand your advisory committee would go out of existence after the NAIC 1984 Winter Annual Meeting. Our NAIC Actuarial Task Force recognizes that it would be almost impossible (perhaps totally impossible) to completely answer all of these questions in time for that meeting.

In the absence of any contrary instructions directly from the NAIC Universal and Other New Plans Task Force, I assume that your committee would do such work on these questions as is possible, prior to the NAIC 1984 Winter Annual Meeting, giving priority to the first four questions. I assume that the NAIC Universal and Other New Plans Task Force would then decide how matters should proceed after that meeting.

I appreciate your interest in the regulation of universal life insurance, and your willingness to help in answering these questions.

Very truly yours,

Ted Becker, Vice Chairman
NAIC Life & Health Standing
Technical Actuarial Task Force

cc: Director Michael Dugan

October 5, 1984

Mr. James M. Jackson
Transamerica Occidental Life Insurance Company
Box 2101, Terminal Annex
Los Angeles, California 90051

Re: NAIC Model Regulation on Universal Life Insurance

Dear Jim:

At the recent NAIC 1984 Fall quarterly meeting in Omaha, Nebraska, Director Michael Dugan asked our NAIC Life and Health Actuarial (EX5) Task Force to furnish you with a list of questions concerning the model regulation on universal life insurance. He proposed that you then endeavor to furnish a response to these questions, on behalf of the advisory committee which you chair. My letter is intended to serve as the list of questions requested by Director Dugan.

The following four questions are the most urgent. We would like to have at least a preliminary response to these questions available in time for the December 1984 NAIC meeting.

(1) If minimum cash values for a flexible premium universal life plan were to be defined to equal or exceed a specific level on a retrospective basis, with due allowance for gross premiums already paid and death benefits or endowment benefits already provided, what would your committee consider to be a reasonable and proper minimum level?

(2) If minimum cash values were to be defined retrospectively for flexible premium plans, would it then be logical also to define such values retrospectively for fixed premium universal life plans? If so, what would be a reasonable and proper minimum for such plans?

(3) Does your committee feel that any portion of the model regulation on universal life insurance which pertains to minimum reserve calculation would need to be reworded if minimum cash values are defined on a retrospective basis as described in questions (1) and/or (2)?

(4) Please review the following questions, which are closely related.

(a) The following condition has been proposed for minimum cash surrender values for universal life plans. "The minimum cash surrender values required for flexible premium life insurance plans should provide equitable and consistent treatment with policyholders under a fixed premium universal life plan, whether calculated in a prospective or retrospective manner. Two policyholders, one under each type of plan, should have similar cash surrender values, assuming equal payments of premiums, interest credits and assumptions, loads and charges etc." Does your committee agree that this condition is a desirable one?

(b) Would your committee consider defining minimum cash surrender values for a flexible premium universal life plan in terms of those provided under a fixed premium universal life plan?

(c) If your committee does not feel that the treatment in (b) would be possible, would your committee investigate defining minimum cash surrender values for a flexible premium universal life plan in terms of those provided under a flexible premium annuity plan?

The following additional questions should receive attention from your committee, as soon as possible:

(5) Could your committee provide numerical examples of the calculation of prospective minimum cash surrender values and prospective minimum reserves for at least six cases, involving various types of universal life plans as described below? Each case should be worked out to illustrate both an assumption of a level death benefit and an assumption of a death benefit that increases by duration. Each case should illustrate a policy which is commonly being sold in some volume in the current marketplace. However, the illustration would not need to specifically be labelled to identify the policies involved. These calculations should illustrate the requirements under the current model regulation.

(a) Flexible premium plan, front loaded premiums, guaranteed interest rate used in accumulations of cash value equal to current maximum interest rate allowed for reserves at date of issue, assuming policyholder pays a level annual premium.

(b) Flexible premium plan, front loaded premiums, guaranteed interest rate used in accumulations of cash value equal to current maximum interest rate allowed for reserves at date of issue <u>except</u> that the guaranteed interest rate used in accumulations of cash value for the first five policy years is <u>1%</u> higher, assuming policyholder pays a level annual premium.

(c) Flexible premium plan, front loaded premiums, guaranteed interest rate used in accumulations of cash value is 1% less than the current maximum interest rate allowed for reserves at date of issue, assuming policyholder pays a level annual premium.

(d) Flexible premium plan, back loaded, with surrender charges applied against the accumulated account value which decrease to zero at the end of the first 20 policy years, assuming policyholder pays a level annual premium.

(e) Fixed premium plan, assuming policyholder pays a fixed premium for life.

(f) Fixed premium plan, assuming policyholder elects a "vanishing premium" option after five years. (Your committee should attempt to find a suitable policy form so as to illustrate this kind of option.)

(6) Could your committee also prepare similar numerical examples of minimum nonforfeiture values on a retrospective basis, and minimum reserves for each of the above cases, consistent with the response to questions (1), (2), (3) and (4)?

(7) If a state determines that it needs a more explicit definition of deceptive trade practices, which may arise specifically from universal life plans, what would your committee suggest as a proper definition?

(8) In the case of universal life plans which provide for relatively high deductions from the accumulation account, in order to determine current cash surrender values, how can the contract language and the annual report make these deductions as clear to policyholders as possible?

(9) In fixed premium universal life plans, backloaded flexible premium universal life plans, and some other types of flexible premium universal life plans, the effect of surrender charges may be to effectively negate excess interest already credited--in some cases more than 12 months in the past. Mortality saving which have already been credited could also be offset completely by surrender charges. Does your committee feel that this is in violation of the current model regulation?

(10) A special advisory committee has now been appointed by the Life Cost Disclosure (A) Task Force to work on yield rates for life insurance policies and annuity contracts, including universal life plans. Does your committee have any preliminary ideas concerning the proper calculation of yield rates for universal life plans, which might be beneficial for this other advisory committee to review and consider?

(11) A relatively new form of universal life plan has fixed premiums, due on specific dates, and contains provisions for lapse and non-forfeiture values on default. However, this plan also allows the policyholder to pay additional premiums of unspecified amounts and at unscheduled dates. Does your committee have any comments as to how a state insurance department should review such a contract under the current model regulation?

(12) Another relatively new form of universal life plan differs from the classic flexible premium plan in that it does not treat mortality, interest rates and expenses as separate elements in an "unbundled" fashion. Instead, the company calculates a new gross premium on the "current basis," somewhat like an indeterminate premium policy. But the policy also permits "jumps" in the cash surrender value from year to year, so that these cash surrender values are not definitely predictable at the date of issue. The typical policy does contain a table of guaranteed values, and contains a provision that a new table will be issued if the policyholder changes his policy. It the policyholder pays a premium, other than the premium determined on the "current" basis, he is deemed to have made a change in the policy. Does your committee feel this type of plan is approvable as a universal life plan? If so, does the committee have any comments as to how a state insurance department should review such a plan under the current model regulation?

(13) Please consider a fixed premium universal life plan, on which the cash surrender value exceeds the net single premium on the "current" interest and mortality bases. The policyholder elects a "vanishing premium" option. Does your committee feel there is proper disclosure required to the policyholder in the model language, as to how guaranteed cash surrender values will develop and as to the possibility that the death benefit coverage can be completely lost if the company is unable to continue the "current" bases.

(14) Does your committee interpret the model language to effectively place any limitation at all on the amount of front end loading which may be deducted from the gross premium, or to place any limitation on the slope of the loadings as the duration increases?

(15) Please consider a universal life policy which has front loading of $10 for any gross premium paid in the first policy year, and of $2 for premium paid in any subsequent policy year. The company is advised that the policy does not meet the minimum standards for cash surrender values defined in the model language, and revises the policy so that a $10 front loading is deducted in all policy years. This revision appears to make the policy approvable. Could the committee explain this anomaly, or else recommend a change in the model language so as to prevent such cases from arising?

(16) The following definition of "class" has been proposed for universal life insurance plans. "The policy form shall define the class of insureds in terms of each of the pricing variables, (for example, age, sex, smokers, risk, etc.), and its initial current premium." Does your committee agree with this definition? If not, what definition of "class" would your committee propose as an alternate?

(17) Many of the companies today have a very refined structure for the classification of risks, with a multitude of substandard (such as smokers) and other classifications, which do not qualify or requalify for the lowest premium rate. What is your committee's recommendation concerning minimum non-forfeiture values for these "substandard" classes?

(18) The mandatory policy provisions need to be interpreted differently for the various types of universal life plans. While the grace period provision, for example, may be acceptable in its present form for fixed premium universal life insurance plans, it may need to be rewritten to meet the unique structure of flexible premium life insurance plans. Some of the other mandatory provisions need a similar review. Could your committee review all the mandatory provisions in the light of the different types of universal life insurance plans available in the marketplace today, and recommend new regulatory language where it would appear to be needed?

Very truly yours,

Ted Becker, Vice Chairman
NAIC Life & Health Standing
Technical Actuarial Task Force

cc: Director Michael Dugan

October 24, 1984

Ted Becker, Vice Chairman
NAIC Life & Health Actuarial Task Force
State Board of Insurance
1110 San Jacinto
Austin, Texas 78786

Re: NAIC Model Regu'ation on Universal Life Insurance

Dear Ted:

Thank you for your recent letters regarding the above regulation. Although dated Oct. 5, the letters did not arrive in my office until the 19th, when I happened to be out of town, so please excuse my delay in responding.

Your letter containing the 18 questions from the NAIC Technical Actuarial Task Force is quite comprehensive and it is obvious you have put considerable thought into framing the questions. I appreciate the time and effort which went into preparing this list of questions and assure you that my advisory committee will proceed as quickly as possible to provide as definitive a set of answers as we can in response to them. As you know, for some time I have been anxious to receive a set of specific criticisms and/or questions relating to the model regulation so that we could respond in some meaningful fashion. I am currently planning to try to arrange a meeting of our advisory committee for November so that we can at least begin to have preliminary responses in time for the December meeting of the NAIC. It is currently my hope that the NAIC will continue our advisory committee's life one more year to complete work on these questions which, unfortunately, I doubt that we will be able to complete prior to the December meeting of the NAIC.

Thanks again for your effort and cooperation. I look forward to resolving the concerns expressed in your Oct. 5 letter to the satisfaction of all concerned.

Very truly yours,

James M. Jackson
Assistant General Counsel
Transamerical Occidental Life Insurance Co.

cc: Michael J. Dugan
John O. Montgomery

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ATTACHMENT THREE

Recommendations for Advisory Committee
on Interest-Indexed Products
(other than Universal Life Insurance)

Advisory to NAIC Universal and Other Plans Task Force of (A) Committee
Director Dugan, Nebraska

Larry Frederickson
Assistant General Counsel
Northwestern National Life Insurance Company
Minneapolis, Minnesota

Gregory Carney
Vice President and Chief Actuary
Variable Annuity Life Insurance Company
Houston, Texas

James Jackson
Assistant General Counsel
Transamerica Occidental Life
Los Angeles, California

Howard Kayton
Executive Vice President
Security First Group
Los Angeles, California

Robert Hersh
Vice President and Associate General Counsel
Equitable Life Assurance Society of the U.S.
New York, New York

Paul Kolkman
Vice President and Corporate Actuary
IDS Life Insurance Company
Minneapolis, Minnesota

Gilbert Fitzhugh, Chairman
Vice President and Actuary
PRUCO Life Insurance Company
Newark, New Jersey

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ATTACHMENT FOUR

UNIVERSAL AND OTHER NEW PLANS (A) TASK FORCE
September 10, 1984
Omaha, Nebraska

The Universal and Other New Plans (A) Task Force met in the Ballroom West of the Red Lion Inn, Omaha, Neb., at 2 p.m. on Sept. 10, 1984. A quorum was not present and Director Michael J. Dugan chaired the meeting and the following states were present: Nebraska, Arkansas, Illinois, New York, Texas and Virginia.

1. Report on status of Universal Life Model Regulation by Jim Jackson, advisory committee.

Jim Jackson (Transamerica Occidental Life Insurance Company), chairman of the advisory committee on Universal Life, gave a report on the states' adoption of the Universal Life Insurance Model Regulation. The following states have adopted the regulation: Nebraska, Arkansas, Mississippi, Wyoming (with the exception of the nonforfeiture and valuation sections) and Pennsylvania ("Administrative Guidelines"). The following states are considering the model or have had some activity regarding the model: Indiana, South Carolina, Texas, New Mexico, Tennessee, Ohio and Washington.

2. Recommendation of Action by Technical Staff Actuarial Group.

Director Dugan requested the Technical Staff Actuarial Group to draft a list of its differences concerning the nonforfeiture and valuation sections of the Universal Life Model Regulations. Director Dugan will then present those differences to the advisory committee and will set a time schedule in which the advisory committee must respond.

With no further business to come before the task force, the meeting was adjourned at 2:33 p.m.