

Commissioner Wilcox called on Mr. Coleman to give a report of the technical resource advisors. Mr. Coleman said that on Aug. 31, 1994, the technical advisors had presented to the Life Disclosure Working Group a revised recommendation on model rules governing the illustrations of life insurance using disciplined current scale (Attachment Four-B). He said the resource advisors' proposal was aimed at achieving three objectives: (1) improving the understandability of illustrations; (2) assuring credibility in the scale used to illustrate nonguaranteed elements; and (3) assuring accountability of the agent and the insurer. He said their draft sought to improve illustration understandability by adopting common definitions, certain format standards and an illustration cover page requirement. He pointed out that many of the features of the document that was presented by the resource advisors were the same features required on the standards document the working group had prepared. Mr. Coleman said that in their urgency to have their document prepared by the Aug. 31 deadline, they had neglected to include a provision that said that if a policy issued was different from that illustrated, a second illustration must be prepared and signed.

Commissioner Wilcox expressed the appreciation of the working group for the significant movement in the technical resource advisors' draft and he thanked them for their quick response to the working group. He asked the technical resource advisors to prepare a document identifying the differences between their draft and the list of standards prepared by the working group.

Commissioner Wilcox next asked Ms. VanLeer to show the illustrations she had prepared that used the standards in the technical resource advisors' draft to prepare an actual illustration (Attachment Four-C). Ms. VanLeer explained the features of the illustration and pointed out the meaningful reform in illustrations over what is being used at the present time. She said she believed the illustrations her office had prepared were consumer friendly.

3. Consider Exposure of Drafts Requiring Illustration of Guarantees Only

Commissioner Wilcox asked what the working group wanted to do with the drafts that they had prepared that allowed for illustrations only of guarantees into the future and illustration of past performance. Roger Strauss (Iowa) said he would recommend that the drafts be tabled while the working group considered the illustration of nonguaranteed elements. Upon motion duly made seconded, the working group adopted a motion to table the drafts on guarantees only for the present time.

Having no further business, the Life Disclosure Working Group adjourned at 6:07 p.m.

ATTACHMENT FOUR-A

Life Disclosure Standards Draft
Prepared by the NAIC Life Disclosure Working Group
September 17, 1994

I. Background Statement.

In recent years the "illustration" has become a standard part of the life insurance agent's sales presentation. The ostensible purpose of the illustration has been to demonstrate to the potential buyer how the policy "works." In its simplest form, the illustration summarizes the insurance contract, with a year-by-year projection of the premiums, cash value, and death benefits. As policies have become more complex, so have the illustrations, portraying not only the contract ("guarantees") but also financial benefits that are outside the contract ("non-guarantees"), illustrating not only what will happen but what could happen. Unfortunately, since "could" was invariably much more attractive than "will," such illustrations have been used to support deceptive-sales presentations, encouraging consumers to base their purchase decisions only on optimistic projections.

The problems associated with life illustrations were summarized in the working group's white paper of August 1993. They have been aired before congressional committees, in the media, and the courts. They have also been the subject of thousands of consumer complaints to state insurance departments.

Unlike many sales abuses, these have not been limited to a handful of players, but, rather, have involved some of the nation's largest companies.

As a step in the process of preparing a model act and a model regulation that will restore integrity to the life insurance sales presentation process, the NAIC Life Disclosure Working Group, based on many months of review, is summarizing here the standards and objectives that are expected to form the basis for the development of these new models.

II. Scope.

A. Specified products and markets that do not use illustrations shall be exempted from these requirements. All other applicants for life and annuity contracts, individual and group, shall receive an illustration.

B. Standard nonforfeiture laws require certain disclosures. The requirements described in this document are intended to harmonize with and avoid conflict with nonforfeiture requirements.

C. Products such as variable life that are subject to other disclosure requirements should correspond as closely as possible to these requirements.

III. Understandability.

- A. Illustrations should be understandable by a typical applicant without assistance from an insurance agent.
- B. The focus of the illustration must shift from use as a sales tool to consumer education.

IV. Standardization of Presentation.

A standard format and content will be used for illustrations. The standard illustration will:

- A. Contain specified information in a specified sequence and format;
- B. Eliminate as far as possible the use of footnotes and caveats as well as excessive detail;
- C. Use a standard glossary of terms;
- D. Use "consumer friendly" language that eliminates arcane insurance terminology;
- E. Emphasize guaranteed values over non-guaranteed values by showing them first and at least as prominently;
- F. If graphic illustrations are used they must reflect only information otherwise illustrated;
- G. Use serialized page numbering (e.g., the fourth page of a seven-page illustration should be labeled "page 4 of 7 pages");
- H. Be clearly labeled as a "Life Insurance Illustration";
- I. Identify the insurer, the generic type of life insurance, and the policy form number;
- J. Contain appropriate personal information including:
 - 1. name
 - 2. age
 - 3. amount
 - 4. rating classification
 - 5. additional benefits
 - 6. dividend option (if applicable)
 - 7. generic policy name
- K. Contain certification of the illustration by an officer of the company and the appointed actuary;
- L. Contain a statement to be signed and dated by the applicant;
- M. Contain a statement to be signed and dated by the producer;

V. Assumptions.

- A. Non-guaranteed elements will be based on separate assumptions for interest, mortality, lapse and expenses that are each not greater than the most conservative of:
 - 1. The rate reflected in the current credited scale;
 - 2. The most recent experience on the policy block; and
 - 3. The rate that can reasonably be expected on the policy block.
- B. Mortality and lapse rates will not reflect future improvement.
- C. Expense rates in each renewal year will be at least equal to expected incurred expenses.
- D. Anticipated, but not yet realized, reductions in aggregate or unit expenses may not be reflected.
- E. Distributions of accumulated surplus or prior gains to a policy block can be included to the extent that such distributions are both:
 - 1. currently being paid by the company to policyowners; and
 - 2. the result of a delayed crediting of gains attributable to that policyholder.
- F. Lapse-supported pricing may not be illustrated. Lapse supported pricing means that minimum profit objectives cannot be met with zero lapse assumptions.
- G. Persistency bonuses may not be illustrated.
- H. Minimum profit objectives must be established by the regulation or the actuarial practice standard.

VI. Actuarial Standards.

- A. It is preferable to have the Actuarial Standards Board develop the necessary standards.
- B. The Actuarial Standards Board must work in close cooperation with the NAIC to assure that the standards drafted in response to the model meet the expectations of the NAIC with regard to specific requirements and minimal actuarial creativity.
- C. In the event that the Actuarial Standards Board fails to meet the expectations of the NAIC, a regulatory standard prepared by the NAIC will be utilized.

VII. Responsibility.

- A. The company shall be responsible for the accuracy and propriety of the illustration as evidenced by the signed and dated certification by a company officer.
- B. The company's appointed actuary shall be responsible for the accuracy of both guaranteed and non-guaranteed portions of the illustration and shall certify that the illustration is accurate and prepared in accordance with the appropriate actuarial standards as evidenced by the signed and dated certification by the appointed actuary.
- C. The producer shall be responsible to provide the appropriate illustration and to assure that no inappropriate illustration is provided to the applicant.

VIII. Annual Reports.

- A. The insurer shall annually on the policy anniversary provide a report to each policyowner.
- B. The report that is provided shall:
1. Be in a format similar to that provided at the time of sale;
 2. Illustrate actual values as of the date of the report;
 3. Illustrate future non-guaranteed values using then current assumptions; and
 4. Explain changes in assumptions since the last report.

IX. Penalties.

- A. A violation of the act or regulation would be subject to civil penalties.
- B. If the insurer provided illustrations that the insurer knew or should have known were not prepared in accordance with these requirements or illustrated benefits that were not supportable based on the prescribed standards, the insurer may be subject to administrative penalties including a requirement to pay benefits based on the illustration.

ATTACHMENT FOUR-B

Technical Resource Committee's Draft Suggestions Concerning
the Life Insurance Illustrations Model Regulation

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On behalf of the Industry Technical Resource Committee (TRC) to the Life Disclosure Working Group I am enclosing our revised proposal for the Life Insurance Illustrations Model Regulation. This revised proposal reflects a great deal of work by TRC members. During the summer we reviewed and evaluated, on your behalf, in two days of meetings, many other proposals for illustration reform. We reviewed and revised our own proposal in light of our evaluations of these other proposals. Our revised proposal is also intended to be responsive to the concerns of the Life Disclosure Working Group as reflected in our excellent meeting with you Aug. 22, 1994. Given our short deadline for crafting our revised proposal we undoubtedly left loose ends and unintended inconsistencies. We will address these as best we can between now and the September meeting of the Working Group.

Our revised proposal follows, to the extent possible, the format of your own draft proposal. We have added elements from our earlier proposals and incorporated ideas from the American Council of Life Insurance (ACLI), other insurers, organizations and the Working Group. We have presented alternatives and questions to the Working Group in drafting notes, recognizing that there is always room for clarification and improvement.