to the State of __________ a sum not to exceed $250,00, except that if such violation is found to be willful, the amount of such penalty shall be a sum not to exceed $1,000.00. The Commissioner, in his discretion, may revoke or suspend the license or certificate of authority of the person, firm or corporation guilty of such violation. Such order for suspension or revocation shall be upon notice and hearing, and shall be subject to judicial review as provided in Section 15 of this Act.

15. Judicial Review.

Any party to the proceeding affected by an order of the Commissioner shall be entitled to judicial review by following the procedure set forth in __________.

Drafting Comment: If such is sufficiently provided in the general insurance laws of the State, the provision for judicial review may be omitted. If this is done, the last sentence of Section 14 should also be changed to reflect the correct reference.

16. Separability Provision.

If any provision of this Act, or the application of such provision to any person or circumstances, shall be held invalid, the remainder of the Act, and the application of such provision to any person or circumstances other than those as to which it is held invalid, shall not be affected thereby.

17. Effective Date.

This bill shall become effective on __________.

LIFE INSURANCE (C3) SUBCOMMITTEE

Reference:
1975 Proc. Vol. I p. 616
1975 Proc. Vol. II p. 414

Hon. Dick L. Rottman, Chairman – Nevada
Hon. Ark Monroe III, Vice-Chairman – Arkansas

AGENDA

1. Report of Technical Subcommittee on Standard Nonforfeiture and Reserve Valuation Laws.
2. Report of the Task Force on Life Insurance Cost Comparison.
3. Report of the Task Force on Premium Deposit Funds.
4. Report of the Task Force on Agents' Compensation.
5. Consider problems of insurance policy lapsation.
6. Any other matters brought before the subcommittee.

The Life Insurance (C3) Subcommittee convened at 2:30 p.m. at the Arecibo Ponce Room of the Americana Hotel, San Juan, Puerto Rico, on Tuesday, December 9, 1975. A quorum was present.

The report of the Life Insurance Cost Comparison Task Force was given by Commissioner William Huff, Chairman. Commissioner Huff, Dan Andersen, and the others members of the task force were congratulated by various persons in the meeting for the excellent work done on the regulation and proposed buyer's guide. Larry Gilbertson of the Aetna Variable Life Insurance Company praised Commissioner Huff and Mr. Anderson for the high caliber of the testimony they presented at the recent hearing before Senator Stone. The task force report was received in open session. In executive session the subcommittee adopted the report containing the regulation with four specific conditions:

First, the task force is to give further study to the equivalent level annual dividend problem. Second, the task force must take measures to simplify the language of the buyer's guide and have tests conducted to determine the understandability of the new version of the guide. Third, the task force is to hold a public hearing on the above two items. Fourth, the subcommittee requests that the NAIC, as a body to delegate the final approval of the revised buyer's guide and equivalent level annual dividend provision to the Executive Committee for consideration of its Spring meeting. The task force report and regulation as adopted is attached.

John Montgomery, chairman of the technical subcommittee on standard nonforfeiture and reserve valuation laws gave its report for the (C3) Subcommittee. The report was received in open session. The (C3) Subcommittee congratulated Mr. Montgomery on the excellent work being done by this technical subcommittee. The report was adopted in executive session with two amendments by Mr. Montgomery. The amended report is attached.

Jim Montgomery of the Washington, D.C. Department gave the report of the Premium and Retirement Deposit Fund Task Force in the absence of C.F.B. Richardson, task force chairman. Dick Minck, ALIA, expressed his organization's support of the report which contains a model act and model regulation. It was noted that the model regulation will be adequate for some states, while others need enabling legislation for the regulation. The report was discussed in executive session and was received by the (C3) Subcommittee. The task force was instructed to review the measure further and to submit a final report for consideration at the June 1976 NAIC meeting. It was requested by the subcommittee that copies of the final version of the report be circulated to the (C3) Subcommittee prior to the June meeting.

Mr. Robert Googins, Vice President of Connecticut Mutual and vice chairman of the industry advisory committee, gave a status report on the work on Life Agents' Compensation Task Force. The (C3) Subcommittee expressed a strong desire to receive a final report from Commissioner Lindsay, task force Chairman, at the June 1976 NAIC meeting.

Commissioner Huff was appointed as Chairman of a new task force on life insurance policy lapsation. The task force was charged with the responsibility of identifying specific problems involved and seeking solutions to the problem of life insurance policy lapsation.

There being no further business, the meeting was adjourned at 4:00 p.m.

Hon. Dick L. Rottman, Chairman, Nevada; Hon. Ark Monroe III, Vice-Chairman, Arkansas; Hon. J. Richard Barnes, Colorado; Hon. Robert A. Short, Delaware; Hon. Maximilian Wallach, District of Columbia; Hon. William H. Huff III, Iowa; Hon. James M. Stone, Massachusetts; Hon. Evelyn Gandy, Mississippi; Hon. Henry W. Edmiston, Missouri; Hon. J. O. Wigen, North Dakota; Hon. Harold R. Wilde, Jr., Wisconsin.

Life Insurance Cost Comparison (C3) Task Force

San Juan, Puerto Rico
December 9, 1975

Following the June 10, 1975 meeting of the Life Insurance Cost Comparison (C3) Task Force, the task force received numerous written comments from insurance industry and insurance department representatives regarding the draft of the model Life Insurance Solicitation regulation which was presented at that meeting. In addition, the task force chairman interviewed a number of insurance industry representatives in order to identify problems facing particular market segments. In an attempt to draw a compromise between a multitude of differing viewpoints, a new draft of the regulation was distributed in October to all insurance departments and all other persons who had demonstrated an interest in the subject.

In an effort to elicit meaningful comments on the October draft of the regulation, a public hearing was scheduled and held on November 17, 1975. The task force received a number of written and verbal comments regarding suggested changes in the model regulation. After reviewing those comments, the task force once again redrafted the regulation in an attempt to remove technical difficulties and simplify the material which will be presented to life insurance buyers.

That redraft was distributed on November 26, 1975 to all persons known to be interested in the subject. The task force met at the El San Juan Hotel, San Juan, Puerto Rico on December 8, 1975 and entertained comments from a number of insurance industry representatives regarding the need for revision of the November 26, 1975 draft of the model Life Insurance Solicitation regulation. Following appropriate amendments to that draft, the task force unanimously adopted a motion to recommend that the (C3) Subcommittee adopt the final draft of the regulation which accompanies this report with the understanding that the Executive Committee be given the authority to approve the language of a Life Insurance Buyers Guide, a preliminary draft of which is contained in the appendix of the model regulation. A suitable version of the buyers guide is to be prepared by the Life Insurance Cost Comparison (C3) Task Force as expeditiously as possible in order to obtain final action of the Executive Committee at an early date in 1976. The purpose of revising the preliminary draft is to produce a buyers guide which contains the same general concepts as those contained in the preliminary draft but in a literary style which can be easily read and understood by the average buyer.

In addition, adoption of the final draft of the regulation is with the understanding that the Executive Committee be given the authority to approve any necessary modification of the method of applying termination dividends in the calculation of the life insurance cost indexes as well as any necessary modification of the regulation to reinstate the use of an equivalent level dividend. Recommendations as to the need for changes, if any, are to be prepared by the Life Insurance Cost Comparison (C3) Task Force as expeditiously as possible in order to obtain final action of the Executive Committee at the time final action is taken on the buyers guide.

If this course of action is adopted by the NAIC, the task force will conduct a public hearing on these issues prior to presenting recommendations for action to the Executive Committee.

Since the June meeting of the NAIC, two bills have been introduced in the U. S. Congress which relate to the work of this task force. Senator Hart introduced S. 2065 on July 8, 1975. Senator Stone introduced S. 2218 on July 29, 1975. Senator Hart's bill includes a mandatory life insurance disclosure statement which includes a complex series of numbers which are designed to artificially split a cash value policy into savings and protection elements. It also includes a number of additional items of information which have been proposed in the writings of Professor Joseph M. Belth of Indiana University.

On October 7, 1975, Senator Stone addressed a letter to Commissioner Huff requesting him to testify as President of the NAIC at hearings scheduled for December 3 and 4. The letter contained a list of 14 questions regarding differences between the life insurance disclosure systems proposed by the NAIC and Senator Hart. The Life Insurance Cost Comparison (C3) Task Force prepared a response to the questions which was included in the NAIC's testimony. Representatives of the task force also accompanied Commissioner Huff at the hearings on December 3, 1975. The testimony and response to questions are attached.

The hearing was intended to give Senator Stone a basis for including, in S. 2218, the life insurance disclosure system proposed by Senator Hart, the system proposed in the NAIC model regulation, or some other approach. That bill provides that sufficient information be given to veterans in order for them to intelligently exercise their right to convert their government life insurance to coverage offered by commercial life insurance companies. During his testimony Commissioner Huff promised to report, to Senator Stone, the action taken by the NAIC on the proposed model regulation.

In the process of developing the proposed model regulation, the task force had identified a number of additional matters which it believes are in need of further study. With the approval of the Life Insurance (C3) Subcommittee, the task force will proceed in the following areas:

1. Development of procedures for proper enforcement of the model regulation.

2. A study of methods of detecting manipulation of policy values and dividends in such a way as to produce unrealistically attractive cost indexes.

3. Development of appropriate regulation of dividend illustrations.

4. A study of the need for a separate disclosure system for group insurance, credit life insurance, annuities and variable life insurance.

5. A study of the feasibility of developing a more extensive disclosure system which would be made available upon request, including a system which would be applicable to dissimilar policies.

6. A study of the need for modification of our disclosure system to accommodate special subgroups of the life insurance buying public including veterans, college students, and senior citizens.

7. A study of the feasibility of developing a central data bank of cost comparison information.

8. A study of the need for developing alternate systems of improving the general public's understanding of the life insurance product through means other than point-of-sale disclosure.

9. A review of the existing NAIC Replacement model regulation in order to determine the need for revision.

10. A study of the feasibility of mandating the use of a standardized portfolio of life insurance products.

11. A study of characteristics of the current system of marketing life insurance, including commission arrangements and exclusive service contracts, which may tend to encourage an agent to sell an inappropriate policy.

The task force also recommends that the proposed model regulation replace the interim regulations adopted by the NAIC in June 1973.

Hon. William H. Huff III, Chairman, Iowa; Hon. Ark Monroe III, Arkansas; Hon. Dick L. Rottman, Nevada; Hon. James J. Sheeran, New Jersey; Hon. Harold R. Wilde, Jr., Wisconsin.

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NAIC LIFE INSURANCE SOLICITATIONS MODEL REGULATION

(Adopted December 9, 1975)

Section 1. Authority.

This rule is adopted and promulgated by (title or supervisory authority) pursuant to sections (4(1)(a) of the Unfair and Deceptive Acts and Practices in the Business of Insurance Act) of the insurance code.

Section 2. Purpose.

(A) The purpose of this regulation is to require insurers to deliver to purchasers of life insurance, information which will improve the buyer's ability to select the most appropriate plan of life insurance for his needs, improve the buyer's understanding of the basic features of the policy which 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 is not in violation of this regulation or any other (state) statute or regulation.

Section 3. Scope.

(A) Except as hereafter exempted, this regulation shall apply to any solicitation, negotiation or procurement of life insurance occurring within this state. This regulation shall apply to any issuer of life insurance contracts including fraternal benefit societies.

(B) Unless otherwise specifically included, this regulation shall not apply to:

1. Annuities.

2. Credit life insurance.

3. Group life insurance.

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).

5. Variable life insurance under which the death benefits and cash values vary in accordance with unit values of investments held in a separate account.

Section 4. Definitions.

(A) "Buyer's Guide." For the purposes of this regulation, a Buyer's Guide is a document which contains, and is limited to, the language contained in the Appendix to this regulation or language approved by (title of supervisory authority).

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

(C) "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 guaranteed amount payable upon death, regardless of the cause of death, at the beginning of each policy year for ten and twenty years at five percent interest compounded annually to the end of the tenth and twentieth policy years respectively.

2. Divide the result of step 1. by an interest factor that converts it into a 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 years, the factor is 13.207 and if the period is twenty years, the factor is 34.719.

(D) "Generic Name." Generic Name means a short title which is descriptive of the premium and benefit patterns of a policy or a rider.

(E) "Life Insurance Cost Indexes."

1. "Life Insurance Surrender Cost Index." The life insurance surrender cost index is calculated by applying the following steps:

    a. Determine the guaranteed cash surrender value, if any, available at the end of the tenth and twentieth policy years,

    b. For participating policies, add the terminal dividend payable upon surrender, if any, to the accumulation of the annual cash dividends at five percent 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 guaranteed-cost 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 guaranteed-cost policies) over the respective periods stipulated in step a. If the period is ten years, the factor is 13.207 and if the period is twenty years, the factor is 34.719,

d. Determine the equivalent level premium by accumulating each annual premium payable for the basic policy or rider at five percent 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 to arrive at the life insurance surrender cost index.

2. "Life Insurance Premium Outlay Index." The life insurance premium outlay index is calculated in the same manner as the comparable life insurance surrender cost index except that the cash surrender value and any terminal dividend are set at zero.

(F) "Policy Summary." For the purposes of this regulation, policy summary 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 policy years and representative durations thereafter sufficient to clearly illustrate the premium and benefit patterns, including, but not necessarily limited to, the durations for which life insurance cost indexes are displayed and at least one age from sixty through 60 to 65 or maturity whichever is earlier:

   a. The annual premium for the basic policy.

   b. The annual premium for each optional rider.

   c. Guaranteed amount payable upon death, regardless of the cause of death other than suicide, which is provided by the basic policy and each optional rider, with benefits provided under the basic policy and each rider shown separately.

   d. Total guaranteed cash surrender values at the end of the year with values shown separately for the basic policy and each rider.

   e. Cash dividends payable at the end of the year. (Dividends need not be displayed beyond the twentieth policy year.)

   f. Guaranteed endowment amounts payable under the policy which are not included under guaranteed cash surrender values above.

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 variable, the policy summary includes the maximum annual percentage rate.

7. Life insurance cost indexes for ten and twenty years but in no case beyond the premium paying period. Separate indexes are 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 and guaranteed insurability benefits nor for 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. A statement in close proximity to the life insurance cost indexes as follows: An explanation of the intended use of these indexes is provided in the life insurance buyer's guide.

10. The date on which the policy summary was 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 to not minimize or render any portion thereof obscure. Any amounts which remain level for two 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 5 of this section shall not be listed on a per thousand nor per unit basis. If more than one insured is covered under one policy or rider, guaranteed 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 zero and shall not be displayed as a blank space.

Section 5. Disclosure Requirements.

(A) The insurer shall provide, to all prospective purchasers, a buyer's guide and a policy summary prior to accepting the applicant's initial premium or premium deposit, unless the policy for which application is made contains an unconditional refund provision of at least ten days or unless the policy summary contains such an unconditional refund offer, in which event the buyer's guide and policy summary must be delivered with the policy or prior to delivery of the policy.

(B) The insurer shall provide a buyer's guide and a policy summary to any prospective purchaser upon request.

(C) In the case of policies whose equivalent level death benefit 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 4(F), items 2, 3, 4, 5a, 5b, 5c, 6, 7, 9 and 10.

Section 6. General Rules.

(A) Each insurer shall maintain at its home office or principal office, a complete file containing one copy of each document authorized by the insurer for use pursuant to this regulation. Such file shall contain one copy of each authorized form for a period of three years following the date of its last authorized use.

(B) An agent shall inform the prospective purchaser, prior to commencing a life insurance sales presentation, that he is acting as a life insurance agent and inform the prospective purchaser of the full name of the insurance company which he 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 generally engaged in an advisory business in which compensation is unrelated to sales unless such is actually the case.

(D) Any reference to policy dividends must include a statement that dividends are not guaranteed.

(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 or more life insurance policies. Such a system may be used for the purpose of demonstrating the cash-flow pattern of a policy if such 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 benefits shall not display guaranteed and nonguaranteed benefits as a single sum unless they are shown separately in close proximity thereto.

(G) A statement regarding the use of the life insurance cost indexes shall include an explanation to the effect that the indexes are useful only for the comparison of the relative costs of two or more similar policies.

(H) A life insurance cost index which includes dividends shall be accompanied by a statement that the index is based on the company's current dividend scale and is not guaranteed.

(I) For the purposes of this regulation, the annual premium for a basic policy or rider, for which the company reserves the right to change the premium, shall be the maximum annual premium.

Section 7. Failure to Comply.

Failure of an insurer to provide or deliver buyer's guide, policy summary or life insurance cost indexes as provided in Section 5 shall constitute an omission which misrepresents the benefits, advantages, conditions or terms of an insurance policy.

Section 8. Effective Date.

This rule shall apply to all solicitations of life insurance which commences on or after __________.

Appendix
Life Insurance Buyer's Guide
(Not Adopted by the NAIC)

1. Introduction.

This guide is designed to help you select a life insurance policy. A life insurance policy is a contract between you and a life insurance company in which you agree to pay premiums and the company agrees to pay the amount of insurance to a beneficiary if you die while you are insured.

This guide will not give you all of the answers but it does contain short explanations of:

How to choose the type and amount of life insurance.

The basic kinds of life insurance.

The difference between policies which pay dividends and those which do not.

How to compare the relative costs of life insurance policies.

2. Selecting the Type and Amount of Life Insurance.

The first step in the process of buying a life insurance policy is to determine the type of policy which is most suitable for your life insurance needs and your budget. The second step is to compare the relative cost of that type of life insurance policy offered by various life insurance companies. There are important differences in the cost of life insurance policies. A good agent will be able and willing to explain the cost and coverage differences among companies.

It is important that a buyer of life insurance understand the basic types of life insurance. This guide is a start but you may also want to read some books and articles on life insurance in your public library or talk with one or more life insurance agents. There is no universally accepted formula for determining how much life insurance a person needs, but one way to start might be to decide how much cash and income your dependents would need if you were to die. You should consider the possible need for life insurance for expenses connected with final illnesses; to cover estate taxes and other cash needs of your survivors; and to meet specific purposes, such as paying mortgages or other debts. Compare that with the income your dependents might expect to receive from Social Security, the life insurance you already own, and your other financial assets. Your new life insurance policy should come as close to making up the difference as you can afford.

It is possible that one or a combination of the three basic types of life insurance will serve your needs. Most life insurance companies offer all three types of life insurance. The assistance of an experienced life insurance company agent may be helpful in determining the type and amount of life insurance which would be best suited for your needs. If one type does not meet your insurance needs and your budget limitations, you should ask to be advised of the other types of life insurance policies which the company offers.

It is also important to remember that, no matter how exotic the policy title or sales presentation might appear, all life insurance policies contain one or more of the three basic types of life insurance. If you are confused about a particular policy, ask the agent or company to explain how their policy compares with one of the three basic plans.

3. The Basic Types of Life Insurance.

3a. Term Insurance.

Term insurance is death protection for a term of one or more years, which means that death benefits will be paid only if you die within the period of the term. The term or duration of insurance coverage may be either for a specified period such as five or ten years or to a specified age such as 65, 70 or 100.

The protection stops at the end of the term, but some policies are "renewable" for one or more additional term periods without submitting any evidence of insurability. Each time you renew the policy for a new term period, premiums will be higher because you will be older, and the change of death increases with age. Some term insurance policies are also "convertible." This means that before the end of the conversion period, you may exchange the policy either for a whole life or endowment insurance plan without evidence of insurability. Premiums for the new policy will be higher, but they generally will remain the same for as long as you have the policy.

Term insurance provides the largest immediate death protection for the premium dollar. Term insurance does not normally have cash surrender values.

3b. Whole Life Insurance.

Whole life insurance provides death protection for as long as you live and continue to pay the required premiums. The most common type is called "Straight Life" or "Ordinary Life" insurance, for which you pay the same premium each year for as long as you live. This premium can be four or five times more than you would pay initially for the same amount of term insurance, but is less than you would ultimately pay for the renewal of a term insurance policy at the older ages. In effect, the premium represents an "average" for the whole of life.

"Limited Payment" whole life policies also protect for the whole life, but you pay premiums for a specified period, such as twenty years, or until age 65. Premiums for these policies are higher than for straight life insurance with the same death benefits. Other premium payment patterns are also available.

3c. Endowment Insurance.

An endowment insurance policy is a life insurance policy which pays either a death benefit to your beneficiary if you die before a specified age or a sum to you if you live to that age. Premiums for an endowment policy are usually higher than for either term or whole life insurance of the same amount. As with whole life insurance, premiums for an endowment life insurance policy usually remain the same every year.

If you stop paying premiums on a whole life or endowment insurance policy, you may have built up some value which you can take either in cash or as continued insurance which requires no further premium payments. These are called "Nonforfeiture Values," a phrase which refers to benefits you do not forfeit or lose when you stop paying the scheduled premiums. The amount of these benefits will depend on the kind of policy you have, its size, and how long you have owned it. Policy values may also be used as collateral for a loan. If you borrow from the life insurance company, the loan and interest must be repaid from the cash surrender value if you surrender the policy or from the death benefit if you die.

4. Guaranteed Cost Versus Participating Policies.

Because life insurance contracts usually provide death protection over long periods of time, the actual future costs to the company of providing the benefits cannot be exactly determined when the policy is issued. Two different types of policies are offered which meet this problem in different ways. One type of policy can be called a "guaranteed cost" policy. If the premiums charged prove to be more than needed, the company makes a profit; if the premiums prove to be inadequate, the company has a loss. The cost to a policyholder is not affected by company profits or losses. The other type of policy is called a "participating" or dividend-paying policy. If the premiums prove to be more than the amounts actually needed, portions of the excess premiums may be refunded to you annually in the form of "policy dividends."

The premiums for participating policies typically are higher than for corresponding guaranteed cost policies. However, the dividend mechanism may eventually result either in higher or lower long-term costs depending on the experience of the company.

5. How to Compare Relative Costs of Life Insurance Policies.

If all policies contained the same cash values and if all policies were either guaranteed cost or participating with identical dividends, it would be necessary only to compare the premiums of two otherwise identical policies to determine which policy offered the lower cost. Since most policies do contain different cash values and since some policies are guaranteed cost while others are participating with many dividend scales, the simple comparison of premiums is not enough to disclose the lower cost policy. Since it is extremely difficult to keep in mind the differences in premiums, cash values and dividends of several policies over a period of years, a set of indexes has been developed from these number to help you compare policy costs. A lower index number generally represents a lower cost than a higher index number.

The index numbers are designed to give more credit for money paid or received today than money paid or received in the future. Although these indexes will help you compare the cost of life insurance policies, an index number alone is not enough information on which to base your purchase decision. You should consider the level and pattern of premiums, cash values, dividends and death benefits of the policy. You should also consider how well the life insurance company or agent will provide service to you as a policyholder.

A comparison of index numbers is useful only for the particular plan, age and amount which is being compared. Since no single company offers the lowest cost for all types of insurance at all ages and for all amounts of insurance, it is important that you obtain the indexes for the actual policy, age and amount which you intend to purchase. It is possible for a company to rank high on a comparison of one policy, age and amount of insurance but also rank low on a comparison of another particular policy, age and amount which you intend to purchase.

Cost comparisons should only be attempted between similar plans of life insurance which provide essentially the same basic benefits and require premium payments for approximately the same period of time. Small differences in index numbers may very well be offset by other policy features or differences in the quality of service you may expect from the company or its agent. Therefore, when you encounter moderate differences in cost indexes, your purchase decision should be based on considerations other than cost. The index numbers cannot be used to compare costs of a new policy with costs of another policy which you purchased previously.

The indexes which have been developed are as follows:

(1) "Life Insurance Surrender Cost Index" – This index is based on the premiums and illustrated dividends for some period of time such as ten or twenty years and the cash value which is available at the end of the same period. This index is useful if you consider the level of the cash surrender values to be of importance to you.

(2) "Life Insurance Premium Outlay Index" – The premium outlay index is very similar to the surrender cost index except that the cash value is not used in the calculation. This index is useful if the level of the cash surrender values is not of great importance to you.

6. Summary.

The most important decision to be made when buying a life insurance policy is the choice of a policy whose premiums and benefits most closely meet your needs. Your next goal should be to find a policy which meets that description and which is also a relatively good buy. Your chances of obtaining a relatively good buy are improved if you select a policy which can be easily compared with policies offered by other insurance companies and if you compare the surrender cost indexes and premium outlay indexes of competing policies. You should attempt to find policies with low index numbers.

Don't buy life insurance, especially a permanent plan of life insurance, unless you intend to stick with it. A long-term policy which is a good buy when held for twenty years can be very costly if you quit during the early years of the contract. If you surrender such a policy during the first few years, much of your premium may have been used for company expenses. If these expenses are spread over a large number of years, the cost per year may be quite reasonable. However, if they are spread over only a few years, the cost to a policyholder in relation to the benefits received is very large.

Whatever you decide now, it is important to review your life insurance program every few years in order to keep it current with your income and responsibilities.

Statement of
The Hon. William H. Huff III
President, National Association of Insurance Commissioners
Insurance Commissioner, State of Iowa
Submitted to
The U. S. Senate Verteran's Affairs Subcommittee
on Housing and Insurance
Re: S. 2218

I

My name is William H. Huff III. I am the Insurance Commissioner of the State of Iowa. I am the President of the National Association of Insurance Commissioners and make this statement on its behalf.

The National Association of Insurance Commissioners (hereinafter NAIC) which began in 1871, is the oldest voluntary association of state officials in the United States. Its members include the principal insurance regulatory officials of the 50 states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands. One of its principal objectives is to promote uniformity in laws and regulations adopted by the several states.

In making this statement, I have before me Senator Stone's letter of October 7 dealing with the evaluation of life insurance costs for veterans. This letter is broken down into some 14 items, many of which have been raised and debated previously in other forums. A number of the items are actuarial in nature. They were considered by the NAIC's Life Insurance Cost Comparison (C3) Task Force (hereinafter (C3) Task Force), by its parent committee, the Life Insurance Committee, by the Executive Committee, and by the NAIC as a whole at various meetings over the last six years, including the most recent meeting of the (C3) Task Force at St. Louis, Missouri on November 18.

The (C3) Task Force[1] has prepared a response to the letter of October 7. It has also prepared (1) a model consumer's guide, and (2) a model summary of information to be supplied policyholders at the time of sale. A copy of the task force response as well as the current draft of our model regulation has been attached to my formal remarks and we request that they be included in the record of this hearing. Through the NAIC committee machinery, the model regulation will be submitted to the full membership of the NAIC at its forthcoming meeting the week of December 7, 1975. As soon as final action is taken, we shall be pleased to submit to your subcommittee copies of the reports in final form and the NAIC action taken on them.

At the June 4-8, 1973 meeting of the NAIC, the Association adopted on an interim basis the interest adjusted cost comparison index as an appropriate measure of relative cost of similar life insurance polices. At its St. Louis meeting on November 18, the task force affirmed the use of the concept embodied in this index and, if it is adopted by the commissioners as a whole, the stage should be set for the widespread use of indexes based on this principle both by members of the general public and by veterans.

II

The NAIC shares Senator Stone's view that any veteran electing to convert his government life insurance to a policy issued by a commercial life insurer ought to have adequate information concerning the terms, costs, and the value of the

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1. Members of the (C3) Task Force are William H. Huff III, Chairman (Iowa); Ark Monroe III (Arkansas); Dick L. Rottman (Nevada); James J. Sheeran (New Jersey); and Harold R. Wilde, Jr. (Wisconsin). The task force is backed up by technicians consisting of Stanley DuRose (Wisconsin), Erma Edwards (Nevada) and three life actuaries, William White (New Jersey), Keith Sloan (Arkansas), and Daniel Andersen (Iowa), Chairman of the technical group.

conversion policy. However, we go one step further. We believe that any prospective purchaser of life insurance, whether a veteran or not, should receive comparable information.[2]

The NAIC model regulation on the life insurance interest adjusted cost comparison method adopted at the Washington, D.C. meeting stated (Section 2: Purpose):

> It is in the interest of prospective purchasers of life insurance that there shall be available to such persons a cost comparison index prepared on a uniform basis for comparison of the relative cost of similar plans of insurance. It is in the public interest to make such index available so that price competition in the life insurance market is encouraged and stimulated. (1973 NAIC Proceedings, Vol. II, p. 538-539).

Thus far, six states have adopted disclosure regulations. Furthermore, there is increasing agreement, even in many of the states which have not acted, that the purchasers of life insurance are entitled to information of this type. So the question arises; why has not the progress been more rapid? The answer is that there has been extended debate over which of the many cost disclosure systems could be used to best advantage. Some are simple – perhaps too simple. Others are more complicated – perhaps too complicated. Each has advantages and disadvantages. Any choice made must necessarily represent a compromise.

We are dealing with the question of balance. If the system ultimately decided upon tells the buyer too much – more than he wants to know or more than he is able to understand – the excessive disclosure tends to "turn off" the buyer. If the information supplied him is too little, it does not serve the educational purposes of the disclosure. A mass of statistical data or actuarial gymnastics that would intrigue an actuary will bore a layman. All regulatory agencies dealing with disclosure techniques face the same problem. For example, while a form 10K issued by the seller of securities under SEC jurisdiction will supply essential data to a security analyst or a sophisticated investor, it would submerge the average buyer of stock. In the NAIC, we have the same problem with the comprehensive NAIC annual statement which contains some 5,000 entries, almost all of a statistical nature which would be incomprehensible to the layman. State Blue Sky administrators – of which I happen to be one – have learned that the attention of the average reader of a prospectus begins to wander after the fourth page.

As a result of our operation of complaint bureaus, those of us in state regulation of insurance have acquired a special insight into policyholder perceptions or lack of perceptions. Every state has at least one complaint office and some states have several. On the average, the states receive each year over 400,000 inquiries and complaints from policyholders. Through these multiple first-hand contacts, we have come to learn how much technical insurance data the average policyholder can intelligently digest.

In the life insurance cost disclosure area, there has been a tendency on the part of some of the technical people to think that policyholders either have the same interest in technical details as they do or can be educated to acquire such an interest. Our experience leads us to believe that this is not so. It has been aptly stated that it is more important for the policyholder to know what he gets than how it works. In that respect, the life insurance buyer can be compared with the purchaser of a television set; he is more interested in what shows up on the tube than what takes place behind it. I have stressed these fundamentals because they have greatly influenced our thinking on this pivotal question of balance. How much information is enough? How much is too little? How much is too much? In this respect, I believe that this subcommittee faces the identical question that we have been dealing with.

III

We do not believe that it should be necessary for Congress to enact laws for the Veterans Administration to issue regulations requiring insurers to supply comparative cost information to veterans converting their insurance. The insurers ought to provide this information as a matter of course. Since all insurers issuing this coverage and all agents selling it are licensed by and under the jurisdiction of the states, we believe that the gound rules dealing with the supplying of such information should be laid down by the states which have that responsibility in the first instance. It is this conviction which led the NAIC, through its (C3) Task Force, to prepare the interim model regulation of 1973 and also to prepare the

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2. Mr. Wilson summed it up very neatly when he said in his memorandum of October 29, 1975:

> Veterans as well as any other individuals should have sufficient information at the time they purchase life insurance to make a rational choice.

comprehensive regulation embracing a buyer's guide, a summary or wrap-up of pertinent information and data, and the adoption of a measuring guide which was reviewed at the St. Louis meeting and which will be submitted to the full Association for action at its December 1975 meeting.

Once the NAIC acts on the model regulation, accelerated action can be expected from states which were awaiting the adoption of the model regulation and thus set the stage for the veteran to receive the needed information in the same way that any other purchaser of life insurance will receive it.

For this reason, we believe that the enactment of S. 2218 at this time would be premature. We believe it will be time enough for Congress to consider the enactment of legislation of this type if the states and the commercial insurers – given an adequate opportunity to implement this disclosure system – do not do so within a reasonable time.

Furthermore, if Congress imposes one type of disclosure regulation for veterans and the states impose a different system with respect to everybody (which includes veterans), endless confusion in agency, company, and regulatory circles, and, above all, among consumers will ensue. Companies will have to maintain a dual system which will ultimately increase the cost to the consumer.

IV

Mr. Wilson's memorandum outlines the multitude of problems that the enactment of legislation of this kind would create for the Veteran's Administration.[3] In effect, the Veteran's Administration, without adequate personnel, would be taking on a large-scale administrative process which ought to be and will be carried on by (1) the state insurance departments staffed with over 5,000 employees spread around in offices in 50 states and which have combined annual budgets of over $80 million and (2) by the commercial insurance carriers who have the flexibility and personnel to supply the needed information once agreement is reached on a practical solution. We believe that the model regulation reviewed as St. Louis (and assuming that it is adopted in substantially its present form by the NAIC as a whole at its December meeting) provides such a solution and should free the Veteran's Administration from what would otherwise be a burdensome and unnecessary regulatory task. It should also make it unnecessary for the Veteran's Administration to employ additional personnel and expand its operating costs at a time when the Federal Government is under heavy attack for the employment of too many people and for excessive budgetary demands.

V

Confronted with this problem of too much or too little information, the NAIC (C3) Task Force has devised what we regard as a middle course, one that is designed to give the prospect the needed information without overwhelming him. The model regulation's requirements are as follows:

1. It requires the insurer to provide a buyer's guide to the prospective purchaser. The buyer's guide would contain an explanation of the basic types of life insurance, e.g. term vs. whole life insurance and endowment insurance, guaranteed cost vs. participating policies, types of insurance companies (stock vs. mutual), determining the need for life insurance and how to compare relative costs of life insurance policies through the use of the life insurance surrender cost index and the life insurance premium outlay index, both of which recognize the time value of money.

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3. Certainly, the Veteran's Administration is in accordance with the expressed intent of the proposed bill. Veterans as well as any other individuals should have sufficient information at the time they purchase life insurance to make a rational choice. This Bill (S. 2218), however, would create many problems and is impractical as far as the Veteran's Administration is concerned. The bill provides that the Administration will require each insurance company offering an individual policy of insurance to furnish sufficient information consistent with the intent expressed in "Subsection (a)." The first question which arises is what is sufficient? The original draft of this bill which your office furnished lists a series of difficult, technical and complicated calculations that every company participating in the Servicemen's Group Life Insurance Program would have to furnish a veteran. We can see the Veteran's Administration buffered from all sides in determining what information the company must furnish. For example, there are those groups who would argue that the Veteran's Administration is not requiring sufficient information while on the other hand there would be the companies which would argue the Veteran's Administration is requiring too much information. If the original draft bill actually expressed the interest of the Senate Committee, then we would expect pressure from the committee on the Administration to adopt all the calculations that were outlined. We seriously question the need for all of these calculations.

2. It requires a policy summary containing twelve relevant items. (Most companies will produce this information by computer, utilizing computer printouts.)

3. It introduces a ten-day unconditional refund provision; this is tied to the providing of the buyer's guide in a timely way. It gives the buyer the right to change his mind -- to rescind the purchase if necessary on the strength of what he has learned from the guide and the summary.

4. It requires the insurer to maintain in its principal office a complete file containing a copy of the documents required for the implementation of the regulation.

5. It contains some additional requirements, e.g. making the agent disclose his true role, provisions preventing a misrepresentation as to the nature of policy dividends, appropriate limitations on the use of systems or presentations which do not recognize the time value of money in comparing the cost of two or more life insurance policies and restrictions on the display of guaranteed and nonguaranteed benefits.

We believe that we have time to get this new program introduced and in effect because the new VGLI program has only recently been started. It permits limited retroactive enrollment. So there should be a relatively small volume of conversions, particularly through 1976, 1977 and 1978. By that time, our program should be widely operative.

Conclusion

We believe that this comprehensive regulation, when it is adopted in final form and made applicable to all purchasers of life insurance, not just veterans, should provide a useful and practical system for improving the buyer's ability to select the most appropriate plan of life insurance for his needs, for improving the buyer's understanding of the basic features of the policy which is under consideration and for improving the ability of the buyer to evaluate the relative cost of similar plans of life insurance. There is general acceptance that the buyer is entitled to more information than that previously supplied to him -- and that furthermore any measuring stick or index prepared for him must take into account the time value of money. The life insurance business, the Society of Actuaries, and the commissioners have worked to develop a program which would command public acceptance.

We respectfully suggest that since the regulation of the insurance business is vested in the states under the McCarran Act and since the states are staffed and financed with offices in every state in the union, Congress should stop, look, and listen before it adopts a measure like S. 2218. The problem has been recognized by the business and the agents, the states are acting, and they have the machinery to implement the necessary steps to protect the public. Under these circumstances, we respectfully urge that your committee should not take affirmative action on S. 2218 at this time.

We do, however, recognize that the circumstances of veterans are unique in several respects, thus requiring a special set of instructions. The (C3) Task Force response to Senator Stone's letter of October 7, 1975 outlines some of these special needs. The NAIC would be happy to assist the Veteran's Administration in designing suitable material for veterans' use in supplementing the information required by the NAIC model regulation.

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To: U. S. Senate Committee on Veterans Affairs

From: Life Insurance Cost Comparison (C3) Task Force

Subject: Questions from Senator Stone dated Oct. 7, 1975

Date: December 3, 1975

The Life Insurance Cost Comparison Task Force has prepared the following comments in response to the questions posed in Senator Stone's October 7, 1975 letter to Commissioner Huff. The task force was appointed in November 1971 by the NAIC to develop a "Model Regulation for Price Illustrations of Life Insurance Products." At various times, its membership has consisted of Commissioners and staff of Arkansas, Iowa, Nevada, New Jersey, and Wisconsin. Commissioners of several other states have also provided valuable input. The present Chairman of the Task Force is Daniel D. Andersen, Director of the Life and Health Division and Chief Actuary for the Iowa Insurance Department.

Understandably, the responses presented here are a defense of the Model Cost Disclosure Regulation which has been developed by the task force. However, we have carefully studied all of the various cost disclosure methods before settling on those which are contained in the model regulation, and our answers try to reconstruct our reasons for not choosing the disclosure methods that seem to form the basis for most of Senator Stone's questions.

Representatives of the task force will be available at the hearings to elaborate on any of the remarks presented here. Needless to say, we are very enthusiastic about the concept of requiring that meaningful information be provided to the prospective buyer of life insurance to assist him in making a wise purchase decision. We willingly offer our services to the Veterans Affairs Committee and the Veterans Administration to achieve this goal.

The remainder of these comments follows the numbering format of Senator Stone's letter, with the question repeated at the beginning of each numbered section.

1. We are seeking through these hearings your views concerning the kind of information that should be disclosed to veterans in order to assist them in making a rational conversion under the SGLI program. Please be specific in your statement about the kind of information you believe should be disclosed to veterans.

While there are restrictions inherent in the sale of life insurance to veterans on conversion (face amount, choice limited to permanent plans), the task force feels that the veteran is fairly typical of the average consumer to whom the NAIC "LIFE INSURANCE SOLICITATION" regulation is directed. We would thus recommend that the veteran be supplied with the same sort of information as will be required, by the regulation, in the sale of life insurance to the average consumer. The kinds of information required to be conveyed are:

(i) a Buyer's Guide, which is intended to improve the buyer's ability to select the most appropriate plan of life insurance for his needs;

(ii) a Policy Summary, which is intended to improve the buyer's understanding of the basic features of the policy which has been purchased or which is under consideration; and

(iii) Life Insurance Cost Indexes, which are intended to improve the ability of the buyer to evaluate the relative costs of similar plans of life insurance.

2. We are aware of the NAIC model regulation concerning disclosure, as well as the discussion draft of a proposed new NAIC model regulation. Please include in your statement your thoughts concerning the strengths and weaknesses of the NAIC approach to life insurance disclosure from the viewpoint of veterans.

The principal strength of the NAIC model regulation is the diversity of opinion that was considered in its design and the resulting "balance" that characterizes the end-product. Commissioner Huff has described the difficult process of attaining a good balance between the near-infinite information which could be supplied to the consumer and the very limited amount of information that can be digested by the average consumer, in a meaningful way, to produce a sound buying decision. The NAIC model regulation is not solely the product of life insurance technicians; lawyers, politicians, economists, psychologists, and persons experienced in life insurance sales and company operations have had a hand in its design. The result is a regulation which should have a maximum beneficial impact on the consumer's buying decision – rather than a regulation which simply inundates the consumer with indigestible data.

From the veteran's own viewpoint, the NAIC model regulation does have weaknesses, but these weaknesses are equally applicable to every other life insurance disclosure method we have studied. The weaknesses arise from failure to address problems which are unique to veterans. The NAIC has not attempted to identify and to resolve disclosure problems peculiar to limited subgroups of the life insurance buying public. Obviously, to do so would seriously diminish the impact, or "balance," of the regulation. In our view, the resolution of these unique veterans' disclosure problems should be the responsibility of the Administrator of Veterans' Affairs and are of concern to your committee. The problems are discussed below.

(i) Most SGLI conversions are made on what is known as a "dual application" basis. This means that the agent completes two applications for the veteran – the first applying for a conversion policy which will be reinsured in the SGLI conversion pool; the second applying for the same coverage, at the same rates, according to the insurer's customary underwriting standards. We are told that nine out of ten policies are issued on the latter basis. However, since the SGLI conversion can only be made to a form of <u>permanent</u> insurance issued by the insurer, the veteran may not know that his "second application" can be for any form of insurance offered by the company. Thus, many veterans may be purchasing permanent insurance through the conversion route when term insurance is available and might be better suited to their needs and abilities to pay. This information should be given to the veteran.

(ii) Conversion of the government administered policy to a commercial life insurance policy is of greatest value to the veteran whose health is significantly worse than the average, or "standard," insurance applicant. It is impossible for any cost disclosure method to identify these veterans or to quantify the value of the conversion privilege. The Veteran's Administration does have information as to health status at discharge which can serve as a basis for advising the veteran of the economic value of his conversion option. As a minimum, any disabled veteran should be strongly cautioned as to the possible consequences if he is not considering exercise of the conversion privilege when it is available.

3. *The NAIC model regulation and the new discussion draft specifically exempt policies with death benefits that vary with policy duration. Please include in your statement your thoughts on this question.*

This defect in the NAIC model regulation has been corrected. The current version of the regulation does not exempt policies with varying death benefits, and it does define the method by which Life Insurance Cost Indexes are to be calculated for such policies.

4. *We are aware of S. 2065, which was introduced by Senator Hart in July of this year. Please include in your statement your thoughts on the application of the priorities of S. 2065 to veterans disclosure legislation.*

By "priorities," we assume the question refers to the "Purposes" stated in Section 2. (b) of S. 2065, which are:

(1) minimum standards which each State must meet or exceed so as to assure to all consumers of policies providing insurance against death full, accurate, and clear disclosure, in understandable form, of all the information necessary to purchase the most suitable coverage for themselves and their beneficiaries at the lowest cost; and

(2) means to safeguard such consumers against unfair or deceptive trade practices with respect to such policies.

Taking into account the conflicting nature of the expressions "full" and "in understandable form," we feel that these purposes are substantially the same as ours and that the NAIC model regulation is better suited to accomplish these purposes than are the provisions of S. 2065.

5. *Please include in your statement your thoughts on the question of whether the veteran should receive, at the time of conversion, detailed information concerning the front-end load associated with the policy he is considering and how the information should be presented to the veteran.*

The "front-end load" in life insurance is undoubtedly an important factor in the buying decision. However, this importance attaches more to the existence and nature of the front-end load than to its magnitude. To be effective, disclosure concerning the front-end load should be such as to dissuade the consumer from buying permanent life insurance if he does not intend to keep it in force beyond the first few years. The NAIC model regulation provides this caution, in plain English, in the required Buyer's Guide. We do not feel that one of forty obscure yearly prices, contained in a table of 200 or more figures and stated in terms of price per thousand of face amount, can have the same impact. For the buyer who is concerned with the size of the front-end load, the data contained in the model regulation's Policy Summary are sufficient to permit a reasonably accurate calculation.

6. *Please include in your statement your thoughts on the question of whether the veteran should receive, at the time of conversion, detailed price information that would enable him to see any major discontinuities in the policy he is considering. If you favor his receiving such information, please be specific about how the information should be presented.*

Most "major discontinuities" in the pattern of yearly insurance costs result from adjustments to a published scale of cash surrender values. For instance, when minimum cash values are graded into net level premium reserves, a discontinuity occurs at the duration when the grading is complete, with apparent lower yearly costs prior to that duration and higher yearly costs subsequent. The danger in illustrating such a "discontinuity" is that it may be misinterpreted and pressure brought to bear on the insurer to take action. This action may be to the detriment of the consumer. In the example cited above, if the insurer were concerned about the erroneous interpretation of his "discontinuity," the easiest way to avoid the problem is to eliminate the grading process, providing only minimum (lower) cash values at all durations. This would obviously not be in the best interests of the policyholder.

This is not to say that manipulation of cash values and dividends, for purposes of generating unrealistically attractive cost indexes, is not a problem. A part of the research commissioned by the NAIC, in preparation for the model regulation, addressed this situation. The results of this research should impose additional responsibilities on state regulators to disapprove policy forms which entail such manipulation. This is also a concern of the NAIC's Valuation and Nonforfeiture Value Subcommittee, which is considering changes in model nonforfeiture (including cash surrender values) legislation.

7. *Some observers have suggested that an adequate system of disclosure at the point of conversion include information going well beyond the conventional twenty policy years. Please include in your statement your thoughts on this question.*

Most actuarial observers concede that predictions regarding the future become more uncertain the further one ventures into the future. The task force felt that twenty years was about as far as projections of future events could be made while retaining any validity for cost comparison purposes. The principal areas of uncertainty are the applicability of dividends according to dividend scales currently in use and the accuracy of interest rates at which future costs are discounted. Also of concern to the task force was the relatively small proportion of life insurance policies that remain in force after twenty years and the possibility of unwarranted emphasis placed on information at these later durations. An additional factor in favor of a twenty year or shorter period is uncertainty as to the course of inflation and the purchasing power of dollars projected for delivery far into the future.

8. *There seems to be general agreement that any summary measures of price should include allowance for the time value of money. Please include in your statement your thoughts on how an appropriate interest rate should be selected.*

The task force's choice of a five percent interest rate for calculation of Life Insurance Cost Indexes was based on two premises:

(i) For the individual consumer, the "time value of money" could vary anywhere from 3% to 18%, depending on such factors as his income tax bracket, whether he is a "net borrower" or a "net investor," and his personal feelings about risk or conservatism in a savings/investment program. For this reason, we concluded that no single interest rate could accurately reflect the time value of money for the majority of prospective life insurance buyers.

(ii) Studies made by the Society of Actuaries indicated that a difference of one or two percentage points has no significant effect on the rankings of competing companies <u>for essentially similar policies</u>.

We also found that, for dissimilar policies, lower interest rates tended to favor permanent and participating policies in comparisons with term and nonparticipating (guaranteed-cost) products, while, conversely, higher interest rates produced more attractive indexes for the latter types in comparison with the former. The Society of Actuaries, and our model regulation, emphasize that cost comparision indexes are appropriate only for similar policies. There is, however, a general expectation that the indexes will also be misused to compare dissimilar policies. For this reason the task force set, as its objective, the use of an interest rate which would be as "neutral" as possible, avoiding unfair advantage for any particular kind of policy when dissimilar policies are compared. The theoretically "neutral" interest rate is that rate on which dividends and guaranteed-cost gross premiums are based. This is roughly equivalent to a company's "portfolio rate of investment return" less provision for federal income tax, profit, and surplus contributions. To the nearest whole percent, this figure is five percent and may be expected to remain at that level for the next few years.

9. *Some observers have suggested that summary measures of price should include not only interest but also payment probabilities. Please include in your statement your thoughts on this question, including your thoughts on how appropriate mortality and lapse tables should be selected.*

As was the case with interest rates, no single pair of mortality and persistency tables is likely to be representative of the individual life insurance buyer. The task force's studies also indicated that the introduction of mortality and persistency assumptions had no significant effect on the relative rankings of companies which had contributed figures to our actuarial data bank. For these reasons, and because we did not want to include an unnecessary complication in a process which, by its very nature, is extremely complicated, we chose not to incorporate mortality and lapse probabilities in our cost indexes.

If mortality were to be made a factor in discounting future costs and benefits for veterans, an appropriate select mortality table could be derived from the experience of SGLI conversion pool. Persistency standards are also available, but these should be modified for the favorable impact that effective information disclosure requirements will have on the life industry's traditionally poor early-duration lapse rates.

10. *Some observers have suggested that the summary measures should provide not only price information, but also information on the relative importance of the protection element and the savings element in cash-value life insurance. Please include in your statement your thoughts on this question, including your thoughts on how such information should be presented.*

As Commissioner Huff has pointed out in his statement, the life insurance buyer's main concern is "what he gets, not how it works." It is theoretically possible to separate a policy of "permanent" life insurance into its protection and savings components, but such an exercise would only serve to confuse the average veteran (consumer) while adding nothing to the information he should have to make an intelligent buying decision as to the kind, amount, and supplier of his life insurance.

11. *Some observers have suggested that an adequate system of disclosure at the point of conversion should include not only summary price information about the proposed conversion policy (such as one or two interest adjusted indexes), but also yearly price information about the policy. Please include in your statement your thoughts concerning the advantages and disadvantages of yearly price information from the viewpoint of veterans.*

The task force gave careful consideration to all of the many methods of cost comparison that have been suggested. The system of disclosure which provides yearly price information belongs to Professor Joseph M. Belth of Indiana University, and special attention was allotted to it, both through correspondence and personal visits with Prof. Belth. It was generally agreed that Prof. Belth's excellent method of analysis would be a valuable tool for an actuary making a detailed study of competing policies; however, for the average buyer of life insurance, the task force concluded that the volume and complexity of data provided would defeat its intended purpose. A further factor in this decision is the likelihood that an unwise buyer or unscrupulous agent could draw erroneous conclusions by emphasizing yearly cost figures that are not representative of the actual overall cost characteristics of competing policies.

12. *Some observers have suggested that an adequate system of disclosure should include not only price information at the time of conversion, but also periodic price information -- presumably on a yearly basis -- after conversion. Please include in your statement your thoughts concerning the advantages and disadvantages of periodic price information from the viewpoint of veterans.*

The task force, while aware of Prof. Belth's proposal for periodic disclosure of price and rate-of-return information after issue of a life insurance policy, did not give serious consideration to this suggestion. The reason is that it is not directed to the task assigned: provision of meaningful information which will assist the consumer to make an informed buying decision. However, the task force has serious reservations about the value of such "after-issue" disclosure. The information would add confusion to an already complicated premium notice. More important, it could easily mislead the policyholder to his eventual detriment. If the purpose of the suggestion is to provide a method for monitoring the performance of the life insurance company and its willingness or ability to "live up to" the statements made during the sale of the policy, this job can and should be more effectively done by the regulatory agencies responsible for reviewing all operations of the life insurance company – the insurance departments of the various states.

13. *Some observers have suggested that an adequate system of disclosure include not only yearly price information at the point of conversion and periodic price information after conversion, but also yearly and periodic information about the rate of return on the savings element in cash-value life insurance. Please include in your statement your thoughts concerning the advantages and disadvantages of rate-of-return information from the viewpoint of veterans, including your thoughts on how an appropriate term insurance rate table should be selected.*

The task force has taken the position that yearly and cumulative rate-of-return information, either before or after issue of a life insurance policy, is not consistent with the basic purposes of its proposed model regulation. Reasons for this position are essentially the same as those noted above (questions 11 and 12) in its consideration of yearly price information, namely: a confusing addition to an already complex set of information, which would be very susceptible to misinterpretation by the consumer.

14. *Please include in your statement your thoughts on the cost of providing various kinds of life insurance disclosure to veterans at the time of conversion. Please include specific cost estimates, if possible.*

The task force was given many estimates of the additional costs that would result from the requirement of information disclosure. Some of these estimates were undoubtedly inflated in order to discourage us from a course of action which is generally unpopular within the life insurance industry. It is safe to conclude that the additional cost will be substantial, although we feel that it is justified in terms of the benefits to the consumer. However, the task force has taken a position strongly urging uniform implementation of the model regulation by all jurisdictions, since a requirement of significantly different disclosure by a number of different regulatory agencies would increase administrative costs to a point which could reverse the cost/benefit ratio. This is because most life insurance is sold by companies that operate in virtually every state.

Technical Subcommittee on Reserve
Valuation and Nonforfeiture Value Regulation

San Juan, Puerto Rico
December 9, 1975

I. Proceedings of the Technical Subcommittee.

A. Meetings of the Technical Subcommittee – Since June, meetings of the Technical Subcommittee were held August 6, 1975 at the Marc Plaza Hotel, Milwaukee, Wisconsin and October 22 and 23, 1975 at the Americana Hotel Bal Harbour, Florida, and December 8, 1975 at the El San Juan Hotel, San Juan, Puerto Rico. Minutes of those meetings are not attached since they consist primarily of discussions of materials presented with this report or to be presented in future reports, and since, with their attachments, they are too voluminous to be incorporated in the Proceedings of the NAIC.

B. Society of Actuaries Activities –

1. The Society of Actuaries Special Committee on Valuation and Nonforfeiture Value Laws submitted a Report to the Society in September, 1975, on "Actuarial Principles and Practical Problems With Regard to Nonforfeiture Requirements." This is a major work and is soon to be available in printed form from the Society of Actuaries. The Technical Subcommittee is very grateful for this excellent contribution.

2. The Technical Subcommittee has asked the Society of Actuaries for professional and technical consideration of a number of questions in two letters.

a. The letter of September 9, 1975 to Charles L. Trowbridge, President of the Society of Actuaries, 1974-75 (attached) presented questions in eight areas:

(1) A new mortality table for valuation purposes

(2) Maximum interest rate for valuation purposes

(3) Allowance for acquisition and renewal expense

(4) Contingency reserves for asset depreciation and negative cash flow

(5) Substandard business

(6) Modifications in valuation methods for special plans

(7) Premium deficiency reserves

(8) Gross premium valuation

b. The letter of December 3, 1975 to John F. Bragg, President of the Society of Actuaries, 1975-76 (attached) is in two parts, the first presenting comments by the Technical Subcommittee on the report of the Society Committee while the second part contains more questions in three other areas:

(1) The relationship between valuation and nonforfeiture value assumptions

(2) More extensive testing of scales of nonforfeiture values

(3) Questions relating to certain conclusions of the report of the Society of Actuaries Special Committee

c. The Society of Actuaries is organizing two more committees to assist the Technical Subcommittee. The present Special Committee will concentrate on nonforfeiture value questions; a new committee will consider life insurance valuation questions; and another new committee will consider asset valuation and cash flow questions (a third new committee is being organized to consider health insurance valuation questions). With respect to asset valuation, a more scientific and less empirical approach than that of the Mandatory Securities Valuation Reserve procedure is one possible goal of such research and it is also possible that such research may support an MSVR procedure adjusted for the findings of the studies conducted by the Society Committee.

C. Advisory Committee Activities -- The advisory committee, with Edward A. Lew as Chairman, has primarily been active in assisting the Technical Subcommittee in drafting requests for assistance from the Society of Actuaries. Research is in process on the history of minimum and maximum surplus requirements. When the scope of the Society of Actuaries endeavor becomes apparent, additional projects will be assigned the advisory committee.

D. Technical Subcommittee Activities -- Members of the Technical Subcommittee have embarked on a number of projects:

1. Valuation of deferred annuities. Work is progressing on this and it is hoped that a recommendation will be made within six months.

2. Expense Analysis

The Technical Subcommittee hopes to obtain expense data from a source which, because of the confidentiality of data, makes it mandatory that only members of the Technical Subcommittee can have access to such data. This information is needed to consider revision of the expense loading formula in the Standard Nonforfeiture Law.

This information is available from one source for a large number of companies, each company separate but not identified by company name. Such information could be obtained by the examination process but this would take considerable time and expense.

3. A "stop-gap" method of valuing group annuity deposit administration funds accumulating at guaranteed interest rates in excess of maximum interest assumptions allowed by statute for the valuation of group annuities purchased by such deposit administration funds.

II. Recommendations.

A. Reserve Requirements Concerning Interest Guarantees on Active Life Funds Held Under Group Annuity Contracts -- It is recommended that the NAIC adopt as a model for minimum reserve requirements for the December 31, 1975 valuation, concerning interest rate guarantees on contributions received in 1975 and prior under deposit administration group annuity contracts, the methods described in the memo attached to this report. These are intended as stop gap requirements and further studies in this area are in progress with the objective of a more permanent solution. The standard valuation law did not anticipate this problem and specifically excludes the deposits on group annuities. Most states have statutes empowering the commissioner to specify regulations, in situations not covered by the standard valuation law.

These methods were developed by the New York Department after studies conducted over the past eighteen months. Some minor adjustments were made to the New York Form to make the methods more generally applicable and yet not essentially depart from the New York regulation. Thus, adoption of the methods suggested here would result in a uniform approach.

B. Minimum Nonforfeiture Values on Individual Deferred Annuities -- It is recommended that the NAIC receive, but not adopt, a proposal for minimum nonforfeiture values on individual deferred annuities attached to this report.

Mr. John O. Montgomery, Chairman, California; Mr. W. Keith Sloan, Arkansas; Mr. Don Fritz, Michigan; Ms. Irma Edwards, Nevada; Mr. William White, New Jersey; Mr. Thomas Kelly, New York; Mr. William R. Burns, North Dakota; Mr. Ramon Estefania, South Carolina; Mr. C. F. B. Richardson, Tennessee, Mr. Marvin Van Cleave, Wisconsin.

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To: Charles L. Trowbridge, President
Society of Actuaries
208 South LaSalle Street
Chicago, Illinois 60604

From: John Montgomery
California Insurance Department

Date: September 9, 1975

Subject: Questions from (C3) Technical Subcommittee

The questions recently submitted to you by the NAIC (C3) Life Technical Subcommittee on Valuation and Nonforfeiture Value Regulation which require the professional technical consideration of the Society of Actuaries have been further edited and amplified. The complete set as attached in eight sections:

A. New Mortality Tables for Valuation Purposes
B. Maximum Interest Rate for Valuation Purposes
C. Allowance for Acquisition and Renewal Expenses
D. Contingency Reserves for Asset Depreciation and Negative Cash Flow
E. Substandard Business
F. Modifications in Valuation Methods for Special Plans
G. Premium Deficiency Reserves
H. Gross Premium Valuation

After you have reviewed these, some further clarification may be needed. It is not intended that any further drafts of these questions will be submitted.

In phrasing the questions the intent has been to ask for purely factual information to enable the NAIC Technical Subcommittee to formulate its conclusions and recommendations. Such information may include the results of experience studies, an enumeration of the advantages and disadvantages or the merits and demerits of a particular point in question, or it may consist only of recommendation of points which should be reviewed before a course of action can be determined. The NAIC Technical Subcommittee may find it necessary to use information from other sources than the Society in making a decision. It is not intended that the Society be asked for an opinion, and if the wording of the questions submitted, either now or in the future, seems strongly to imply a request for an opinion, such questions should be rephrased to make the request specific.

As mentioned previously, when the Society Special Committee on Valuation and Nonforfeiture Value Regulation has presented its report next month, the NAIC Committee will most likely have further questions to be answered with respect to Nonforfeiture Value Regulation. The NAIC (C1) Accident and Health Valuation and Nonforfeiture Value Regulation Technical Task Force is also preparing questions requiring technical assistance from the Society in that area and these questions should be presented to you sometime this fall.

With respect to the questions presently described, please let me know if the Society of Actuaries will be able to provide the information asked. For those items which the society can provide assistance, please let me know when each project is expected to be undertaken when it is expected to be completed, and if further clarification is needed.

A. New Mortality Tables for Valuation Purposes.

1. How does the experience underlying the 1965-70 Basic Tables compare with the corresponding unloaded experience underlying the 1958 CSO Table? Please show the comparison separately for males, females and both sexes combined.

2. How do the net level premium reserves based on the experience underlying the 1965-70 Basic Tables compare with corresponding reserves based on the unloaded experience underlying the 1958 CSO Table? Details of such a comparison should include at least:

   (a) Net level annual premiums and terminal reserves calculated on a continuous value basis.

   (b) Values at interest rate assumptions of 3-1/2%, 4-1/2% and 5-1/2%.

   (c) Ratios of values based on the ultimate experience underlying the 1965-70 Basic Tables to those corresponding values based on the ultimate basic experience underlying the 1958 CSO Table; and for values based on interest assumptions of 4-1/2% and 5-1/2%, ratios to those values based on the ultimate basic experience underlying the 1958 CSO Table with an interest assumption of 3-1/2%.

   (d) Separate sets of values for males, females and both sexes combined.

   (e) Values for issue ages 25, 35, 45 and 55.

   (f) Values where applicable at the end of policy years 1, 2, 3, 4, 5, 10, 15, 20, 30, 40.

   (g) Plans for which sets of values are to be prepared are:

      (1) Whole life

      (2) Life paid up at age 65.

      (3) Endowment at age 65.

      (4) Term insurance to age 65.

      (5) Five year renewable term insurance expiring at age 65.

      (6) Twenty year decreasing term insurance (decreasing annually after the first year by 5% of the first year amount).

   This minimum set of comparisons would consist of 72 Plan-Age-Sex cells showing six sets of values and five ratios for ten durations and appropriate net premiums.

3. How does the select experience in the first five policy years underlying the 1965-70 Basic Tables differ from the underlying ultimate experience? What would be the financial effect on net level premium reserves of assuming a five year select period?

Details of such an investigation should include at least:

(a) Net level annual premiums and terminal reserves calculated on a continuous value basis.

(b) Values at interest rate assumptions of 3-1/2%, 4-1/2% and 5-1/2%.

(c) Ratios of values based on the select experience for 1965-70 to those corresponding values based on the ultimate experience underlying the 1965-70 Basic Tables; and ratios to those values based on the experience underlying the 1958 Basic Tables with an interest assumption of 3-1/2%.

(d) Separate sets of values for males, females and both sexes combined.

(e) Values for issue ages 35 and 55.

(f) Values where applicable at the end of policy years 1, 2, 3, 4, 5, 10, 15, 20.

(g) Plans for which sets of values are to be prepared are:

(1) Whole life

(2) Five year renewable term insurance expiring at age 65 (with the select period to apply only to the initial term period).

(3) Twenty year decreasing term insurance (decreasing annually after the first year by 5% of the first year amount).

This minimum set of comparisons would consist of 18 Plan-age-sex cells showing three sets of values and six ratios for eight durations and appropriate net premiums.

4. Loadings recommended for mortality tables should be such as could be supported on scientific grounds and not merely inserted as a matter of judgment. To enable the formulation of such recommendations, what mortality margins might be appropriate to cover:

(a) Extraordinary mortality losses such as those due to epidemics and wars over the period 1914-1973, and

(b) Fluctuations in mortality such as those which were experienced over the period 1949-1973, and

(c) Recent mortality trends?

B. Maximum Interest Rate for Valuation Purposes.

1. What has been the experience of a group of representative U. S. life insurance companies over the period 1924-73 with respect to the interest rate on invested assets, after investment expenses:

(a) Before federal income tax and before adjustment for net gains and losses on sale or maturity of investments,

(b) After federal income tax but before adjustment for net gains or losses on sale or maturity of investments,

(c) After federal income tax and after adjustment for net gains or losses on sale or maturity of investments?

2. What has been the corresponding experience of the companies in the lowest quartile of 1(c)?

3. What loadings for margins in the interest rate might be appropriate to cover:

(a) Federal income tax,

(b) Net realized investment losses,

(c) Depreciation on investments,

(d) Likelihood of lower interest rates in the future?

4. What are the advantages and disadvantages of substituting a suitable scale of decreasing interest rates for a single interest rate prescribed as the maximum for valuation purposes? Please illustrate with scales of decreasing interest rates approximately equivalent to a single maximum rate of 3-1/2%, 4-1/2% and 5-1/2%.

C. Allowances for Acquisition and Renewal Expenses.

1. What has been the experience of a group of representative U. S. life insurance companies over the period 1949-1973 with respect to:

(a) Acquisition expenses on ordinary insurance (expressed as percentages of the first year premiums).

(b) Renewal expenses on ordinary insurance (expressed both as a cost per policy and as a percentage of renewal premiums).

This question may need further definition after the Society has had time to review it.

2. What has been the corresponding experience of the companies:

(a) In the quartile with the highest acquisition expenses (highest percentages of first year premiums).

(b) In the quartile with the highest renewal expenses for each of the two definitions:

(i) expressed as a cost per policy, or

(ii) expressed as a percentage of renewal premiums

3. What have been some of the common patterns of renewal expenses by policy duration? (i.e. renewable term, limited pay life, etc.)

4. What have been the patterns of expenses on various kinds of monthly premium insurance including specifically monthly debit insurance? The answer to this question should bring out the differences, if any, between salary deduction, preauthorized check plans, traditional monthly billed business, and monthly premium debit insurance.

D. Contingency Reserves for Asset Depreciation and Negative Cash Flow.

1. What has been the experience of a group of representative U. S. life insurance companies in 1970, 1971, 1972, 1973 and 1974 with respect to asset depreciation, and more particularly with respect to bonds and mortgages in default which have been written down from an amortized to a market value basis? Did the proportions so written down correlate with changes in economic indices?

2. What has been the corresponding experience of the companies in the lowest performance quartile in "1" above.

3. Separately for high cash value plans versus nonhigh cash value plans (as defined by regulations of the New York Insurance Department), what has been the demand expressed as a percentage of cash or loan value available, for (a) cash values, and (b) policy loans in a group of representative U. S. life insurance companies in 1970, 1971, 1972, 1973 and 1974 by age groups (under 30, 30-39, 40-49, 50-59, 60 and older)? Did this increased demand correlate with changes in economic indices? Include the prime interest rate as one of the economic indices.

4. What was the corresponding experience of the companies in the quartile with the highest demand for cash and loan values?

5. What are the advantages and disadvantages of providing for asset depreciation other than loss on sale or maturity of investments, by means of a contingency reserve scaled to economic indices? What are the advantages and disadvantages of providing for negative cash flow through a like contingency reserve?

6. What alternative forms of contingency reserves for asset depreciation and negative cash flow are possible?

E. Substandard Business.

1. What has been the recent mortality experience on substandard business, calling for premiums higher than standard for more than ten years, in a group of representative life insurance companies for the principal degree of risk classifications based on:

   (a) Percent extra mortality?

   (b) Constant extra premiums?

   (c) Other types of ratings?

   It is desired to obtain experience data by broad age groups at entry extending over a period of at least twenty years.

2. What has been the corresponding mortality experience on substandard business calling for ten or fewer premiums in excess of standard premium rates?

3. What fluctuations in mortality experience on substandard business have been observed over the period 1949 through 1973?

F. Modifications in Valuation Methods for Special Plans.

What modifications in valuation methods appear appropriate for:

1. Deferred annuities and deposit contracts.

   (a) With level premiums.

   (b) With flexible premiums or deposits.

   (c) Single premium contracts.

   What changes in maximum interest rate and in allowance for acquisition expenses would be appropriate?

2. Contracts guaranteeing interest accumulation rates in excess of the maximum valuation interest accumulation rate.

   The answer should be given separately for each of the following and where appropriate should differentiate between contracts to which the investment year method applies and those to which that method does not apply:

   (a) Annual premium deferred annuities with level premiums

   (b) Annual premium deferred annuities with flexible premiums

   (c) Supplementary contracts involving life contingencies

   (d) Supplementary contracts not involving life contingencies

(e) Premium or retirement deposit funds

(f) Deposit administration group annuities

(g) Discounted premiums paid in advance by single payment.

3. Renewable term plans.

(a) What is the current mortality experience on renewals of term insurance.

4. Life cycle policies.

5. Variation of maximum interest for insurance plans.

What variation in statutory maximum interest rate would be appropriate for:

(a) Short period annual premium insurance plans?

(b) Single premium insurance policies?

G. Premium deficiency reserves.

1. What should be the function of premium deficiency reserves? What are the advantages and disadvantages of regarding them as an adjustment to the net premium reserve to recognize the inadequacy of a prospective reserve which takes credit for future premiums larger than those provided in the policy?

2. What are the merits and demerits of premium deficiency reserves now being held? Should they be based on the minimum valuation standard rather than on the standard actually used by a company in computing reserves?

3. What modifications in premium deficiency reserves appear appropriate for renewable term insurance?

4. What are the merits and demerits of the California approach to deficiency reserves (See California Insurance Department Bulletin 74-11.)

H. Gross premium valuation.

1. What are the advantages and disadvantages of a gross premium valuation under current conditions?

2. What are the advantages and disadvantages of a gross premium valuation system under which mortality, interest, expense and other key assumptions are expressed in terms of ranges of values, with the requirement that a company use those particular values which are warranted by its own experience? Please illustrate with hypothetical cases.

3. Would gross premium valuation on more conservative assumptions provde a satisfactory measure of the minimum surplus required?

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To: John F. Bragg, President
Society of Actuaries
208 South LaSalle Street
Chicago, Illinois 60604

From: John Montgomery
California Insurance Department

Date: December 2, 1975

Subject: Report of the Society of Actuaries Special
Committee on Valuation and Nonforfeiture Law

The NAIC (C3) Life Technical Subcommittee for Valuation and Nonforfeiture Value Regulation has reviewed the "Report on Actuarial Principles and Practical Problems with Regard to Nonforfeiture Requirements" prepared by the Society of Actuaries Special Committee on Valuation and Nonforfeiture Laws to determine areas where further information would be helpful in deciding possible revisions or additions to present regulations. It will take more time to digest the material presented in the Society report. Some portions of the report meet the views of the NAIC Committee so squarely that it is considering their adoption either unchanged or with relatively minor modifications. A recommendation will be presented for consideration at the December meeting of the NAIC for a definition of minimum nonforfeiture values for deferred annuities based on the Society report.

Comments of the NAIC Technical Subcommittee on each of the thirty conclusions presented in the Society's report are given in Appendix I, attached, along with some observations with respect to the material supporting those conclusions. Appendix II outlines the areas in which the NAIC Technical Subcommittee believes that the Society Committee could be even more helpful by furnishing additional information on:

A. The relationship between valuation and nonforfeiture value assumptions.

B. More extensive testing of scales of nonforfeiture values.

C. Some questions relating to certain conclusions of the report.

The NAIC Technical Subcommittee believes that it needs further expense analyses and will attempt to obtain expense information from sources not readily available to the Society of Actuaries Committee. When such information is confidential, it will not be possible for the NAIC Technical Subcommittee to release it to those who are not members of its committee.

The NAIC (C3) Technical Subcommittee wishes to express gratitude to the Society ofActuaries Special Committee for the broad scope and excellence of its findings.

Appendix I

Review of the Society of Actuaries Special Committee On Valuation and Nonforfeiture Laws Report On Actuarial Principles and Practical Problems With Regard To Nonforfeiture Requirements

Part A – Observations on Conclusions Presented in the Report

1. "The current nonforfeiture laws have worked well and their basic structure should be retained."

   The NAIC Technical Subcommittee agrees substantially with this conclusion. However, the statement in the text, page 14, that "unless profit levels are to be regulated, the NAIC's Committee's ideal is still a desirable objective for minimum values" may have to be reexamined to observe the results of departing from that criterion.

2. "The formula for adjusted premiums could be simplified by basing expense allowances on net premiums (rather than adjusted premiums)."

The NAIC Technical Subcommittee agrees entirely with this conclusion and will include it in any recommendation made to the NAIC.

3. "Any updating of the expense allowance would probably involve decreasing the per $1000 component and increasing the percent of premium component."

The NAIC Technical Subcommittee believes that the per thousand component should be eliminated completely for the sake of simplicity; further comment on the per thousand component follows later.

"The need to update expense allowances does not appear to be urgent."

The NAIC Technical Subcommittee believes this conclusion is wrong. Public pressure demands that such allowances be updated as soon as possible. Further testing of expense allowances is proposed in Appendix II, Part B.

4. "The effect of inflation on expense allowances does not appear substantial."

No opinion is given on this conclusion at this time.

5. "Equivalent level insurance amounts should not reflect amount changes after the tenth policy year."

This conclusion would be of no consequence if the per thousand expense component were removed completely from the adjusted premium formula. However, if the per thousand expense component were not completely removed, further study is indicated.

6. "Expense allowances should be based on levelized net premiums rather than the first adjusted premium."

Sufficient evidence is not presented in the report to support this conclusion. The NAIC Technical Subcommittee believes that the conclusion merits further work on this point particularly with respect to policies providing for graded premiums and modified whole life plans.

7. "If premiums grade by size, anomalies occur due to the uniform percent of gross premium requirements; these can be largely removed."

Sufficient evidence is not presented to support or illustrate this conclusion, but the NAIC Technical Subcommittee believes that further work is needed on this point, including the effect of removing the per thousand expense component from the adjusted premium formula.

8. "On multiple track policies, the automatic track should be used for nonforfeiture compliance, and changes after issued under specified policy options should be ignored unless and until they are exercised."

This appears to be an adequate solution of the problem; but before recommendation can be made to the NAIC, further study is needed as to how the solution suggested could be mainpulated.

9. "Life cycle and many open policies can be accommodated in a new law in a manner similar to multiple track policies."

This conclusion will require more study and documentation before any recommendations to the NAIC can be made.

"Completely undefined policies cannot be so accommodated; however, they should be freely permitted. Regulators should be given broad powers to approve experimental designs."

Although this is not really an actuarial problem, it should be recognized that if this broad power were given to the regulators a specific charge might be required for the technical service of examining and approving or rejecting such new products. This alternative should be given serious consideration by those proposing such broad exercise of regulatory discretion.

10. "A single national review body would facilitate approval, particularly of complex policies, and would promote flexibility of product design while decreasing risk of abuse."

Although this seems to be a very logical and straight forward conclusion, there is considerable reluctance on the part of the various state insurance departments to relinquish this function to a central technical staff of the NAIC. This is not really an actuarial problem, but it is a problem of a political nature which the NAIC Technical Subcommittee will attempt to resolve.

11. "No recommendations on specific interest rates are made."

Proposals already made to the Society indicate the need for recommendation on this point.

12. "No recommendations as to modernizing the 1958 CSO Mortality Table are made. However, a 'Modern CSO' Table was developed for test purposes and the resulting calculations show in general a decrease in cash values of a magnitude somewhat lower than the effect of a 1% increase in interest rate."

The NAIC Technical Subcommittee believes that the Society Committee should be requested to further study the margins used in developing its "Modern CSO" Table rather than merely adopting those used in preparing the 1958 CSO Table. There are additional questions in this area which require answers. These questions are listed in Appendix II, Part C.

13. "The Mortality Table should continue to contain margins."

The reasons given in the late 1950's for including certain kinds of margins in a mortality table may not all be valid at the present time. The use of different mortality tables by sex requires review in the light of views of some state legislators in disallowing the age-setback approach and requiring either completely separate mortality tables by sex or only one unisex mortality table. Some inquiry into current expense levels on paid up policies is pertinent to the margins in the mortality tables for paid up contracts.

14. "A six year age setback for determining whole life cash values for females would reasonably approximate the results using a separate female table."

The age setback adjustment does not fit the current mortality experience by sex. Separate mortality tables based on the experience by sex appear to be the only approach currently acceptable, unless a unisex table could be used. There is much uncertainty as to which attitudes to take to meet the views of the feminist movement.

15. "Certain additional considerations are discussed in the mortality area, principally a more flexible treatment of substandard policies."

The NAIC Technical Subcommittee would appreciate further analysis by the Society Committee of the problems in this area and will propose this in Appendix II, Part C.

16. "Policies that never give rise to significant values should be exempted; a specific test for triviality is proposed."

More specific documentation of this proposal is requested. Further investigation is indicated before this concept can be pursued. In particular, a test for triviality, alternative to that proposed by the Society Committee, should be examined. This alternative test considers values as a percentage of accumulated net premiums. Some details along these lines are called for in Appendix II, Part C.

17. "Term exemptions from cash values should be extended."

Calculations of the amounts accumulated from net premiums should be made with the intent of developing criteria for the determining the propriety of cash values on certain term plans.

18. "Term riders as defined should be treated as separate policies under a 'severability' principle."

The NAIC Technical Subcommittee agrees with this conclusion and will include it in its recommendation to the NAIC for updating the Standard Nonforfeiture Law.

19. "Renewable and convertible term policies should be viewed uniformly as a series of short term policies for nonforfeiture purposes."

This conclusion appears reasonable only for plans where the gross premium scale at renewal ages is independent of issue age. For "select and ultimate" type renewable and convertible term plans, when the select period extends into the renewal period, such that renewal premiums are dependent upon the duration from initial issue date as well as the attained age at renewal, a different view may be more appropriate.

20. "Proposed treatment of Deposit Term and Deposit Whole Life is discussed."

The NAIC Technical Subcommittee agrees with the proposals of the Society Committee on this subject and will submit them to the NAIC for consideration when an adequate form for such a recommendation has been determined by the NAIC Committee.

21. "A single interest rate for statutory minimum cash values is proposed. This eliminates present linkage with the valuation and the policy cash value rates."

The NAIC Technical Subcommittee will give further study to this conclusion and may have some questions to raise at a later date.

22. "Guaranteed paid-up insurance options should be those purchased by the cash value on any interest rate at least as high as that used for cash values."

The NAIC Technical Subcommittee agrees with this conclusion and will include it in any recommendation to the NAIC for updating the Standard Nonforfeiture Law.

23. "The cash value mortality table should be used for determining guaranteed paid-up values except that extended term should employ higher mortality."

This conclusion will also be included in any recommendation to the NAIC for updating the Standard Nonforfeiture Law.

24. "Specific expense loadings in paid-up insurance options guarantees are not recommended."

As indicated in Appendix II, Part C, the NAIC Technical Subcommittee intends to give this recommendation further thought, particularly with respect to the effect of the reduced paid-up insurance option being exercised to a markedly different extent by age.

25. "Substitute (nonparticipating) purchase bases granting larger than guaranteed amounts should be permitted for insurance options and paid-up additions."

The NAIC Technical Subcommittee will consider incorporating this feature in its recommendations to the NAIC.

26. "Complete exposition of nonforfeiture values in a policy table should not be required for multi-track policies or 'open' plans."

The NAIC Technical Subcommittee believes that complete exposition <u>should</u> be required in the policy form for the automatic option only, with complete exposition for other options available only upon request. A complete exposition of nonforfeiture options for <u>all</u> options, would be extremely voluminous. Perhaps what is needed is a complete exposition of all formulas used to derive values for the various options, together with some illustrative values. This conclusion by the Society Committee requires further study by the NAIC Technical Subcommittee.

27. "Single premium life minimum cash values should be based on higher interest rates than annual premium policies."

The NAIC Technical Subcommittee agrees with this conclusion and is currently in the process of formulating some recommendations for consideration by the NAIC.

28. "Deferred annuities should be subject to minimum cash value requirements during the build-up period; an accumulation of percentage of premiums (after exclusions) is proposed; flexible contracts pose special problems."

The NAIC Technical Subcommittee is currently preparing recommendations along the lines suggested by the Society Committee, to be submitted this December for consideration by the NAIC.

29. "Nonforfeiture values should not be required for accident and health insurance with the possible exception of contracts with a return of premium provision."

    This subject is being considered by the NAIC (C1) Accident and Health Insurance Valuation and Nonforfeiture Value Regulation Technical Task Force.

30. "Various miscellaneous technical problems are listed."

    Some of these problems appear to require further consideration and recommendation to this effect are made in Appendix II, Part C.

Appendix II

Additional Project for the Society of Actuaries
Special Committee on Nonforfeiture Value Laws

A. The Relationship Between Valuation and Nonforfeiture Value Assumptions

   1. Assuming a reasonable maximum difference between the interest rate used for valuation and that used for the determination of nonforfeiture values, what type of modifications, if any, should be advisable for:

      (a) Participating policies as compared to nonparticipating policies?

      (b) Single premium contracts as compared to annual premium contracts?

   2. To what extent should similar consideration be given:

      (a) Mortality, and

      (b) Expense Assumptions?

B. More Extensive Testing of Scales of Nonforfeiture Values

   It appears desirable to test the consequences of the meaning to be given to the word "largest" in the statement:

   "Provision . . . . for the amortization of the largest reasonable excess of initial over renewal expense that can be justified . . . ."

   1. The NAIC Technical Subcommittee would appreciate receiving illustrative values based on the assumptions and specifications set forth below under (a), (b), (c), (d), (e) and (f):

      (a) Adjusted premiums based on 1958 CSO 3% net premiums with the excess of first year over renewal expenses based on each of six formulas, each net premium subject to a maximum limit of $50 per $1,000:

Formula	When net premium for plan exceeds that for ordinary life	When net premium for plan is equal to or less than that for ordinary life
1.	100% net premium for plan plus 50% net premium for ordinary life	150% net premium for plan
2.	80% net premium for plan plus 40% net premium for ordinary life	120% net premium for plan
3.	60% net premium for plan plus 30% net premium for ordinary life	90% net premium for plan
4.	$10 per $1,000, plus 50% net premium for plan, plus 50% net premium for ordinary life	$10 per 1,000 plus 100% net premium for plan
5.	$8 per $1,000, plus 40% net premium for plan, plus 40% net premium for ordinary life	$8 per $1,000, plus 80% net premium for plan
6.	$6 per $1,000, plus 30% net premium for plan, plus 30% net premium for ordinary life	$6 per $1,000, plus 60% net premium for plan

(b) Plans and ages for which values are desired are:

(1) Plans: Ordinary Life – $20,000 average size
Life Paid Up at 65 – $20,000 average size
Endowment at 65 – $15,000 average size
Term to 65 – $40,000 average size

(2) Issue ages:

For all plans: 0, 20, 35, 45, 55
For ordinary life only: 65

(c) The interest assumption to be used in testing should be:

6% for the first 10 years
5% for the next five years
4% for the remaining years

(d) The mortality assumption to be used in testing should be the 1965-70 Basic Select Table with no margins.

(e) The expense assumption to be used in testing should be:

First Year – Formula 1
Renewal expenses based on $8 per policy plus renewal commissions and taxes

(f) The two separate scales of lapse rate assumptions to be used in testing are those by the Moorehead Scales S and T.

As a result of these specifications 252 formula-plan-age-lapse cell are requested, each cell showing the progression per $1,000 of initial amount inforce of values and surplus year by year for twenty years, or maturity or expiry if sooner, also showing at durations 5, 10 and 20 years the ratio of cash values to the net level premiums accumulated at 3-1/2%.

2. To study the effect of a change in interest assumptions for determining adjusted premiums, the progression of values and surplus year by year as described above is requested for cells based on Formulas 1, 3 and 4 using Moorehead's Scale S lapse assumptions and 1958 CSO 4-1/2% net premiums with the calculation of the ratio of cash values at durations 5, 10 and 20 years to the net level premiums accumulated at 4-1/2%. This will add another 63 cells to the studies previously requested.

3. The NAIC Technical Subcommittee would appreciate any further calculations along the same lines based on assumptions deemed more appropriate by the Society of Actuaries.

C. Some Questions Relating to the Conclusions of the Society Committee on Actuarial Principles and Practical Problems with Regard to Nonforfeiture Requirements.

1. What evidence has been adduced to support conclusion 6 that "Expense allowances should be based on levelized net premiums rather than the first adjusted premium?" Is this conclusion valid for policies with graded premiums and modified whole life plans?

2. What evidence has been adduced to support conclusion 7 that "If premiums grade by size, anomalies occur due to the uniform percent of gross premium requirements; these can be largely removed?" What would be the affect of removing the per thousand expense factor completely?

3. With respect to the 'Modern CSO' Table developed for test purposes:

   (a) What was the rationale of using the same formula for the mortality margin as that used in the construction of the 1958 CSO table?

   (b) What effect do the margins have on the slope of q_x and the reserves for ordinary life and life paid up at age 65 plans?

   (c) What is the rational for producing reserves different from those based on the underlying experience?

   (d) What kind of margins superimposed on the underlying experience would provide more appropriately for mortality fluctuations.

4. Page 47 of the report states that with respect to substandard insurance "other methods are possible and it would be desirable to spell out a sufficient number of these methods in the law so as to simplify the process of supervision without sacrificing legitimate plan design." It is requested that calculations presenting the results of some "other methods" be made so that the NAIC Technical Subcommittee will be in a position to consider alternative solutions. The NAIC Technical Subcommittee in a letter to Mr. Trowbridge September 9, 1975 requested that a study of substandard mortality be implemented.

5. The test for triviality should be spelled out both in relation to the death benefit and also as a percentage of the accumulated net premiums.

6. Tests of the relationship of cash values to accumulated net premiums on each of the possible minimum value formulas of B1(a) appears desirable for the purpose of making decisions as to whether cash value requirements should be extended or reduced.

7. The NAIC Technical Subcommittee would appreciate receiving information as to what extent the reduced paid up insurance option is selected by age.

8. The Society Committee Report singled out for further study six items. The NAIC Technical Subcommittee would appreciate studies on five of these plus one more item not indicated by the Society Committee.

   (a) Refund of unearned premiums at death

   (b) Fractional modes

   (c) Age nearest and last birthday bases

(d) Family policies

(e) Uniform seniority rules

(f) The arguments for and against the use of continuous functions for both valuation and minimum nonforfeiture values.

It should be noted that the sixth item listed by the Society Committee, "Removal of any requirement for complex or confusing policy provisions relating to cash values," was not considered by the NAIC Technical Subcommittee an appropriate topic for study by a Society of Actuaries Committee.

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Memo Re: Valuation of Funds Held Under Group Annuity Contracts

By: John Montgomery

The current practice by many companies of guaranteeing high interest earnings on funds held under group annuity contracts has caused significant surplus strains in certain instances. These surplus strains appear questionable when considered with current new money rates. However, the use of new money rates for valuation interest assumptions has a member of perils:

(1) The interest income on funds currently deposited must be reinvested and a provision must be included for the chance that such reinvestment rates may not be as favorable as those currently available.

(2) The entire investment supporting the deposit may mature before the funds are used and the reinvestment at maturity of the original investment may not be at rates as favorable as those at present.

(3) There is a chance that the investments may deteriorate to the point of default and this must be considered in deciding to what extent the valuation interest rate should reflect the current new money interest rate.

The consideration of these problems and the formulation of a valuation structure which can more adequately provide a safe reserve system for group annuity funds will take some time to develop. Until then, the procedure suggested here is recommended as the basis for a "stop-gap" solution to the problem for the minimum reserve requirements for the December 31, 1975 valuation concerning interest rate guarantees on contributions received in 1975 and prior under deposit administration group annuity contracts. The procedure includes the attached submission of a "New Money Reporting Form" by all companies writing group annuity business.

Reserve Requirements for the December 31, 1975 Valuation Concerning Interest Rate Guarantees on Active Life Funds Held Under Group Annuity Contracts

(New Money Reporting Form)

As a part of the determination of the aggregate group annuity reserves, a computation must be made of minimum reserves for deposit administration group annuity funds with interest rate guarantees. In making such computation the procedure and minimum standards described below shall be applicable for the December 31, 1975 valuation. Where appropriate, recognition may be taken of turnover rates, of expense assessments against the fund, of excess of purchase price over minimum reserves, and of the date the deposits were made. In no event shall the reserve be less than the transfer value, if any, of the fund.

Approximate calculations for the December 31, 1975 valuation will be acceptable in view of the late date of promulgation of this instruction.

For funds received:

1. Prior to 1974, follow the procedure used at that time

2. For funds received in calendar year 1974 follow the less restrictive of:

(a) The procedure used prior to 1974 or

(b) With the approval of the Department of Insurance, a company may use the following basis to determine the additional reserve for interest rate guarantees relating to contributions received in 1974 under Deposit Administration group annuity funds.

Interest Guarantee Factor = $[1 + (i_g - i_p)]^n - 1$

Where: i_g = interest rate guaranteed under the contract

i_p = lesser of the net new money rate credited on group annuity funds received in 1974 or .075 but in no year greater than i_g

n = number of guarantee years, and fractions thereof, remaining as of the valuation date.

Where appropriate, recognition may be taken of turnover rates and of excess of purchase price over minimum reserve.

3. For funds received in calendar year 1975, the procedure and minimum standards prescribed here shall apply.

Minimum reserve - $[C \times (1 + i_g)^n] / (1 + i_p)^n$

Where: C = Contributions received in 1975

i_g = Interest rate guaranteed under the contract

i_p = Lowest of:

(1) the net new money rate credited by the company on group annuity funds received in calendar year 1975 less .005, or

(2) i_g, or

(3) i_m, where

i_m = .081* for calendar years 1976-1980

.077 for calendar year 1981

.073 for calendar year 1982

.069 for calendar year 1983

.065 for calendar year 1984

.060 for calendar years 1985 and later

n = Number of guarantee years, and fractions thereof, remaining as of December 31, 1975

*This factor is equal to the average gross new money rate based on the reports of 37 companies for specified investments made in 1974 less .01.

Memo Re: Minimum Nonforfeiture Values: Individual Deferred Annuity Contracts

By: John Montgomery

During the accumulation period, individual deferred annuity contracts (commonly referred to as retirement annuities) should be subject to minimum nonforfeiture value requirements. No such model requirements have as yet been recommended by the NAIC although four states, Maryland, New Jersey, New York and Washington have passed laws requiring such values. The Maryland and Washington laws have based such values, at least in part, on the accumulation of gross premiums while the New Jersey and New York laws view such values as present values of paid-up deferred income. If such deferred annuities provide only for the accumulation at interest of gross premiums received during the deferred period, then the Maryland and Washington views are appropriate. However, if each payment is viewed as the purchase of a small amount of deferred annuity considering accumulation during the deferred period assuming both the interest and mortality parameters then the New York view would be appropriate.

Practically all of the deferred annuity contracts written today assume the accumulation at interest only of gross premiums received during the deferred period. Therefore, it is recommended that a schedule of minimum nonforfeiture values be based only upon an accumulation at interest of gross premiums received. There are three principal forms of deferred annuities:

A. The Single Premium Deferred Annuity

B. The Fixed Multiple Premium Deferred Annuity, including plans with level premiums and plans with high first year premiums or initial deposits.

C. The Flexible Premium Deferred Annuity

Minimum nonforfeiture value requirements will be specified separately for each of these forms of deferred annuities. For all forms the interest assumption is to be 3%. The amount of any policy fee to be subtracted from the gross premium before application of the accumulation percentages should not exceed $50.00 for single premium contracts and $20.00 for other contracts.

Minimum Nonforfeiture Values

The minimum nonforfeiture values are equal to the accumulation of the following percentages of gross premiums:

A. Single Premium Deferred Annuity

90% of the single premium

B. Fixed Multiple Premium Deferred Annuity

60% of the first annual premium

85% of the annual premiums paid for policy years two through ten

90% of the remaining annual premiums

30% of any excess of the first annual premium over the lower of the next two annual premiums

C. Flexible Premium Deferred Annuity

60% of the first annual premium

85% of the amount of annual premium received for policy years two through ten not exceeding the largest annual premium previously received

90% of the amount of annual premium received after the tenth policy year not exceeding the largest annual premium previously received

60% of the amount of an annual premium received which is in excess of the largest annual premium previously received

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Premium or Retirement Deposit Funds (C3) Task Force

San Juan, Puerto Rico
December 9, 1975

(Note: this is a revision of the report made at the December 1975 meeting.) The comments of the Industry Task Force were considered at a meeting in Washington, D. C. on October 6, 1975 at which Richard Minck and John Booth of ALIA were present in addition to Messrs. Montgomery and Richardson. This is the final report of this task force and it is requested that the task force be discharged.

In recent years there has been increasing use of deposit accounts under individual life and deferred annuity policies, variously described as "Premium Deposit Fund," "Retirement Deposit Fund," etc., the true purpose of which in most cases is to accumulate large demand deposits, in addition to the regular policy benefits, to provide a "savings fund" withdrawable upon demand. These funds as illustrated in sales proposals are frequently several times larger than the cash values of the underlying policy and can reach amounts much larger than the sum assured. A predetermined amount of deposit, starting in the second policy year, usually larger than the annual premium on the policy, is generally billed with the premium. The premium and deposit structures are designed so that the premium plus deposit is a level amount. In summary, the accumulation under the deposit account, withdrawable upon demand without penalty, is the predominant purpose of the purchase, rather than an ancillary feature of it.

Such accounts are generally governed by a special policy provision or rider, and the resulting accumulations are an important part of the sales package; indeed, in most cases, the primary emphasis is on a "savings fund" rather than on a life insurance policy. Generally, but not always, upon default in payment of premium the fund is used to pay it, and generally, but not in all cases, the fund may be applied to buy a life income under the settlement options. However, neither of these possibilities is the real purpose of the arrangement. The fund seems to be designed to escape premium tax since all deposits are returned in full and no agent commissions are paid, so it actually constitutes a demand deposit, withdrawable at any time with full accumulated interest, with no penalty or charge. Most companies pay very high interest rates (currently from 7% to 9%) and illustrate accumulations to age 65, frequently for juvenile ages at issue, at these very high interest rates. A predetermined deposit is usually billed with the premium and special policies with a premium reducing in the second year are used, often with nonlevel death benefits. The resulting picture is most confusing to the prospect and highly misleading sales promotion material and sales talks are frequently involved.

A. Typical Policy Provisions.

1. Duration of Deposit Fund. Fund terminates with policy on death or surrender or if nonforfeiture option becomes effective. Some agreements terminate at age 70 or 75.

2. Amount of Annual Deposits. In most cases, there is no limit on the annual deposit, but a few are limited to two or three times the annual premium.

3. Limit on Total Fund. The majority of the provisions have no limit, but a few have a limit of all future premiums (not defined) or various other limits, such as the amount required to make the policy paid-up. (A very few states have statutory limits.)

4. Interest Guarantee. 5% for 10 years is a common rate with a lower rate thereafter, but there are many variations.

5. Interest Paid. Current rates generally range from 7% to 9%.

6. Withdrawals. Withdrawals equal to the full amount paid in with interest, or partial withdrawals, are allowed in almost all cases without penalty. In most cases, there is no provision for 6 months' deferment as required by many states in the cash value policy provison.

7. Life Income. The majority of provisions permit application of the fund to purchase life income at settlement option rates and in quite a number of cases there is no provision for a deduction from the fund for any premium tax payable on such purchases. Many provisions allow the fund to be placed under any settlement option, in some cases without requiring termination of the policy.

8. Owner of Fund. Generally the policyowner, but in some cases the insured or the depositor has the right to withdraw the fund. Ownership is sometimes not clearly defined. In some cases the beneficiary has no interest in the fund, which is paid to the estate of the insured on death.

9. Policy Loans. Sometimes the deposit fund is automatically terminated and paid out if a policy loan is made, sometimes not. In a few cases, new deposits are suspended during the existence of a loan.

10. Payment of Premiums. In most but not all cases, the fund is automatically applied to pay premiums in default. Usually, but not always, the fund is used before any automatic premium loan is made. The important point is that premiums continue to be paid in cash along with deposits to the fund, which continues to grow. This is quite unlike the situation where single payments are made to pay discounted premiums in advance and no premiums are billed or paid in cash.

11. Billing. In the majority of cases, a predetermined deposit is billed along with the premium. In some cases, the policy contract or premium notice actually refers to the deposit as "Combination Premium" or "Additional Premium."

B. Sales Illustrations.

The type of illustration used assumes level deposits in addition to premiums and a projection of the accumulated deposit fund at today's extremely high interest rates for as long as 65 years hence. In most cases the accumulation using the guaranteed interest rates is not included and the guaranteed rates are shown in fine print. Passbooks which look exactly like savings bank passbooks are frequently used. (Their use is prohibited in some states.) Illustrations usually describe the difference between the accumulated fund and the total deposits made as "Profit" or "Gain," clearly a misleading label, especially as the interest is taxable income. The emphasis is on "savings" and "deposits" throughout.

C. Design of Policies.

Special policies are generally used with a reduction in the second and later premiums equal to the amount of deposit illustrated, the reduction frequently being half or two-thirds of the first premium, so that the deposit is equal to or double the premium of the policy. The sum assured frequently reduces by 50% at age 65 and in some cases decreasing term coverage starting at issue, or even deferred decreasing term coverage is involved. Return of premium benefits for limited periods of time are also used. The resulting combinations of several types of death benefits, policy values and deposit funds, some guaranteed and others purely illustrative, are frequently very complicated and most unlikely to be understood by the purchaser.

D. Discrimination.

Interest rates paid on these funds frequently exceed the rates earned before income tax on the company's total assets. If the company has participating policyholders or pays a substantially lower interest rate on settlement options or other withdrawable funds left at interest, discriminatory practices may quite possibly be involved even if the Investment Year Method of allocating interest is used, especially if the bulk of these funds were on nonparticipating policies.

E. Financial Aspects.

The investment laws for life insurance companies were never designed to prescribe the type of assets required to cover demand deposits of this kind, where there is no penalty on withdrawals. The laws envisage long-term assets and liabilities, not the types of short-term, liquid assets required under the banking statutes. In many respects, these deposit fund operations are dangerously close to a banking function. If such demand liabilities with no penalty on withdrawals, not backed by suitable assets, represented a large portion of total liabilities, they could have an adverse effect on the solvency of a company.

F. Additional Reserves for High Interest Guarantees.

Many of these contracts guarantee interest rates higher than the maximum of 3.5% or 4% permitted for valuation of deferred annuities and pure endowments. Under these contracts insurers accept deposit funds ancillary to insurance or annuity contracts which may be used to provide benefits at a future date or to pay future premiums. Such funds provide benefits which, in many respects, are similar to those under deferred annuity or endowment contracts. Some states are therefore requiring the maintenance of additional reserves to take account of the excess of the guaranteed interest rates over the maximum permitted valuation interest rate (3.5% or 4% as the case may be) on the accumulated fund, usually computed to an arbitrary age, such as 65.

G. Premium Tax Aspects.

The taxability of payments made under these deposit funds would have to be determined according to the laws of each state. It seems probable that many of these funds may be escaping tax.

H. Qualified Pension Plans.

There are various types of funds involved under individual policies issued under qualified pension and profit-sharing plans; for example, side funds applied at retirement date to fund part of a defined pension benefit, or additional funds accumulated at interest under a deferred annuity to provide pension benefits in addition to the basic benefits under the policy. Such funds should not be subject to the limits and other controls recommended for the type of funds referred to in A above.

I. Annuity Purchase Agreements.

Various types of agreements are available on life and deferred annuity policies which permit payment of additional single premiums to provide deferred annuity benefits, or for single payments at maturity or surrender of the policy to purchase life income benefits at rates guaranteed in the policy. These arrangements provide for cash values in case of termination of the contract on a basis defined in the policy. There is no objection to such arrangements under either qualified or nonqualified plans.

J. Replacement of Existing Policies.

It has been found that these funds are also being used as a device to facilitate replacement of existing policies with cash values. The procedure is to suggest surrender of the existing policies in force and replacement with term insurance or other low premium contracts, with a premium deposit fund into which the cash values of the replaced policies are paid, and additional annual deposits are made under the new policies to build up a savings account.

K. Recommended Legislation.

To control the use of these funds either legislation or regulation is needed. Two model acts follow this report. The first, entitled "Premium and Retirement Deposit Funds Model Act," should be used where legislation is required. The second, entitled "Regulation of Premium and Retirement Deposit Funds Model Act," should be used where flexible regulatory authority is preferred; it is suggested that the regulation promulgated contain the same provisions as the "Premium and Retirement Deposit Funds Model Act."

This legislation has the following major objectives:

1. To limit the total fund on deposit to a reasonable amount so that the deposit fund cannot become the predominant feature of the purchase, and take on the character of a savings account, which resultant large demand deposit liabilities.

2. To limit the annual deposit to reasonable amounts so as to control the replacement problem.

3. To require the same deferment provision on withdrawals as required for cash values.

4. To provide controls on misleading advertising and sales promotion material, including interest accumulations.

5. To exempt qualified pension plans and single payments made in respect of discounted premiums paid in advance from any of these limitations.

Charles F. B. Richardson, Tennessee, Chairman; William A. White, New Jersey; James R. Montgomery III, Washington, D. C.; Keith Sloan, Arkansas; William R. Toler, President, MFA Life insurance Company.

Proposed Premium and Retirement Deposit Funds Model Act

A life insurance company may not accept additional payments under policy provisions which permit deposits to be made in funds which are ancillary to the basic benefits and which are established for the payment of future premiums on individual life or annuity policies, or for the purchase of annuity benefits under such policies at a future date, unless it meets the following conditions and limitations:

(a) The maximum amount which may be held by the insurer at any time in such funds is the smaller of (1) the total amount of the next ten (10) annual premiums payable or (2) the difference between the greater of the sum assured or the guaranteed maturity value and the cash value of a life insurance policy, or the difference between the maturity value and the cash value of a deferred annuity with level premiums.

(b) The maximum amount which may be deposited in said funds in any one year is two (2) annual premiums currently payable under the policy, or in the case of policies under which premiums may vary in amount, twice the average amount of annual premiums paid under the policy during the previous five (5) years or the number of years for which the policy has been in force, if less than five (5) years.

(c) If the insurer guarantees interest rates on such funds in excess of the interest rate permitted for the valuation of annuities and pure endowments, additional reserves in respect of such interest guarantees may be required, based on such requirements as are determined by the commissioner.

(d) Unpaid premiums shall be automatically paid from the premium deposit fund unless the policy provides that any automatic premium loan provision shall first become effective.

(e) Such funds shall be payable upon death or other termination of the policy.

(f) Provisions may be included to allow policyowners to withdraw such funds subject to the condition that the policy provision reserves to the insurer the right to defer payment for six (6) months.

(g) Any projections of these funds that may be used must illustrate the projected accumulation of the fund using the guaranteed interest rates, irrespective of whether or not projected results are also shown on the basis of the rate currently being paid or some lesser rate.

(h) Sales promotion literature and contract forms shall not in any way create the impression that such funds are the same as a savings account or deposit in a banking or savings institution and the use of passbooks which bear any resemblance to savings bank passbooks or similar items is prohibited. Projections at interest rates in excess of the rates guaranteed may not be made for a period in excess of twenty (20) years.

(i) The limitations in (a) and (b) shall not apply to a single payment equal to the discounted value of specific premiums paid in advance. The limitations in (a) and (b) shall not apply to a policyholder's deposit account established primarily as a premium payment facility unless the total amount in such account exceeds twice the sum of the annual premiums payable on all policies for which premiums are being paid from such account.

(j) Except for paragraphs (c), (g) and (h), this act shall not apply to policies issued under pension or profit-sharing plans which qualify for special tax treatment under the United States Internal Revenue Code and are regulated by the Employee Retirement Income Security Act of 1974, as now or hereafter amended.

Proposed Regulation of
Premium and Retirement Deposit Funds Model Act

A life insurance company may not accept additional payments under provisions of individual life or annuity policies which permit deposits to be made in funds which are ancillary to the basic coverage and which are established for the payment of future premiums or for the purchase of annuity benefits under such policies at a future date if either the conditions or method of operation of the company in connection with the acceptance of such additional payments are misleading to prospective policyholders in fact or by implication or will be hazardous to the public or the policyholders in this state.

In furtherance of these objectives, the commissioner may, after notice and hearing, promulgate reasonable regulations with respect to additional payments accepted under provisions of such policies.

Such regulations may prescribe, but not be limited to, (1) limitations on the amount of additional payments which may be accepted and the amount of such funds to ensure that such payments or funds are ancillary to the basic policy benefits, (2) controls to prohibit misrepresentations, misleading statements or incomplete comparisons in an insurer's or agent's advertising with respect to additional payments and the funds arising therefrom, (3) reserve requirements with respect to interest guaranteed by an insurer to be paid on additional payments or funds arising therefrom, and (4) required policy provisions regarding withdrawal of funds arising from additional payments and the disposition of such funds on the termination of the policy.

Items (1) and (4) in the preceding paragraph shall not be construed to apply to policies and contracts issued under pension, annuity, or profit-sharing plans which qualify for special tax treatment under the United States Internal Revenue Code and are regulated by the Employee Retirement Income Security Act of 1974, as now or hereafter amended.

VARIABLE LIFE INSURANCE AND VARIABLE ANNUITIES (C4) SUBCOMMITTEE

Reference:
1975 Proc. Vol. I p. 751
1975 Proc. Vol. II p. 442

Hon. Jay W. Jackson, Chairman – Connecticut
Hon. Maximilian Wallach, Vice-Chairman – District of Columbia

AGENDA

1. Status report by (C4) Industry Advisory Committee.

2. Report by American Life Insurance Association, Variable Life Insurance Committee.

3. Any other matters brought before the Subcommittee.

The Variable Life Insurance and Variable Annuities (C4) Subcommittee convened on December 8, 1975 at 1:10 p.m. in the Isla Verde Room of the El San Juan Hotel, San Juan, Puerto Rico. Soon thereafter, the quorum was established and various reports were received with very little discussion.

Sam Cantor, speaking for ALIA, furnished "Recommended changes to the NAIC Model Variable Life Insurance Regulations" (attached).

Harry Walker, speaking for Equitable's subsidiary EVLICO, read a prepared statement (attached) and furnished some proposed amendments to the NAIC Variable Life Insurance model regulation – to Art. IV, Sec. 3-f; to Art. III, Sec. 4; to Art. IV, Sec. 3-o; and a proposed Art. X. The text of the amendments is attached.

Robert Routier spoke on behalf of six companies whose request for exemptions is pending before the SEC (no written statement furnished).

The Chairman stated that despite repeated requests in the past, this material again was not furnished until the time of the meeting instead of having been furnished thirty days in advance.

Dick Minck, Actuary of the ALIA, upon request, stated that the sufficiency of reserves for the guaranteed portion of the benefits, reviewed as of 1974, was not tested again, but this will be done in 1976 as of year-end 1975.

In executive session, the subcommittee, upon proper motion made and seconded, decided to receive the reports and concluded that members should keep in touch by mail to determine whether or not a meeting should be held prior to the June 1976 NAIC meeting.

There being no other matters brought before the subcommittee, motion was made and unanimously approved to adjourn at 1:50 p.m.

Hon. Jay W. Jackson, Chairman, Connecticut; Hon. Maximilian Wallach, Vice-Chairman, District of Columbia; Hon. Ark Monroe III, Arkansas; Hon. Wesley J. Kinder, California; Hon. Manuel A. Chaco, Guam; Hon. H. Pete Hudson, Indiana; Hon. Thomas C. Jones, Michigan; Hon. Berton W. Heaton, Minnesota; Hon. E. Benjamin Nelson, Nebraska; Hon. Thomas A. Harnett, New York; Hon. Gerald Grimes, Oklahoma.

Statement of Harry Walker
President, Equitable Variable Life Insurance Company

December 8, 1975

I endorse and commend for your favorable action the amendments to the NAIC Model Variable Life Insurance Regulation which have been proposed by the ALIA at this meeting.

At the same time, I can appreciate that the subcommittee may wish to defer action upon so many amendments, in order to more carefully review them. With this in mind, I wish to propose that the subcommittee consider the present adoption of a limited number of the recommendations, if it is decided that consideration of the remainder should be deferred.

There are a total of four amendments to which I call the subcommittee's attention. Their present adoption would remedy technical flaws, broaden the discretionary powers of the commissioner in dealing with a foreign insurer, and generally smooth the operation of this important regulation. Let me specify the reasons for these four proposed changes.

1. Mandatory exchange of policy provision -- (Article IV, Section 3f, page 10)

   The NAIC contemplated that amendment of this provision would be necessary, and the regulation circulated by letter of March 4, 1975 stated that it was "Awaiting Proposed Technical Amendments." Also, at its June 1975 meeting, the (C4) Subcommittee received a paper from Robert A. Lomicky, Supervising Actuary -- Life Bureau of the New York Insurance Department, discussing the "deficiencies" in the existing provision.

   The mathematical basis for the exchange is simply unworkable. As presently written, for example, a windfall could accrue to the insured where the premium for the new (fixed benefit) policy is less than that for the original (variable) policy, and where the tabular cash value of the new policy is less than that of the original. Under the existing provision, not only would the insured receive a refund of the excess premium, but he also would receive the excess of the higher tabular cash value of the original policy over the new one. (It thus would be advantageous for an insured who wishes to surrender his variable life policy during its first eighteen months to convert first to a fixed benefit policy, and then surrender.)

   The proposed amendment eliminates the specific mathematical basis of the change. To attempt to revise the basis, and state it "correctly," would involve inordinate detail, as there are numerous bases of exchange depending upon the precise relationship of the original policy to the one exchanged. Also, in a newly developing field where new forms of variable life policies may be designed, it appears unwise to rigidly establish the mathematical basis of change in the regulation. It should be sufficient protection for the policyholder if the mathematical basis of the exchange is filed with the Commissioner, at the time the policy form is filed for approval, as required by the proposed amendment.

   The amendment incidentally includes language that further serves to clarify the right of exchange.

2. Discretionary power of commissioner -- (New Article X, page 25)

   This new article would give the commissioner discretion to determine that a foreign insurer's compliance with its domiciliary state's law or regulation constitutes compliance with the model regulation, where such domiciliary law or regulation "provides a degree of protection to the policyholders and the public which is substantially equal to that provided by these regulations."

   This provision is precisely the same in concept and language as that contained in the NAIC Model Variable Annuity Regulation. There is no discernible reason for its being left out of the Model Variable Life Insurance Regulation, and from my knowledge of the development of that regulation, it was simply an oversight. Inclusion of the one sentence article in the present regulation would not require a commissioner to undertake any action; it would simply give him the authority to do so, if future circumstances so warranted.

3. Sales materials -- (Article III, Section 4, page 4)

   Deletion of this section -- except for the overall prohibition against false and misleading sales material -- would integrate the workings of the Model Variable Life Insurance Regulation and the Model Life Insurance Advertising

Rules. The latter rules, adopted at the June 1975 NAIC meeting in Seattle, did not exist at the time of the adoption of the Variable Life Regulation. Since, at the suggestion of your subcommittee, they do cover the variable life insurance product, and are comprehensive in nature, it would seem most reasonable for the new rules, rather than separate requirements of another regulation, to govern advertising.

Also, the current provision conflicts with the Model Life Insurance Advertising Rules. It requires filing of sales material with the commissioner, who may disapprove its use. Such a prefiling requirement, which was deliberately kept out of the Model Life Insurance Advertising Rules, could obviously throw considerable hurdles in the way of an insurer's national advertising campaign, particularly if network television were contemplated.

4. Deferment of benefit payments – (Article IV, Section 3-o, page 11)

The revised provisions would limit the six month deferment right to fixed benefits, and in that respect would conform more closely to the NAIC Model Variable Contract Law, which makes inapplicable to variable life insurance certain provisions of the insurance law which do not fit variable life insurance. The six month deferment clause is part of the nonforfeiture provision of the insurance law. The model law (at the explanatory note to Section 5) makes "inapplicable any provisions of the Insurance Law requiring . . . nonforfeiture provisions," and, at Section 5, states that a variable life insurance contract "shall contain . . . nonforfeiture provisions appropriate to such contract."

The proposed change, of course, retains the insurer's right to defer in the case of a stock market emergency.

The blanket six month deferment right is inappropriate for variable life insurance, since at the time of any surrender or loan request, the levels of variable cash values will simply reflect the market value of the separate account assets at that time. In contrast, fixed benefit policies have cash values guaranteed in amount without regard to the market value of the assets supporting reserves and cash values. Thus, the forced liquidation of securities at a loss could impact on the solvency of the company. This is the primary reason for the six month deferment provision, which clearly should not be applicable to variable cash values.

I also point out, as I believe you are aware, that the proposed modification would be compatible with the so-called "seven day rule" under the 1940 Investment Company Act, which requires that variable proceeds be paid within a seven day period except in emergency situations. I must add, though, that wholly apart from this consideration, the proposed change has compelling merit, and would bring the model regulation into harmony with the Model Variable Life Insurance Law.

I urge, then, the the (C4) Subcommittee accept these four amendments at this meeting. They are designed to fill in gaps and to eliminate the more obvious, but nonetheless important, technical imperfections in the regulation. I believe they will strengthen the existing regulation, without in any way sacrificing desirable requirements.

Proposed Article IV, Section 3f

f. a provision that at any time during the first eighteen months of the variable life insurance policy, so long as premiums are duly paid the owner may exchange the policy for a policy of permanent fixed benefit life insurance on the life of the insured for the same initial amount of insurance as the variable life insurance policy and on a plan of insurance specified in the policy, provided that the new policy:

(1) shall bear the same date of issue and age at issue as the original variable life insurance policy;

(2) is issued on a substantially comparable [any] plan of permanent insurance offered in this state by the insurer or an affiliate on the date of issue of the variable life insurance policy and at the premium rates in effect on that date for the same class of insurance;

(3) includes such riders and incidental insurance benefits as were included in the original policy if such riders and incidental insurance benefits are issued with the fixed benefit policy. [If the conversion results in an increase or decrease in cash value, such increase or decrease will be payable to the insurer or the insured as the case may be.]

[(4) must apply as an advance premium on the new policy any excess of the accrued premium on the original variable life insurance policy from the date of issued to the date of request for exchange over the corresponding accrued premium on the new fixed benefit policy, except that any portion of such excess which is less than a regular mode premium on the new policy may either be applied as an advance premium or refunded in cash at the option of the insurer.]

(4) shall be issued subject to an equitable premium or cash value adjustment that takes appropriate account of the premiums and cash values under the original and new policies. A detailed statement of the method of computing such adjustment shall be filed with the commissioner.

(5) shall not require evidence of insurability for this exchange.

Proposed New Article X

ARTICLE X: FOREIGN COMPANIES

If the law or regulation in the place of domicile of a foreign company provides a degree of protection to the policyholders and the public which is substantially equal to that provided by these regulations, the commissioner, to the extent deemed appropriate by him in his discretion, may consider compliance with such law or regulation as compliance with these regulations.

Proposed Article III, Section 4

4. Use of Sales Materials: An insurer authorized to transact variable life insurance business in this state shall not use any sales material, advertising material, or descriptive literature or other materials of any kind in connection with its variable life insurance business in this state which is false, misleading, deceptive, or inaccurate.

[a. All variable life insurance sales material, advertising material, and descriptive literature shall be filed (___ business days prior to use) (within _____ business days after use) with the commissioner who shall require an insurer to cease the use of any such materials upon finding that any such materials are false, misleading, deceptive, or inaccurate. Revised versions of such materials containing changes of substantial import from versions on file with the commissioner shall be filed with the commissioner.

b. For purposes of this regulation, variable life insurance sales material, advertising material, or descriptive literature shall include but is not limited to:

(1) printed and published material, audio-visual material, and descriptive literature of an insurer used in direct mail, newspapers, magazines, radio scripts, TV and film scripts, billboards, and similar displays for variable life insurance;

(2) descriptive literature and sales aids of all kinds used to sell variable life insurance by or on behalf of an insurer or any person authorized to sell variable life insurance for presentation to members of the insurance-buying public, including but not limited to circulars, leaflets, booklets, depictions, illustrations and form letters, and

(3) prepared sales talks, presentations, and material for use in the sale of variable life insurance by any person authorized to sell variable life insurance.]

Proposed Article IV, Section 3-o

o. a provision that payment of variable death benefits in excess of the minimum death benefits, cash values, policy loans, or partial withdrawals (except when used to pay premiums) or partial surrenders may be deferred:

(1) for up to six months from the date of request if such payments are based on policy values which do not depend on the investment performance of the separate account or

(2) otherwise for any period during which the New York Stock Exchange is closed for trading (except for normal holiday closing) or when the Securities and Exchange Commission has determined that a state of emergency exists which may make such payment impractical;

AMERICAN LIFE INSURANCE ASSOCIATION
1730 Pennsylvania Avenue, N. W.
Washington, D. C. 20006

December 8, 1975

RECOMMENDED CHANGES* TO THE NAIC MODEL VARIABLE LIFE INSURANCE REGULATION

ARTICLE I: AUTHORITY

The following regulations applicable to variable life insurance policies are promulgated under the authority of Section ______, of the Insurance Laws of ______, and are effective ______.[1]

ARTICLE II: DEFINITIONS[2]

As used in this regulation:

1. "Affiliate" of an insurer means any person, directly or indirectly, controlling, controlled by, or under common control with such insurer; any person who regularly furnishes investment advice to such insurer with respect to its variable life insurance separate accounts for which a specific fee or commission is charged; or any director, officer, partner, or employee of any such insurer, controlling or controlled person, or person providing investment advice or any member of the immediate family of such person.

2. "Agent" means any person, corporation, partnership, or other legal entity which is licensed by this state as a life insurance agent.[3]

3. "Assumed investment rate" means the rate of investment return which would be required to be credited to a variable life insurance policy, after deduction of charges for taxes, investment expenses and mortality and expense guarantees to maintain the variable death benefit equal at all times to the amount of death benefit, other than incidental insurance benefits, which would be payable under the plan of insurance if the death benefit did not vary according to the investment experience of the separate account.

4. "Benefit base" means the amount, not less than the amount specified under Sec. 2b of Article VI, specified by the terms of the variable life insurance policy to which the difference between the net investment return and the assumed investment rate is applied in determining the variable benefits of the policy.

5. "Commissioner" (Director, Superintendent) means the Insurance Commissioner (Director, Superintendent) of this state.[4]

6. "Control" (including the terms "controlling," "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or nonmanagement services, or otherwise, unless the power is the result of an official position with or corporate office held by the person. Control shall be presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing more than ten (10) percent of the voting securities of any other person. This presumption may be rebutted by a showing made to the satisfaction of the Commissioner that control does not exist in fact. The Commissioner may determine, after furnishing all persons in interest notice and opportunity to be heard and making specific findings of fact to support such determination, that control exists in fact, notwithstanding the absence of a presumption to that effect.

7. "General account" means all assets of the insurer other than assets in separate accounts established pursuant to Section ______ of the Insurance Laws of this state,

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* Recommended deletions in brackets
Recommended additions underscored

or pursuant to the corresponding section of the Insurance Laws of the state of domicile of a foreign or alien insurer, whether or not for variable life insurance.

8. "Incidental insurance benefit" means all insurance benefits in a variable life insurance policy, other than the variable death benefit and the minimum death benefit, including but not limited to accidental death and dismemberment benefits, disability income benefits, guaranteed insurability options, family income, or fixed benefit term riders.

9. "May" is permissive.

10. "Minimum death benefit" means the amount of the guaranteed death benefit, other than incidental insurance benefits, payable under a variable life insurance policy regardless of the investment performance of the separate account.

11. "Net investment return" means the rate of investment return in a separate account to be applied to the benefit base after deduction of charges for taxes, investment expenses and mortality and expense guarantees in accordance with the terms of the policy.

12. "Person" means an individual, corporation, partnership, association, trust, or fund.

13. "Separate account" means a separate account established for variable life insurance pursuant to Section ______ of the Insurance Laws of this state or pursuant to the corresponding Section of the Insurance Laws of the State of domicile of a foreign or alien insurer.

14. "Shall" is mandatory.

15. "Variable death benefit" means the amount of the death benefit, other than incidental insurance benefits, payable under a variable life insurance policy dependent on the investment performance of the separate account, which the insurer would have to pay in the absence of the minimum death benefit.

16. "Variable life insurance policy" means any individual policy which provides for life insurance which varies according to the investment experience of any separate account or accounts established and maintained by the insurer as to such policy, pursuant to Section ______ of the Insurance Laws of this state or pursuant to the corresponding section of the Insurance Laws of the state of domicile of a foreign or alien insurer.

ARTICLE III: QUALIFICATION OF INSURER TO ISSUE VARIABLE LIFE INSURANCE

The following requirements are applicable to all insurers either seeking authority to issue variable life insurance in this state or which have authority to issue variable life insurance in this state.

1. **Licensing and Approval to Do Business in This State:** An insurer shall not deliver or issue for delivery in this state any variable life insurance policy unless:

a. the insurer is licensed or organized to do a life insurance business in this state;

b. either (1) the state of domicile of such insurer requires that permissible investments be substantially the same as provided in Section 3 of Article VI and that changes in the investment policy of the variable life insurance separate account be regulated in a manner substantially similar to that required under Article VI for such separate accounts operated by insurers domiciled in this state;[and] or (2) the insurer's investment policy, as described in the statement required to be filed under Subsection 2c of this Section, conforms to Section 3 of Article VI, and the Commissioner is satisfied that the procedures for changing the investment policy of a variable life insurance separate account, as described in the statement required to be filed under Subsection 2c of this Section, provide safeguards consistent with those provided under Section 6 of Article VI; and

c. the insurer has obtained the written approval of the Commissioner for the

Recommended deletions in brackets
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issuance of variable life insurance policies in this state. The Commissioner shall grant such written approval only after he has found that:

(1) the plan of operation for the issuance of variable life insurance policies is not unsound;

(2) the general character, reputation, and experience of the management and those persons or firms proposed to supply consulting, investment, administrative, or custodial services to the insurer are such as to reasonably assure competent operation of the variable life insurance business of the insurer in this state; and

(3) the present and foreseeable future financial condition of the insurer and its method of operation in connection with the issuance of such policies is not likely to render its operation hazardous to the public or its policyholders in this state. The Commissioner shall consider, among other things:

(A) the history of operation and financial condition of the insurer;

(B) the qualifications, fitness, character, responsibility, reputation, and experience of the officers and directors and other management of the insurer and those persons or firms proposed to supply consulting, investment, administrative, or custodial services to the insurer;

(C) the applicable law and regulations under which the insurer is authorized in its state of domicile to issue variable life insurance policies. The state of entry of an alien insurer shall be deemed its state of domicile for this purpose; and

(D) if the insurer is a subsidiary of, or is affiliated by common management or ownership with another company, its relationship to such other company and the degree to which the requesting insurer, as well as the other company, meet these standards.

2. **Filing for Approval to Do Business in This State:** Before any insurer shall deliver or issue for delivery any variable life insurance policy in this state, it must file with this Department the following information for the consideration of the Commissioner in making the determination required by Section 1, subsection c of this Article:

a. copies of and a general description of the variable life insurance policies it intends to issue;

b. a general description of the methods of operation of the variable life insurance business of the insurer, including the names of those persons or firms proposed to supply consulting, investment, administrative, or custodial services to the insurer;

c. with respect to any separate account maintained by an insurer for any variable life insurance policy, a statement of the investment policy the insurer intends to follow for the investment of the assets held in such separate account,[The statement] and a statement of the procedures for changing such investment policy. The statement of investment policy shall include a description of the investment objective and orientation intended for the separate account:

d. a description of any investment advisory services contemplated as required by Section 10 of Article VI;

e. if requested by the Commissioner, a copy of the statutes and regulations of the state of domicile of the insurer under which it is authorized to issue variable life insurance policies; and

f. if requested by the Commissioner, biographical data with respect to officers and directors of the insurer on the National Association of Insurance Com-

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missioners Uniform Biographical Data Form.

3. **Standards of Suitability.** Every insurer seeking approval to enter into the variable life insurance business in this state shall adopt by formal action of its Board of Directors and file with the Commissioner a written statement specifying the Standards of Suitability to be used by the insurer and applicable to its officers, directors, employees, affiliates, and agents with respect to the suitability of variable life insurance for the applicant. Such Standards of Suitability shall be binding on the insurer and those to whom it refers, and shall specify that no recommendation shall be made to an applicant to purchase a variable life insurance policy and that no variable life insurance policy shall be issued in the absence of reasonable grounds to believe that the purchase of such policy is not unsuitable for such applicant on the basis of information furnished after reasonable inquiry of such applicant concerning the applicant's insurance and investment objectives, financial situation and needs, and any other information known to the insurer or to the agent making the recommendation. Lapse rates for variable life insurance within the first two policy years which are significantly higher than both those encountered by the insurer or an affiliate thereof for corresponding fixed benefit life insurance policies and lapse rates of other insurers issuing variable life insurance policies shall be considered by the Commissioner in determining whether the guidelines adopted by the insurer are reasonable and also whether the insurer and its agents are engaging, as a general business practice, in the sale of variable life insurance to persons for whom it is unsuitable. For purposes of this subsection, conversions from variable life insurance to fixed benefit life insurance policies pursuant to this regulation shall not be considered lapses.

4. **Use of Sales Materials:** An insurer authorized to transact variable life insurance business in this state shall not use any sales material, advertising material, or descriptive literature or other materials of any kind in connection with its variable life insurance business in this state which is false, misleading, deceptive, or inaccurate.[5]

[a. All variable life insurance sales material, advertising material, and descriptive literature shall be filed (______ business days prior to use)[6] (within ______ business days after use)[7] with the Commissioner who shall require an insurer to cease the use of any such materials upon finding that any such materials are false, misleading, deceptive, or inaccurate. Revised versions of such materials containing changes of substantial import from versions on file with the Commissioner shall be filed with the Commissioner.

b. For purposes of this regulation, variable life insurance sales material, advertising material, or descriptive literature shall include but is not limited to:

(1) printed and published material, audio-visual material, and descriptive literature of an insurer used in direct mail, newspapers, magazines, radio scripts, TV and film scripts, billboards, and similar displays for variable life insurance;

(2) descriptive literature and sales aids of all kinds used to sell variable life insurance by or on behalf of an insurer or any person authorized to sell variable life insurance for presentation to members of the insurance-buying public, including but not limited to circulars, leaflets, booklets, depictions, illustrations, and form letters; and

(3) prepared sales talks, presentations, and material for use in the sale of variable life insurance by any person authorized to sell variable life insurance.]

5. **Requirements Applicable to Contractual Services**

a. Any contract between an insurer and suppliers of consulting, investment, ad-

Recommended deletions in brackets
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ministrative, sales, marketing, custodial, or other services which are material with respect to variable life insurance operations shall be in writing and provide that the supplier of such services shall furnish the Commissioner with any information or reports in connection with such services which the Commissioner may request in order to ascertain whether the variable life insurance operations of the insurer are being conducted in a manner consistent with these regulations and any other applicable law or regulations.

b. Such contract shall be fair and equitable to all parties and not endanger any policyholders of the insurer in this state.

c. Such contract shall not relieve the insurer from any responsibilities or obligations imposed upon the operations of its variable life insurance business by this regulation or any other law or regulation.

6. **Reports to the Commissioner:** Any insurer authorized to transact the business of variable life insurance in this state shall submit to the Commissioner, in addition to any other materials which may be required by this regulation or any other applicable laws or regulations:

a. an Annual Statement of the business of its variable life insurance separate account or accounts in such form as may be prescribed by the National Association of Insurance Commissioners; and

b. prior to the use in this state any Information Furnished to Applicants as provided for in Article VII; and

c. prior to the use in this state the form of any of the Reports to Policyholders as provided for in Article IX; and

d. such additional information concerning its variable life insurance operations or its variable life insurance separate accounts as the Commissioner shall deem necessary.

e. Any material submitted to the Commissioner under this Section shall be disapproved if it is found to be false, misleading, deceptive, or inaccurate in any material respect and, if previously distributed, the Commissioner shall require the distribution of an amended report.

7. **Authority of Commissioner to Disapprove:** Any material required to be filed with the Commissioner, or approved by him, shall be subject to disapproval if at any time it is found by him not to comply with the standards established by this regulation.

ARTICLE IV: INSURANCE POLICY REQUIREMENTS

Policy Qualification. The Commissioner shall not approve any variable life insurance form filed pursuant to this regulation unless it conforms to the requirements of this Article.

1. **Filing of Variable Life Insurance Policies:** All variable life insurance policies, and all riders, endorsements, applications and other documents which are to be attached to and made a part of the policy and which relate to the variable nature of the policy, shall be filed with the Commissioner and approved by him in writing prior to delivery or issuance for delivery in this state.

a. The procedures and requirements for such filing and approval shall be, to the extent appropriate and not inconsistent with this regulation, the same as those otherwise applicable to other life insurance policies.

b. The Commissioner may approve variable life insurance policies and related

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forms with provisions the Commissioner deems to be not less favorable to the policyholder and the beneficiary than those required by this regulation.

(c) the requirements of Sections [2a, 2d], 3e(1) [and 3(p)] of this Article shall not apply to variable life insurance policies and related forms issued in connection with pension, profit-sharing and retirement plans if separate accounts for such policies are exempt pursuant to Section 3(c)(11) of the Investment Company Act of 1940.

2. **Mandatory Policy Benefit and Design Requirements:** Variable life insurance policies delivered or issued for delivery in this state shall comply with the following minimum requirements:

a. [Coverage shall be provided for the lifetime of the insured with] [t]The mortality and expense risk shall be borne by the insurer.

b. Gross premiums for death benefits shall be a level amount for the duration of the premium payment period, but this subsection shall not be construed to prohibit temporary or permanent additional premiums for incidental insurance benefits or substandard risks. This subsection shall not be deemed to prohibit the use of fixed benefit preliminary term insurance for a period not to exceed 120 days from the date of the application for a variable life insurance policy. The premium rate for such preliminary term insurance shall be stated separately in the application or receipt.

c. A minimum death benefit shall be provided in an amount at least equal to the initial face amount of the policy so long as premiums are duly paid (subject to the provisions of Section 4b of this Article);

[d. The amount payable upon the death of the insured so long as premiums are duly paid (subject to the provisions of Section 4b of this article) shall be not less than a minimum multiple of the gross premium payable in that year, exclusive of that portion allocable to any incidental insurance benefit, by a person who meets standard underwriting requirements, as shown in the following table:

Issue Ages	Multiples
0—5	80
6—10	71
11—15	63
16—20	55
21—25	47
26—30	40
31—35	33
36—40	27
41—45	21
46—50	15
51—55	13
56—60	11
61—65	9
66—70	8
71 and over	7

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d. [e.]The policy shall provide that the variable death benefit shall reflect the investment experience of the variable life insurance separate account established and maintained by the insurer and that the excess, positive or negative, of the net in-

Recommended deletions in brackets
Recommended additions underscored

vestment return over the assumed investment rate, as applied to the benefit base of each variable life insurance policy, shall be used to provide [either]:

(1) fully paid-up variable life insurance providing coverage for the same period as the basic insurance under the policy or fully paid-up term insurance amounts for a term of annual periods of not less than one year nor more than five years, positive or negative, as the case may be, or a combination thereof; or

(2) variable life insurance amounts, positive or negative, as the case may be, so that the reserve maintains the same percentage relationship to the variable death benefit as it would have on a corresponding fixed benefit policy; or

(3) any other form of insurance benefits as the Commissioner may approve.

e. [f.] Each variable life insurance policy shall be credited with the full amount of the net investment return applied to the benefit base.

f. [g.] Changes in variable death benefits of each variable life insurance policy shall be determined at least annually.

g. [h.] The cash value of each variable life insurance policy shall be determined at least monthly. The method of computation of cash values and other non-forfeiture benefits, as described either in the policy or in a statement filed with the Commissioner of the state in which the policy is delivered, or issued for delivery, shall be in accordance with actuarial procedures that recognize the variable nature of the policy. The method of computation must be such that, if the net investment return credited to the policy at all times from the date of issue should be equal to the assumed investment rate with premiums and benefits determined accordingly under the terms of the policy, then the resulting cash values and other non-forfeiture benefits must be at least equal to the minimum values required by Section _____ of the Insurance Laws of this state (Standard Non-Forfeiture Law) for a fixed benefit policy with such premiums and benefits. The assumed investment rate shall not exceed the maximum interest rate permitted under the Standard Non-Forfeiture Law of this state. The method of computation may disregard incidental minimum guarantees as to the dollar amounts payable. Incidental minimum guarantees include, for example, but are not to be limited to, a guarantee that the amount payable at death or maturity shall be at least equal to the amount that otherwise would have been payable if the net investment return credited to the policy at all times from the date of issue had been equal to the assumed investment rate.

h. [i.] The computation of values required for each variable life insurance policy may be based upon such reasonable and necessary approximations as are acceptable to the Commissioner.

[j. (1) If the gross premiums for any variable life insurance policy delivered or issued for delivery in this state produce an excess of (A) over (B) as defined in (2) below, the present value as of the date of issue of the adjusted premiums used in determining the minimum cash values required by Section 2h of Article IV shall be decreased by such excess by decreasing each adjusted premium by a uniform percentage.

(2) The excess of (A) over (B) referred to in subsection (1) above shall be determined as of the date of issue on the basis of the mortality table and maximum rate of interest permitted by Section _____ of Insurance Laws of this state (Standard Non-Forfeiture Law); and

(A) is the present value of the gross premiums for the policy, decreased by one dollar per thousand of equivalent uniform amount for policies with an equivalent uniform amount of less than ten thousand, payable on an annual

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basis (exclusive of those portions of the gross premiums allocable to any incidental insurance benefits) by a person who meets standard underwriting requirements; and

(B) is the product of (1) times (2) where (1) is the present value of the maximum premium rates per thousand of insurance shown below payable at the beginning of each policy year to attained age 65 of the insured for issue ages below age 51, for fifteen years for issue ages 51 to 70 and for life for issue ages above age 70 and (2) is the ratio of (i) the present value of the benefits under the policy to (ii) the present value of an insurance of one thousand for the whole of life.

TABLE OF RATES

Age at Issue	Premium Rate	Age at Issue	Premium Rate
0	11.50	41	38.65
1	11.60	42	40.45
2	11.76	43	42.51
3	11.97	44	44.89
4	12.22	45	47.62
5	12.50	46	50.71
6	12.80	47	54.17
7	13.11	48	58.00
8	13.43	49	62.18
9	13.75	50	66.67
10	14.08	51	68.58
11	14.42	52	70.54
12	14.77	53	72.57
13	15.13	54	74.69
14	15.49	55	76.92
15	15.87	56	79.29
16	16.27	57	81.84
17	16.70	58	84.61
18	17.16	59	87.63
19	17.65	60	90.91
20	18.18	61	94.45
21	18.74	62	98.25
22	19.34	63	102.31
23	19.97	64	106.61
24	20.62	65	111.11
25	21.28	66	115.48
26	21.95	67	119.39
27	22.64	68	122.51
28	23.37	69	124.50
29	24.15	70	125.00
30	25.00	71	118.86
31	25.92	72	123.96
32	26.91	73	129.66
33	27.97	74	135.96
34	29.10	75	142.86

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Age at Issue	Premium Rate	Age at Issue	Premium Rate
35	30.30	76	150.36
36	31.55	77	158.46
37	32.84	78	167.16
38	34.17	79	176.46
39	35.56	80	186.36
40	37.04		

(3) For purposes of this Section, any portion of the premium set aside to support a guarantee that any surrender value shall not be less than a specified amount or for any other benefit that the Commissioner shall deem to be excludable, shall not be included.]

i. [k.] In determining the net investment return to be applied to the benefit base the insurer may deduct only the charges described in paragraphs (1), (2), (4) and (5) of Article VI, Section 7a.

3. **Mandatory Policy Provisions:** Every variable life insurance policy filed for approval in this state shall contain at least the following:

a. the cover page or pages corresponding to the cover page of each such policy shall contain:

(1) a prominent statement in either contrasting color or in boldface type at least four points larger than the type size of the largest type used in the text of any provision of that page, that the death benefit may be variable or fixed under specified conditions;

(2) a prominent statement in either contrasting color or in boldface type at least four points larger than the type size of the largest type size used in the text of any provision on that page that cash values may increase or decrease in accordance with the experience of the separate account subject to any specified minimum guarantees;

(3) a statement that the minimum death benefit will be at least equal to the initial face amount at the date of issue if premiums are duly paid and if there are no outstanding policy loans, partial withdrawals, or partial surrenders;

(4) the rule, or a reference to the policy provision, which describes the method for determining the variable amount of insurance payable at death;

(5) a captioned provision which provides that the policyholder may return the variable life insurance policy within 45 days of the date of the execution of the application or within 10 days of receipt of the policy by the policyholder, whichever is later, and receive a refund of all premium payments for such policy; and

(6) such other items as are currently required for fixed benefit life insurance policies and which are not inconsistent with this regulation.

b. a provision for a grace period of not less than thirty-one days from the premium due date which shall provide that where the premium is paid within the grace period, policy values will be the same, except for the deduction of any overdue premium, as if the premium were paid on or before the due date;

c. a provision that the policy will be reinstated at any time within two years from the date of default upon the written application of the insured and evidence of in-

Recommended deletions in brackets
Recommended additions underscored

surability, including good health, satisfactory to the insurer, unless the cash surrender value has been paid or the period of extended insurance has expired, upon the payment of any outstanding indebtedness arising subsequent to the end of the grace period following the date of default together with accrued interest theron to the date of reinstatement and payment of an amount not exceeding the greater of:

(1) all overdue premiums with interest at a rate not exceeding ________percent* per annum compounded annually and any [other] indebtedness in effect at the end of the grace period following the date of default with interest at a rate not exceeding________percent* per annum compounded annually; or

(2) 110% of the increase in cash surrender value resulting from reinstatement plus all overdue premiums for incidental insurance benefits with interest at a rate not exceeding ______percent * per annum compounded annually.

d. a full description of the benefit base and of the method of calculation and application of any factors used to adjust variable benefits under the policy;

e. a provision designating the separate account to be used and stating that:

(1) such separate account shall be used to fund only variable life insurance benefits, except to the extent permitted by Section 5c(6) of this Article;

(2) the assets of such separate account shall be available to cover the liabilities of the general account of the insurer only to the extent that the assets of the separate account exceed the liabilities of the separate account arising under the variable life insurance policies supported by the separate account; and

(3) the assets of such separate account shall be valued at least as often as any policy benefits vary but at least monthly.

f. a provision that at any time during the first eighteen months of the variable life insurance policy, so long as premiums are duly paid the owner may exchange the policy for a policy of permanent fixed benefit life insurance on the life of the insured for the same initial amount of insurance as the variable life insurance policy, and on a plan of insurance specified in the policy, provided that the new policy:

(1) shall bear the same date of issue and age at issue as the original variable life insurance policy;

(2) is issued on a substantially comparable [any] plan of permanent insurance offered in this state by the insurer or an affiliate on the date of issue of the variable life insurance policy and at the premium rates in effect on that date for the same class of insurance;

(3) includes such riders and incidental insurance benefits as were included in the original policy if such riders and incidental insurance benefits are issued with the fixed benefit policy[If the conversion results in an increase or decrease in cash value, such increase or decrease will be payable to the insurer or the insured as the case may be.]

[(4) must apply as an advance premium on the new policy any excess of the accrued premium on the original variable life insurance policy from the date of issue to the date of request for exchange over the corresponding accrued premium on the new fixed benefit policy, except that any portion of such excess which is less than a regular mode premium on the new policy may either be applied as an advance premium or refunded in cash at the option of the insurer.]

(4) shall be issued subject to an equitable premium or cash value adjustment that takes appropriate account of the premiums and cash values under the original and new policies. A detailed statement of the method of computing such adjustment shall be filed with the Commissioner.

(5) shall not require evidence of insurability for this exchange.

g. a provision that the policy and any papers attached thereto by the insurer, including the application if attached, constitute the entire insurance contract;

h. a designation of the officers of the insurer who are empowered to make an agreement or representation on behalf of the insurer and an indication that statements by the insured, or on his behalf, shall be considered as representations and not warranties.

i. an identification of the owner of the insurance contract;

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j. a provision setting forth conditions or requirements as to the designation, or change of designation, of a beneficiary and a provision for disbursement of benefits in the absence of a beneficiary designation;

k. a statement of any conditions or requirements concerning the assignment of the policy;

l. a description of any adjustments in policy values to be made in the event of misstatement of age or sex of the insured;

m. a provision that the policy shall be incontestable by the insurer after it has been in force for two years during the lifetime of the insured;

n. a provision stating that the investment policy of the separate account shall not be changed without the approval of the Insurance Commissioner of the state of domicile of the insurer, and that the approval process is on file with the Commissioner of this state;

o. a provision that payment of variable death benefits in excess of the minimum death benefits, cash values, policy loans, or partial withdrawals (except when used to pay premiums) or partial surrenders may be deferred:

(1) for up to six months from the date of request, if such payments are based on policy values which do not depend on the investment performance of the separate account, or

(2) otherwise, for any period during which the New York Stock Exchange is closed for trading (except for normal holiday closing) or when the Securities and Exchange Commission has determined that a state of emergency exists which may make such payment impractical.

[p. Settlement options which shall be provided on a fixed basis only;]

p. [q] a description of the basis for computing the cash surrender value under the policy shall be included. Such surrender value may be expressed as either:

(1) a schedule of cash value amounts per one thousand dollars of variable face amount at each attained age or policy year for at least 20 years from issue, or for the premium paying period, if less than 20 years; or

(2) one cash value schedule as described in paragraph (1) for the death benefit, or for each one thousand dollars of death benefit, which would be in effect if the net investment return is always equal to the assumed investment rate and a second schedule applicable to any adjustments to the death benefit (disregarding the minimum death benefit guarantee and term insurance amounts) if the net investment return does not equal the assumed investment rate at each age for at least 20 years from issue, or for the premium paying period if it is less than 20 years.

q. [r] Premiums for incidental insurance benefits shall be stated separately;

r. [s.] any other policy provisions required by this regulation;

s. [t] such other items as are currently required for fixed benefit life insurance policies and are not inconsistent with this regulation.*

4. **Non-Forfeiture, Partial Withdrawal, Policy Loan, and Partial Surrender Provisions:** Every variable life insurance policy delivered or issued for delivery in this state shall contain provisions which are not less favorable to the policyholders than the following:

a. A provision for non-forfeiture insurance benefits so that at least one such benefit is offered on a fixed basis from the due date of the premium in default.

(1) Variable extended term insurance may not be offered.

(2) A given non-forfeiture option need not be offered on both a fixed and a variable basis.

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(3) The insurer may establish a reasonable minimum cash surrender value below which any such non-forfeiture insurance options will not be available.

b. A provision for policy loans (which may at the option of the insurer be entitled and referred to as a partial withdrawal provision) not less favorable to the policyholder than the following:

(1) Up to 75% but if the loan is made from the general account not more than 90% of the policy's cash value may be borrowed;

(2) The amount borrowed, or any repayment thereof, shall not affect the amount of the premium payable under the policy.

(3) The amount borrowed shall bear interest at a rate not to exceed ______ %[10] per year compounded annually.

(4) Any indebtedness shall be deducted from the proceeds payable on death.

(5) Any indebtedness shall be deducted from the cash value upon surrender or in determining any non-forfeiture benefit.

(6) Whenever the indebtedness exceeds the cash value, the insurer shall give notice of intent to cancel the policy if the excess indebtedness is not repaid within thirty-one days after the date of mailing of such notice.

(7) The policy may provide that if, at any time, so long as premiums are duly paid, the variable death benefit is less than it would have been if no loan or withdrawal had ever been made, the policyholder may increase such variable death benefit up to what it would have been if there had been no loan or withdrawal by paying an amount not exceeding 110% of the corresponding increase in cash value and by furnishing such evidence of insurability as the insurer may request.

(8) The policy may specify a reasonable minimum amount which may be borrowed at any time but such minimum shall not apply to any automatic premium loan provision.

(9) No policy loan provision is required if the policy is under the extended insurance non-forfeiture option.

(10) In addition to the foregoing, the policy may contain a partial surrender provision; however, any such provision shall provide that the policyholder may request part of the cash value and both the variable and minimum death benefits will be reduced in proportion to the percentage of the cash value received by the policyholder and the premium for the remaining amount of insurance will also be reduced to the appropriate rates for the reduced amount of insurance. The policy may provide that a partial surrender provision shall not require the insurer to reduce the amount of the minimum death benefit to less than the lowest amount of minimum death benefit which would have been issued to the insured under the insurance plans of the insurer at the time the policy was issued. The policy must clearly provide that the policyholder has the option of electing to exercise the cash value privileges of the policy loan or partial withdrawal provision rather than the partial surrender provision.

(11) All policy loan, partial withdrawal, or partial surrender provisions shall be constructed so that variable life insurance policyholders who have not exercised such provision are not disadvantaged by the exercise thereof.

(12) Monies paid to the policyholders upon the exercise of any policy loan, partial withdrawal, or partial surrender provision shall be withdrawn from the separate account and shall be returned to the separate account upon repayment

Recommended deletions in brackets
Recommended additions underscored

except that a stock insurer may provide the monies for policy loans from the general account.

5. **Other Policy Provisions:** The following provisions may in substance be included in a variable life insurance policy or related form delivered or issued for delivery in this state:

a. An exclusion for suicide within _____ years of the policy issue date;

b. incidental insurance benefits may be offered on a fixed basis only;

c. policies issued on a participating basis shall offer to pay dividend amounts in cash. In addition, such policies may offer the following dividend options:

(1) the amount of the dividend may be credited against premium payments;

(2) the amount of the dividend may be applied to provide paid-up amounts of additional fixed benefit whole life insurance;

(3) the amount of the dividend may be applied to provide paid-up amounts of additional variable life insurance;

(4) the amount of the dividend may be deposited in the general account at a specified minimum rate of interest;

(5) the amount of the dividend may be applied to provide paid-up amounts of fixed benefit one-year term insurance;

(6) the amount of the dividend may be deposited as a variable deposit in the separate account if the separate account is exempt pursuant to Section 3(c)(11) of the Investment Company Act of 1940.

d. A provision allowing the policyholder to elect in writing in the application for the policy or thereafter an automatic premium loan on a basis not less favorable than that required of policy loans or partial withdrawals under Section 4 of this Article, except that a restriction that no more than two consecutive premiums can be paid under this provision may be imposed.

ARTICLE V: RESERVE LIABILITIES FOR VARIABLE LIFE INSURANCE

1. Reserve liabilities for variable life insurance policies shall be established under the Standard Valuation Law in accordance with actuarial procedures that recognize the variable nature of the benefits provided and any mortality guarantees.

2. Reserve liabilities for the guaranteed minimum death benefit shall be the reserve needed to provide for the contingency of death occurring when the guaranteed minimum death benefit exceeds the death benefit that would be paid in the absence of the guarantee, and shall be maintained in the general account of the insurer and shall be not less than the greater of the following minimum reserves:

a. The aggregate total of the term costs, if any, covering a period of one full year from the valuation date, of the guarantee on each variable life insurance contract, assuming an immediate one-third depreciation in the current value of the assets of the separate account followed by a net investment return equal to the assumed investment rate; or

b. The aggregate total of the "attained age level" reserves on each variable life insurance contract. The "attained age level" reserve on each variable life insurance contract shall not be less than zero and shall equal the "residue," as described in paragraph (1), of the prior year's "attained age level" reserve on the contract, with

Recommended deletions in brackets
Recommended additions underscored

any such "residue" increased or decreased by a payment computed on an attained age basis as described in paragraph (2) below.

(1) the "residue" of the prior year's "attained age level" reserve on each variable life insurance contract shall not be less than zero and shall be determined by adding interest at the valuation interest rate to such prior year's reserve, deducting the tabular claims based on the "excess," if any, of the guaranteed minimum death benefit over the death benefit that would be payable in the absence of such guarantee, and dividing the net result by the tabular probability of survival. The "excess" referred to in the preceding sentence shall be based on the actual level of death benefits that would have been in effect during the preceding year in the absence of the guarantee, taking appropriate account of the reserve assumptions regarding the distribution of death claim payments over the year.

(2) the payment referred to in Subsection 2b of this Article shall be computed so that the present value of a level payment of that amount each year over the future premium paying period of the contract is equal to (A) minus (B) minus (C), where (A) is the present value of the future guaranteed minimum death benefits, (B) is the present value of the future death benefits that would be payable in the absence of such guarantee, and (C) is any "residue," as described in paragraph (1), of the prior year's "attained age level" reserve on such variable life insurance contract. If the contract is paid-up, the payment shall equal (A) minus (B) minus (C). The amounts of future death benefits referred to in (B) shall be computed assuming a net investment return of the separate account which may differ from the assumed investment rate and/or the valuation interest rate but in no event may exceed the maximum interest rate permitted for the valuation of life insurance contracts.

c. The valuation interest rate and mortality table used in computing the two minimum reserves described in (a) and (b) above shall conform to permissible standards for the valuation of life insurance contracts. In determining such minimum reserve, the company may employ suitable approximations and estimates, including but not limited to groupings and averages.[11]

3. Reserve liabilities for all fixed incidental insurance benefits shall be maintained in the general account in amounts determined in accordance with the actuarial procedures appropriate to such benefit.

ARTICLE VI: SEPARATE ACCOUNTS

The following requirements apply to the establishment and administration of variable life insurance separate accounts:

1. **Establishment and Administration of Separate Accounts:** An insurer issuing variable life insurance in this state shall establish one or more separate accounts pursuant to Sections ______ of the Insurance Laws of this state.

a. If no law or other regulation provides for the custody of separate account assets and if the insurer itself is not the custodian of such assets, all contracts for such custody shall be in writing and the Commissioner of the insurer's state of domicile shall approve of both the terms of any such contract and the proposed custodian prior to the transfer of custody.

b. An insurer shall not without the prior written approval of the Commissioner employ in any material connection with the handling of separate account assets any person who:[12]

Recommended deletions in brackets
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(1) within the last ten years has been convicted of any felony or a misdemeanor arising out of such person's conduct involving embezzlement, fraudulent conversion, or misappropriation of funds or securities or involving violation of Sections 1341, 1342, or 1343 of Title 18, United States Code; or

(2) within the last ten years has been found by any state regulatory authority to have violated or has acknowledged violation of any provision of any state insurance law involving fraud, deceit, or knowing misrepresentation; or

(3) within the last ten years has been found by federal or state regulatory authorities to have violated or has acknowledged violation of any provision of federal or state securities laws involving fraud, deceit, or knowing misrepresentation.

c. All persons with access to the cash, securities, or other assets of the separate account shall be under bond in an amount of not less than $______.

d. If an insurer establishes more than one separate account for variable life insurance, justification for the establishment of each additional separate account shall also be filed with the Commissioner and shall be subject to his approval. [The creation of additional separate accounts to avoid lower maximum charges against the separate account is prohibited.]

e. The assets of such separate accounts established for variable life insurance policies shall be valued at least as often as variable benefits are determined but in any event at least monthly.

f. A separate account exempt pursuant to Section 3 (c)(11) of the Investment Company Act of 1940 because of the tax qualified status of the policies funded thereby shall not be used to fund other variable life insurance policies.

g. Except for separate accounts exempt pursuant to Section 3(c)(11) of the Investment Company Act of 1940, variable life insurance separate accounts shall not be used for variable annuities or for the investment of funds corresponding to dividend accumulations or other policyholder liabilities not involving life contingencies.

2. **Amounts in the Separate Account**

a. The insurer shall maintain in each variable life insurance separate account assets with a fair market value at least equal to the greater of the valuation reserves for the variable portion of the variable life insurance policies or the benefit base for such policies.

b. The benefit base of any variable life insurance policy as of the beginning of any valuation period shall not be less than the sum of the following factors after deducting amounts of any indebtedness pursuant to Section 4b of Article IV:

(1) the valuation net premium for such period for the variable portion of the policy minus the discounted cost of term insurance for such period, based on the tabular mortality and interest rates used in determining valuation reserves; and

(2) the valuation terminal reserve, for the variable portion of the policy, at the end of the immediately preceding valuation period adjusted for the net investment return of such preceding period.

c. In lieu of the minimum benefit base requirement specified above, an insurer may otherwise qualify under this Section if it can be demonstrated, to the satisfaction of the Commissioner, that the policy benefits obtained over a 20-year period from the date of issue by the use of the insurer's benefit base are at least substantially equivalent in value to the benefits obtained by the use of the minimum benefit base

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Recommended deletions in brackets
Recommended additions underscored

specified above. The Commissioner may specify the range of net investment return to be used in this demonstration.

d. Notwithstanding the actual reserve basis used for policies that do not meet standard underwriting requirements, the benefit base for such policies may be the same as for corresponding policies which do meet standard underwriting requirements.

3. **Investments by the Separate Account**

a. No sale, exchange, or other transfer of assets may be made by an insurer or any of its affiliates between any of its separate accounts or between any other investment account and one or more ot its separate accounts unless:

(1) in case of a transfer into a separate account, such transfer is made solely to establish the account or to support the operation of the policies with respect to the separate account to which the transfer is made; and

(2) such transfer, whether into or from a separate account, is made by a transfer of cash; but other assets may be transferred if approved by the Commissioner in advance.

b. Assets allocated to a variable life insurance separate account shall be held in cash or investments having a reasonably ascertainable market price. For purposes of this subsection, only the following shall be considered "investments having a reasonable ascertainable market price":

(1) liens in favor of the insurer against separate account policy reserves resulting from use by policyholders of cash values;

(2) securities listed and traded on the New York Stock Exchange, the American Stock Exchange, or regional stock exchanges or successors to such exchanges having the same or similar qualifications;

(3) securities listed on the NASDAQ System;

(4) shares of an investment company registered pursuant to the Investment Company Act of 1940. Where such an investment company issues book shares in lieu of share certificates, such book shares shall be deemed to be adequate evidence of ownership;

(5) obligations of or guaranteed by the United States Government, the Canadian government, any state, or municipality or governmental subdivision of a state;

(6) commercial paper issued by business corporations when the total of such paper issued by the corporation does not exceed in value a guaranteed short line of credit by a bank;

(7) certificates of deposit issued by financial institutions the deposits of which are insured by the FDIC or FSLIC; and

(8) new bond or debt issues which may reasonably be expected to be listed on an exchange regulated by the Securities Exchange Act of 1934.

c. Notwithstanding any other provision of law or the provisions of subsection b above, assets allocated to a variable life insurance separate account shall not be invested in:

(1) commodities or commodity contracts;

(2) put and call options or combinations of such options;

(3) short sales;

(4) purchases on margins;

(5) letter or restricted stock;

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(6) units or other evidences of ownership of a separate account of another insurer, except those registered under the Investment Company Act of 1940; or

(7) real estate other than shares of a real estate investment trust listed as described in subsection (2) above.

4. **Limitations on Ownership**

a. A variable life insurance separate account shall not purchase or otherwise acquire the securities of any issuer, other than securities issued or guaranteed as to principal and interest by the United States, if immediately after such purchase or acquisition the value of such investment, together with prior investments of such separate account in such security valued as required by these regulations, would exceed 10% of the value of the assets of the separate account. The Commissioner may waive this limitation in writing if he believes such waiver will not render the operation of the separate account hazardous to the public or the policyholders in this state.

b. No separate account shall purchase or otherwise acquire the voting securities of any issuer if as a result of such acquisition the insurer and its separate accounts, in the aggregate, will own more than 10% of the total issued and outstanding voting securities of such issuer. The Commissioner may waive this limitation in writing if he believes such waiver will not render the operation of the separate account hazardous to the public or the policyholders in this state or jeopardize the independent operation of the issuer of such securities.

c. The percentage limitation specified in subsection a of this Section shall not be construed to preclude the investment of the assets of separate accounts in shares of investment companies registered pursuant to the Investment Company Act of 1940 if the investments and investment policies of such investment companies comply substantially with the provisions of Section 3 of this Article and other applicable portions of this regulation.

5. **Valuation of Assets of a Variable Life Insurance Separate Account**

a. Investments of the separate account shall be valued at their market value on the date of valuation.

(1) Market value for investments traded on the recognized exchanges means the last reported sale price on the date of valuation. If there has been no sale on that date, the market value means the last reported bid quotation on the date of valuation.

(2) Market value for investments listed on the NASDAQ System means the last representative bid quotation on the valuation date. If an investment ceases to be listed but continues to be traded over the counter, it shall be valued at the lowest bid quotation as it appears on the National Quotation Bureau sheets.

(3) If the valuation date referred to in paragraphs (1) and (2) above is a day when the exchange or the NASDAQ System is not open for business, the valuation date shall be the last date when the exchange or the NASDAQ System was open for business.

b. If an investment ceases to be traded, it shall be valued at fair value as determined in good faith by or at the direction of the Committee of the Separate Account, or, if there is no such Committee, the Board of Directors of the insurer but not in excess of the last reported bid quotation. Within thirty days notification of cessation of trading of any investment shall be reported by the insurer to the Insurance Commissioner of the state of domicile of the insurer. Such Commissioner shall within a reasonable period of time determine the method of valuation or disposition of such investment.

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6. Separate Account Investment Policy

a. The investment policy of a separate account operated by a domestic insurer filed under Section 2c of Article III shall not be changed without the approval of the Insurance Commissioner and any approval of variable life insurance policyholders that may be required under the Investment Company Act of 1940.

b. With respect to changes of investment policy for which the Commissioner must give his approval, the following regulations shall apply:

(1) Such approval shall be deemed to be given sixty days after the date the request for approval was filed with the Commissioner, unless he notifies the insurer before the end of such sixty-day period of his determination that the proposed change is a material change in the investment policy.

(2) If the change is deemed material by the Commissioner, he shall approve such change only if he determines [after a public hearing,] that the change does not appear detrimental to the interest of the policyholders of the insurer or adverse to the operations of the insurer.

[(3) At least thirty days prior to any public hearing under paragraph (2), the insurer shall mail a notice to each policyholder and to the Insurance Commissioner of each state in which the affected variable life insurance policies are being sold. Such notice shall describe the proposed change in investment policy, list the reasons therefor, designate the date and place of the public hearing, inform the policyholder of the procedures to be followed in commenting on the change, and describe the conduct of the meeting. Any such notice shall be in a form approved by the Commissioner.

(4) Within sixty days after such public hearing, the Commissioner must approve or deny the proposed change in investment policy.

(5) Should any policyholder object to the proposed change and the change is allowed by the Commissioner, the objecting policyholder shall be given the option within sixty days of notification to the policyholder of the approval by the Commissioner of such change, of converting, without evidence of insurability, under one of the following options, to a fixed benefit life insurance policy issued by the insurer or an affiliate:]

(3) If a proposed change of investment policy is deemed material by the Commissioner, any policyholder objecting to such change shall be given the right to request that, within sixty days of the effective date of the change, his policy be converted without evidence of insurability, under one of the following options, to a fixed benefit life insurance policy issued by the insurer or an affiliate:

(A) If the policy is in force on a premium paying basis, either:

(i) conversion as of the original issue age to a substantially comparable permanent form of fixed benefit life insurance, based on the insurer's premium rates for fixed benefit life insurance at the original issue age, for an amount of insurance not exceeding the death benefit of the variable life insurance policy on the date of conversion; or

(ii) conversion as of the attained age to a substantially comparable permanent form of fixed benefit life insurance for an amount of insurance not exceeding the excess of the death benefit of the variable life insurance policy on the date of conversion over:

(aa) its cash value on the date of conversion if the policyholder elects to surrender the variable life policy for its cash value, or

(bb) the death benefit payable under any paid-up insurance option if the policyholder elects such nonforfeiture option under the variable life policy.

(B) If the policy is in force as paid-up variable life insurance, then conversion will be to a substantially comparable paid-up fixed benefit life insurance policy for an amount of insurance not exceeding the death benefit of the variable life insurance policy on the date of conversion.

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If conversion is made pursuant to (A)(i) or (B) above, then there will be an equitable premium or cash value adjustment that takes appropriate account of the premiums and cash values under the original and new policies. A detailed statement of the method of computing such adjustment shall be filed with the Commissioner. [(1) if the cash value of the variable life insurance policy exceeds the cash value of the fixed benefit life insurance policy, the difference shall be paid to the policyholder; (2) if the cash value of the fixed benefit life insurance policy exceeds the cash value of the variable life insurance policy, the difference shall be paid by the policyholder; and (3) any indebtedness under the variable life insurance policy shall become indebtedness under the fixed benefit policy, provided that any excess of such indebtedness over the cash value of the fixed benefit policy on the date of conversion shall be deducted from any amount otherwise payable to the policyholder.]

7. **Charges Against a Variable Life Insurance Separate Account**

a. The insurer may deduct only the following from the separate account:

(1) taxes or reserves for taxes attributable to investment gains and income of the separate account;

(2) actual cost of reasonable brokerage fees and similar direct acquisition and sales costs incurred in the purchase or sale of separate account assets;

(3) actuarially determined costs of insurance (tabular costs) and the release of reserves and benefit base consistent with the release of separate account liabilities;

(4) charges for investment management expenses, including internal costs attributable to the investment management of assets of the separate account at a rate not in excess of that stated in the policy. [not exceeding the following percentages, on an annual basis, of the average net asset value of the separate account as of the dates of valuation under Section 1e of this Article:

(A) .75% of that portion of separate account assets valued at or under $75,-000,000; and

(B) .50% of that portion of separate account assets valued in excess of $75,-000,000 but less than $150,000,000; and

(C) .40% of that portion of separate account assets valued in excess of $150,-000,000 but less than $400,000,000; and

(D) .35% of that portion of separate account assets valued in excess of $400,-000,000 but less than $800,000,000; and

(E) .30% of that portion of separate account assets valued in excess of $800,000,000.]

(5) [A charge, at the rate specified in the policy, not to exceed .50% per year of the average net asset value of the separate account as of the dates of valuation under Section 1e of this Article.] Charges for mortality and expense guarantees at a rate not in excess of that stated in the policy.

(6) Any amounts in excess of those required to be held in the separate account.

b. Any charges against the separate account made by either an affiliate of the insurer or an unaffiliated fund shall be considered part of the charges limited by paragraphs (4) and (5) of subsection a above. Any charge against the separate account, excluding taxes, shall not vary in accordance with the difference between the investment performance of the separate account and any index of securities prices or other measure of investment performance.

8. **Standards of Conduct:** Every insurer seeking approval to enter into the variable life insurance business in this state shall adopt by formal action of its Board of Directors and file with the Commissioner a written statement specifying the Standards of Conduct of the insurer, its officers, directors, employees, and affiliates with respect to investments of variable life insurance separate accounts and variable life insurance

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operations. Such Standards of Conduct shall be binding on the insurer and those to whom it refers[and must contain at a minimum the items contained in subsection 9b of this Article.]

9. **Conflicts of Interest**

a. Rules under any provision of the Insurance Laws of this state or any regulation applicable to the officers and directors of insurance companies with respect to conflicts of interest shall also apply to members of any separate account's committee or other similar body. No officer or director of such company nor any member of any managing committee or body of a separate account shall receive directly or indirectly any commission or any other compensation with respect to the purchase or sale of assets of such separate account.[The Board of Directors of the insurer shall be responsible for all acts concerning the separate account.]

[b. Unless otherwise approved in writing by the Commissioner in advance of the transaction, with respect to variable life insurance separate accounts, an insurer or affiliate thereof shall not:

(1) sell to or purchase from any such separate account established by the insurer any securities or other property, other than variable life insurance policies;

(2) purchase or allow to be purchased for any such separate account any securities of which the insurer or an affiliate is the issuer;

(3) accept any compensation, other than a regular salary or wages from such insurer or affiliate, for the sale or purchase of securities to or from any such separate account other than as provided in Section 9c(3) of this Article;

(4) engage in any joint transaction, participation, or common undertaking whereby such insurer or an affiliate participates with such a separate account in any transaction in which an insurer or any of its affiliates obtains an advantage in the price or quality of the item purchased, in the service received, or in the cost of such service and the insurer or any of its other affiliates is disadvantaged in any of these respects by the same transaction;

(5) borrow money or securities from any such separate account other than under a policy loan provision.]

<u>b.</u> [c.]No provision of this regulation shall be construed to prohibit:

(1) the investment of separate account assets in securities issued by one or more investment companies registered pursuant to the Investment Company Act of 1940 which is sponsored or managed by the insurer or an affiliate, and the payment of investment management or advisory fees on such assets;

[(2) the combination of orders for the purchase or sale of securities for the insurer, an affiliate thereof, any separate accounts, or any one or more of them, which is for their mutual benefit or convenience so long as any securities so purchased or the proceeds of any sale thereof are allocated among the participants on some predetermined basis expressed in writing which is designed to assure the equitable treatment of all participants;]

<u>(2)</u> [(3)]an insurer or an affiliate to act as a broker or dealer in connection with the sale of securities to or by such separate account;[h]owever, any commission, fee or remuneration charged therefor shall not exceed the minimum broker's commission established for any such transaction by any national securities exchange through which such transaction could be effected, or where such charges are subject to negotiation or where no minimum charge is applicable, then such

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Recommended additions underscored

charge shall be consistent with the charges prevailing in the ordinary course of business in the community where such transaction is effected;]

(3) [(4)]the rendering of investment management or investment advisory services by an insurer or affiliate, for a fee, subject to the provisions of this regulation.

[d. The Commissioner may, upon the written request of an insurer or an affiliate, approve a particular transaction or series of proposed transactions which would otherwise be prohibited under subsection b if he determines such transaction is not unfair or inequitable to persons affected under the circumstances of such transactions]

10. **Investment Advisory Services to a Separate Account**

a. An insurer shall not enter into a contract under which any person undertakes, for a fee, to regularly furnish investment advice to such insurer with respect to <u>any of</u> its separate accounts maintained for variable life insurance policies unless:

(1) the person providing such advice is registered as an investment adviser under the Investment Advisers Act of 1940; or

<u>(2) the person providing such advice is an investment manager under the Employee Retirement Income Security Act of 1974 with respect to the assets of each employee benefit plan allocated to the separate account; or</u>

<u>(3)</u>[(2)]the insurer has filed with the Commissioner and continues to file annually the following information and statements concerning the proposed adviser:

(A) the name and form of organization, state of organization, and its principal place of business;

(B) the names and addresses of its partners, officers, directors, and persons performing similar functions or, if such an investment adviser be an individual, of such individual;

(C) a written Standard of Conduct complying in substance with the requirements of Section 8 of this Article which has been adopted by the investment adviser and is applicable to the investment adviser, its officers, directors, and affiliates;

(D) a statement provided by the proposed adviser as to whether the adviser or any person associated therewith:[13]

(i) has been convicted within ten years of any felony or misdemeanor arising out of such person's conduct as an employee, salesman, officer or director of an insurance company, a bank, an insurance agent, a securities broker, or an investment adviser; involving embezzlement, fraudulent conversion, or misappropriation of funds or securities, or involving the violation of Sections 1341, 1342, or 1343 or Title 18 of the United States Code;

(ii) has been permanently or temporarily enjoined by order, judgement, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, or dealer, or as an affiliated person or as an employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity;

(iii) has been found by federal or state regulatory authorities to have willfully violated or has acknowledged willful violation of any provision of federal or state securities laws or state insurance laws or of any rule or regulation under any such laws; or

(iv) has been censured, denied an investment adviser registration, had a registration as an investment adviser revoked or suspended, or been barred

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or suspended from being associated with an investment adviser by order of federal or state regulatory authorities; and

(3) such investment advisory contract shall be in writing and provide that it may be terminated by the insurer without penalty to the insurer or the separate account upon no more than sixty days' written notice to the investment adviser]

b. The Commissioner may, after notice and opportunity for hearing, by order require such investment advisory contract to be terminated if he deems continued operation thereunder to be hazardous to the public or the insurer's policyholders.

ARTICLE VII: INFORMATION FURNISHED TO APPLICANTS

An insurer delivering or issuing for delivery in this state any variable life insurance policies shall deliver to the applicant for the policy, and obtain a written acknowledgement of receipt from such applicant coincident with or prior to the execution of the application, [the following information. The requirements of this Article shall be deemed to have been satisfied by the delivery to the applicant of] a prospectus included in a registration statement relating to the policies which satisfies the requirements of the Securities Act of 1933 and which was declared effective by the Securities and Exchange Commission , or if the policies are exempted from the registration requirements of such Act by Section 3(a)(2) thereof, the insurer shall furnish all information and reports required by the Employee Retirement Income Security Act of 1974 [to the extent that the prospectus contains the information required by this Article.

1. A summary explanation, in non-technical terms, of the principal features of the policy, including a description of the manner in which the variable benefits will reflect the investment experience of the separate account and the factors which affect such variation. Such explanation must include notices of the provisions required by Article IV Sections 3a(5) and 3f;

2. a statement of the investment policy of the separate account, including:

a. a description of the investment objective and orientation intended for the separate account and the principal types of investments intended to be made; and

b. any restriction or limitations on the manner in which the operations of the separate account are intended to be conducted.

3. A statement of the net investment return of the separate account for each of the last ten years for which the separate account was in existence;

4. a statement describing, as an approximate percentage of an annual gross premium for each year and for the life of the policy all commission or equivalent payments to be paid to all agents or other persons as a result of the proposed sale for each year of the policy for which such payments are to be made. As used in this Section, "commissions" means all monies and other valuable consideration, including but not limited to prizes, bonuses paid directly or indirectly to, for, or on behalf of the selling agent as compensation for services in the sale of variable life insurance;

5. a statement of the annual taxes, brokerage fees, and similar costs, and the charges, expressed as an annual percentage, levied against the separate account during the previous year;

6. a summary of the method to be used in valuing assets held by the separate account;

7. a summary of the federal income tax liabilities of the policy applicable to the insured, the policy owner, and the beneficiary;

8. if the applicant is furnished illustrations of benefits payable under any variable

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life insurance contract, such illustrations shall be prepared by the insurer and shall not include projections of past investment experience into the future or attempted predictions of future investment experience, provided that nothing contained herein prohibits use of hypothetical assumed rates of return to illustrate possible levels of benefits if it is made clear that such assumed rates are hypothetical only;

9. a prominent statement either in contrasting color or in boldface type at least four points larger than the type size of the largest type used in the text of any provision on the page, providing in substance the following information:

> The purpose of this variable life insurance policy is to provide insurance protection for the beneficiary named therein.
>
> No claim is made that this variable life insurance policy is in any way similar or comparable to a systematic investment plan of a mutual fund.]

ARTICLE VIII: APPLICATIONS

The application for a variable life insurance policy shall contain:

1. a prominent statement that the death benefit may be variable or fixed under specified conditions;

2. a prominent statement that cash values may increase or decrease in accordance with the experience of the separate account (subject to any specified minimum guarantees);

3. questions designed to elicit information which enables the insurer to determine the suitability of variable life insurance for the applicant.

ARTICLE IX: REPORTS TO POLICYHOLDERS

Any insurer delivering or issuing for delivery in this state any variable life insurance policies shall mail to each variable life insurance policyholder at his or her last known address the following reports:

1. Within thirty days after each anniversary of the policy, a statement or statements of the cash surrender value, death benefit, any partial withdrawal or policy loan, any interest charge, and any optional payments allowed pursuant to Section 4 of Article IV under the policy computed as of the policy anniversary date. Provided, however, that such statement may be furnished within thirty days after a specified date in each policy year so long as the information contained therein is computed as of a date not more than forty-five days prior to the mailing of such notice. This statement shall state in contrasting color or distinctive type that, in accordance with the investment experience of the separate account, the cash values and the variable death benefit may increase or decrease, and shall prominently identify any value described therein which may be recomputed prior to the next statement required by this Section. If the policy guarantees that the variable death benefit on the next policy anniversary date will not be less than the variable death benefit specified in such statement, the statement shall be modified to so indicate.

2. Annually, a statement or statements including:

a. a summary of the financial statement of the separate account based on the annual statement last filed with the Commissioner;

b. the net investment return of the separate account for the last year and, for each year after the first, a comparison of the investment rate of the separate ac-

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count during the last year with the investment rate during prior years, up to a total of five years when available;

c. a list of investments held by the separate account as of a date not earlier than the end of the last year for which an annual statement was filed with the Commissioner;

d. any charges, taxes, and brokerage fees determined on an accrual basis payable by the separate account during the previous year, each expressed as a dollar amount and a percentage and the total expressed as a dollar amount and as a percentage, of the assets of the separate account;

e. a statement of the portfolio turnover rate as defined herein during the preceding fiscal year of investments allocated to the separate account.

(1) The rate shall be calculated by dividing (A) the lesser of purchases or sales of portfolio securities for the particular fiscal year by (B) the monthly average of the value of the portfolio securities owned by the separate account during the particular fiscal year. Such monthly average shall be calculated by totaling the values of the portfolio securities as of the beginning and end of the first month of the particular fiscal year and as of the end of each of the succeeding eleven months, and dividing the sum by 13, except that the average value of securities for which market quotations are not available may be based upon the value of such securities as of the end of the preceding fiscal quarters.

(2) For the purposes of this item, there shall be excluded from both the numerator and the denominator all U.S. Government securities (short-term and long-term) and all other securities whose maturities at the time of acquisition were one year or less. Purchases shall include any cash paid upon the conversion of one portfolio security into another. Purchases shall also include the cost of rights or warrants purchased. Sales shall include the net proceeds of the sale of rights or warrants. Sales shall also include the net proceeds of redemptions of portfolio securities by call or maturity.

(3) The insurer shall show, in addition to the calculated portfolio turnover rate, both the amount of the purchases and the amount of the sales (calculated as prescribed in (2) above) and the monthly average (but not the individual monthly figures) of the value of the portfolio securities owned by the separate account during the fiscal year.

(4) The insurer may, if it wishes, make any statement or explanation with respect to any significant variations in the portfolio turnover rate during the three fiscal years next preceding.

f. a statement of any change, since the last report, in the investment objective and orientation of the separate account, in any investment restriction or material quantitative or qualitative investment requirement applicable to the separate account, or in the investment adviser of the separate account;

g. the name of each broker or dealer handling portfolio transactions on behalf of the separate account in which the insurer or an affiliate has any material direct or indirect interest and the nature of such transactions and the amount of compensation received by each such broker or dealer from business originating with the separate account during the preceding fiscal year;

h. the names and principal occupations of each principal executive officer and each director of the insurer; and

i. the names of all parents of the insurer and the basis of control of the insurer,

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Recommended deletions in brackets
Recommended additions underscored

and the name of any person who is known to own, of record or beneficially, 10% or more of the outstanding voting securities of the company.

ARTICLE X: FOREIGN COMPANIES

If the law or regulation in the place of domicile of a foreign company provides a degree of protection to the policyholders and the public which is substantially equal to that provided by these regulations, the Commissioner, to the extent deemed appropriate by him in his discretion, may consider compliance with such law or regulation as compliance with these regulations.

XI ARTICLE [X]: QUALIFICATION OF AGENTS FOR THE SALE OF VARIABLE LIFE INSURANCE

1. **Qualifications to Sell Variable Life Insurance**

a. No person may sell or offer for sale in this state any variable life insurance policy unless such person is an agent and has filed with the Commissioner, in a form satisfactory to the Commissioner, evidence that such person holds any license or authorization which may be required for the solicitation or sale of variable life insurance by any federal or state securities law.

b. Any examination administered by the Department for the purpose of determining the eligibility of any person for licensing as an agent shall, after the effective date of this regulation, include such questions concerning the history, purpose, regulation, and sale of variable life insurance as the Commissioner deems appropriate.

2. **Reports of Disciplinary Actions:** Any person qualified in this state under this Article to sell or offer to sell variable life insurance shall immediately report to the Commissioner:

a. any suspension or revocation of his agent's license in any other state or territory of the United States;

b. the imposition of any disciplinary sanction, including suspension or expulsion from membership, suspension, or revocation of or denial of registration, imposed upon him by any national securities exchange, or national securities association, or any federal, state, or territorial agency with jurisdiction over securities or variable life insurance;

c. any judgement or injunction entered against him on the basis of conduct deemed to have involved fraud, deceit, misrepresentation, or violation of any insurance or securities law or regulation.

3. **Refusal to Qualify Agent to Sell Variable Life Insurance. Suspension, Revocation, or Nonrenewal of Qualification:** The Commissioner may reject any application or suspend or revoke or refuse to renew any agent's qualification under this Article to sell or offer to sell variable life insurance upon any ground that would bar such applicant or such agent from being licensed to sell other life insurance contracts in this state. The rules governing any proceeding relating to the suspension or revocation of an agent's license shall also govern any proceeding for suspension or revocation of an agent's qualification to sell or offer to sell variable life insurance.

XII ARTICLE [XI]: SEPARABILITY ARTICLE

If any provision of this regulation or the application thereof to any person or circumstance is for any reason held to be invalid, the remainder of the regulation and the application of such provision to other persons or circumstances shall not be affected thereby.

Recommended deletions in brackets
Recommended additions underscored

DRAFTING NOTES

[1]The blank portions of this article should be completed with appropriate references to the selection of the Variable Contract Law authorizing promulgation of regulations and to appropriate additional citations such as the general rule-making authority of the Commissioner.

[2]Each definition should be reviewed to assure that the definition corresponds to the actual language used by the statutes of the particular state. Additional definitions may be necessary.

[3]Those states which have life insurance brokers and/or solicitors should modify the definition of agent to include them.

[4]Each state should modify the term "Commissioner" so that it corresponds to the correct title of the insurance regulatory official in the state where this regulation is adopted.

[[5]Those states which do not wish to have sales material filed may make appropriate amendments to this Section.

[6]Those states which desire filing prior to use should include this provision and insert the desired number of days.

[7]Those states which desire use and file should use this provision and insert a maximum time period after use for filing.]

[8]Each state should word this provision to reflect the maximum permissible rates of interest for reinstatement and policy loans, if state law provides therefor.[E.G., if one rate applies to both, such rate should be inserted in the blank space. If a state has different rates, then in the text of 3c(1), after "per annum" insert "for overdue premiums and at a rate not exceeding _____ percent per annum on indebtedness", filling the blanks accordingly.]

[9]The provisions of this Section having corresponding provisions in fixed life insurance regulation should be revised to conform to those corresponding provisions to the extent appropriate.

[10]Each state should fill this blank with its maximum permissible policy loan interest rate.

[11]At the December, 1972 meeting of the NAIC, this Section was adopted as an amendment to the model variable contract regulation with a proviso that the reserve calculation basis would be applicable for a five-year period only. The minutes of the (C4) Subcommittee indicate that the amendment was adopted "*in order that a basis for reserves could be created now and that results* of the accumulated statistics over a five-year period would be available for testing and credibility."

[12]This subsection should be modified to conform to state laws concerning previous convictions, if necessary.

[13]This subparagraph should be modified to conform to state laws concerning previous convictions, if necessary.

Recommended deletions in brackets
Recommended additions underscored

November 11, 1975

To: Members of the NAIC Executive Committee

Re: Variable Life Insurance Litigation with the SEC

From: Jon S. Hanson, Executive Secretary – Director of Research
Richard A. Hemmings, Counsel

Pursuant to the discussion and directions at the Executive Committee meeting in Carson City, July 31-August 1, 1975, we have reviewed the question as to whether the NAIC should litigate the issue of whether the SEC has jurisdiction over variable life insurance (VLI). This memorandum is our response to that direction. In discussing this question, the memorandum covers the present (1) regulatory situation, (2) synopsis of the federal securities laws, (3) reasons why the NAIC should litigate, (4) reasons why the NAIC should not litigate and (5) recommendation.

VARIABLE LIFE LITIGATION WITH THE SEC

I. PRESENT REGULATORY SITUATION

After failure to obtain from the SEC, through informal efforts, an exemption for VLI from the federal securities laws, the predecessors to the ALIA formally petitioned the SEC for such exemption therefrom in November, 1971. In its rules adopted January 1973, the SEC determined that even though VLI is a security and that a VLI separate account is an investment company, the SEC would refrain from regulating except for registration and disclosure requirements under the Securities Act of 1933. The SEC release included the commentary that it anticipated state regulation to provide relevant investor (VLI policyholder) protections. However, the SEC indicated that it would monitor state regulation of VLI and that it reserved the right to change its regulatory posture. This decision was made during the term of Mr. Casey, as Chairman of the SEC, who thereafter shortly left the Commission.

Even though no VLI policy had been marketed and no changes in the underlying circumstances occurred (other than the mutual funds appealing the ruling to the Court of Appeals), under its new Chairman Garrett, in September 1973, the SEC proposed to amend its earlier rules. In essence the proposal would condition VLI exemptions on SEC prior approval of state VLI regulation as being substantially equivalent to the relevant protections of the Investment Company Act of 1940. Then, in February 1975, again after no marketing activity or changed circumstances, the SEC announced rescission of the original rules and a proposal to define specific exemptions designed to accommodate VLI under the federal securities laws. Subsequently, EVLICO, a subsidiary of Equitable Life Assurance Society, obtained an order granting it certain exemptions. EVLICO is expected to commence marketing in the near future.

In short, after four years of hearings, adoption of rules, new proposals, recission of rules and litigation, we are approximately at the same point we started—i.e., SEC determination that it will regulate variable life insurance as a security under the 1933 Act and the separate account underlying VLI as an investment company under the 1940 Act.

II. SYNOPSIS OF FEDERAL SECURITIES LAWS

As background to a better understanding of the potential implications involved in applying the several securities laws to life insurance, a brief review of the scope of such laws may be helpful.

1. Securities Act of 1933.

The Securities Act was designed to afford potential investors an adequate informational basis so as to be able to determine what new securities offerings are good investments and to prevent misrepresentation and fradulent practices in the sale of securities. The regulatory essence of the 1933 Act is the principle of disclosure. The facts which the prudent investor needs for investment analysis are to be presented by the issuer of the securities. (Theoretically, the actual merits of the security are of no concern to the SEC. Practically, however, the Commission's power over what has to be disclosed can be used as an indirect means to regulate the merits of the security.) The disclosure objective is achieved by requiring the filing of a detailed registration statement and requires use of a prospectus during marketing which sets forth relevant financial and investment data. The 1933 Act also contains antifraud and civil liability provisions applicable to the sale of securities.

2. Securities Exchange Act of 1934.

Whereas the Securities Act of 1933 focuses on the initial distribution process, the Securities Exchange Act of 1934 concentrates on post distribution trading. It has five general purposes. (1) The 1934 Act attempts to achieve disclosure by requiring (a) a registration statement to be filed with a securities exchange for a listed security or with the SEC[1] for securities to be traded over the counter, (b) issuers of registered securities to file periodic reports to keep information up to date, (c) compliance with SEC proxy rules and (d) compliance with insider trading rules. (2) The 1934 Act contains several provisions designed to control the manipulation of the securities markets. (3) The SEC is authorized to regulate securities exchanges. (4) The SEC also controls the OTC market (i.e., distribution and trading of securities other than on an exchange) by regulating the brokers who must register and are subject to disciplinary action for violation of various requirements. Brokers must meet certain standards relating to training and experience and must pass a general securities examination. (5) In addition, the SEC is involved in controlling the use of credit on the securities markets. The primary relevance of the 1934 Act to the VLI is the Commission's control over the brokers (or VLI agents in insurance terminology).

3. Investment Company Act of 1940.

Whereas the 1933 Act places heavy reliance on disclosure and the 1934 Act relies on disclosure with some regulatory provisions, the 1940 Act is primarily a regulatory tool designed for an industry whose abuses were thought to require measures more restrictive than mere disclosure. An investment company is an issuer of securities that engages primarily in the business of investing, reinvesting and trading in securities (e.g., mutual fund, variable annuity separate account). There are various types of investment companies including a "diversified open end" investment company (mutual fund) which offers redeemable shares that represent a fluctuating interest in a pool of securities. Since the liquid and readily negotiable nature of an investment companies assets offers a tempting target for exploiters, the 1940 Act was designed to eliminate certain conditions such as the lack of information; the organization, operation and management of investment companies for the interest of persons other than the securities holders; and inequitable methods and concentration of control. The essential thrust of the 1940 Act is to prevent private profit by investment managers at the expense of investors whose money is at risk. To do so, the Act encompasses six main areas.

(a) Disclosure is required through the technique of registration statements concerning the investment company.

(b) The Act attempts to assure honest and unbiased management by improving requirements concerning the make up of the investment company's board of directors so as to assure some degree of independent management and by prohibitions against self dealing.

(c) The Act reflects the concept of shareholder democracy by imposing, in addition to the right of security holders to elect the board of directors, special voting rights. That is, investment policy may not be changed without majority vote of security holders. Similarly,

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1 However, some OTC securities are exempt from registering including those issued by investment companies registered under the 1940 Act (e.g., mutual funds, variable annuities).

no person may act as an investment advisor without annual security holder approval nor may a principal underwrite shares except under a written contract subject to security holder approval. Also the security holder has the right to ratify or reject the company's selection of independent accountants.

(d) No registered investment company may issue securities unless it has a net worth of at least $100,000 and complies with other requirements pertaining to its capital structure.

(e) Several requirements are imposed concerning the filing of annual and periodic reports with the Commission as well as furnishing reports and financial statements to the security holders.

(f) Several restrictions surround the sale of investment companies securities, such as mutual fund shares and variable annuity contracts. For example, such sales are subject to the registration and prospectus requirements of the 1933 Act in addition to those of the 1940 Act.

Special requirements apply to a periodic payment plan certificate defined as a contract or certificate providing for a series of periodic payments by the holder and representing an undivided interest in specified securities or in a fund of securities.[2] The most familiar examples of periodic payment plans are the contractual mutual fund programs under which the investor agrees to make periodic payments over a specified period of time. Such certificates are prohibited if, among other things, (1) the sales loan exceeds 9% of the total annual payments made thereon, (2) more than 50% of the first 12 monthly payments is deducted for a sales load, or (3) the proceeds from such certificates are subject to unreasonable management fees as the Commission may prescribe.[3] An oft repeated complaint aimed at periodic payment plan certificates involves the sales load. Although the maximum sales load is 9% of total payments, up to 50% of the first year payments may be deducted with a corresponding reduction in the amount of sales load deductible in subsequent years. Such certificates frequently are sold to persons of lesser means who are more likely to default in their payments. The SEC feels that the 50% "front end load" in the first year results in a severe penalty which such persons can ill afford. The contractual mutual fund plans have been severely criticized by the SEC because of the contractual nature of the plan, the permissible load of 9%, and the "front end load."

Another control applied to selling activities relates to sales literature. A registered investment company (or any underwriter for such company) must file with the Commission copies of its sales literature distributed to prospective investors in connection with a public offering of such company's securities. The Commission has issued a statement of policy indicating the types of advertisements and sales literature which may violate statutory standards.[4]

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2 Section 2(a)(26).

3 Section 27(a)(1), (2), and (5).

4 Section 24(b) and Investment Company Act of 1940 Rel. No. 40-2621, Nov. 5, 1957 3 CCH Sec. Law Rep. Para 48,902.

4. Investment Advisor Act of 1940.

The Investment Advisor Act of 1940 was enacted as a companion to the Investment Company Act of 1940. An investment advisor is defined as any person who for compensation engages in the business of advising others—either directly or through publication or writings—as to the value of securities or as to the advisability of acquiring or disposing of securities.[5] The investment advisor must register under the Act by disclosing the required information and he must maintain accounts, books and other records which are subject to SEC examination.[6] He may not enter into or renew any advisory contract which provides for compensation based upon a share of capital appreciation of his client's funds.[7] The Act also outlaws fraudulent practices.[8]

The outline on the following page compares the 1933, 1934 and 1940 Acts and highlights their basic features, similarities and differences.

III. REASONS WHY THE NAIC SHOULD LITIGATE THE JURISDICTION QUESTION

SEC action to date clearly manifests a purposeful intent to become significantly involved in the regulation of variable life insurance. It is also apparent that no one in the insurance industry is willing to challenge SEC jurisdiction. If the NAIC fails to contest the jurisdictional authority of the SEC to regulate variable life insurance, the SEC will have completed a significant expansion of authority without Congressional legislation. More specifically, the reason to find a judicial determination that the SEC does not possess jurisdiction can be categorized into three areas; (1) potential conflict with state regulation of variable life insurance, (2) implications for regular life insurance and (3) the state versus federal arguments.

A. Potential Conflict with State Regulation of Variable Life Insurance.

Potential conflict between state and SEC regulation may arise in a variety of contexts, only some of which can be perceived at this early stage of VLI development. The SEC regulation of VLI not only can impact on state regulation of VLI but also on traditional state regulation of life insurers. In this memorandum we can only anticipate a few of the potential ramifications of SEC involvement.

1. Both Systems Regulate Marketing.

Life insurance regulation has not used, on a widespread basis, a regulatory technique similar to the prospectus used with the sale of securities. This, at least in part, can be attributed to the fact that insurance policies impose contractual obligations on the insurer rather than offering the mere possibility of profit. The obligation remains fixed, despite the good or bad fortunes of the company. Insurance departments, not the policyholders, are

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5 Investment Advisor Act of 1940, Section 202(a)(11). Several persons are specifically excluded from this definition, e.g., a bank, a broker-dealer whose performance of such services is incidental to his business and who receives no special compensation therefore, etc.

6 Sections 203 and 204.

7 Section 205(1).

8 See Sections 206 and 207.

STATUTORY COMPARISONS

	SECURITIES ACT OF 1933	SECURITIES EXCHANGE ACT OF 1934	INVESTMENT COMPANY ACT OF 1940
BASIC PURPOSE	Govern Distribution Process	Govern Post Distribution Trading	Regulate Investment Companies
PHILOSOPHY	Disclosure	Disclosure and some Regulation	Regulation and some Disclosure
TECHNIQUES	(1) Registration of Securities and Prospectus Requirements (2) Antifraud Prohibitions	(1) Registration of Securities, Reporting, Proxy, and Insider Trading Requirements (2) Antifraud and Antimanipulation Prohibitions (3) Registration of Securities Exchanges (4) Regulation of OTC Markets Through Controls over Broker-Dealers (5) Regulation of Credit in Securities Markets	(1) Registration of Investment Companies (2) Unbiased and Honest Management Provisions (3) Securityholder Participation in Management Requirements (4) Capital Structure Requirements (5) Financial Statements and Accounting Requirements (6) Controls over Selling Activities

charged with the primary responsibility to assure the performance of the insurer's obligations. The same holds true for both regular and variable life insurance. This is not to say that the states do not use disclosure as a regulatory tool. For example, many states are using compulsory disclosure requirements in the area of replacement regulations. Furthermore, some states contemplate using some type of mini-prospectus (coupled with the other disclosure requirements) tailored to the variable life situation. As we move into the development of variable life, there is both precedent and authority (particularly the Unfair Trade Practices Act) to more fully utilize the disclosure technique, where relevant, to the extent appropriate as a supplement to other regulatory safeguards.

Under the Securities Act of 1933, the Commission is charged with administration of laws which essentially require disclosure (through registration and prospectus requirements). To the extent that the Commission requires disclosure or advertising contrary to insurance law, it could impair the latter. For example, let us assume that the Commission requires a prospectus and advertisements that emphasize the investment risks involved in variable life insurance. To the extent that these rules reduce the impact of insurance department rules requiring explanation of the policy from an insurance standpoint, conflict is inevitable. If securities aspects are emphasized, the misunderstanding could be extensive.

A common state regulatory problem is the attempt to sell life insurance policies as investments to prospects who do not fully understand the basic nature of the life insurance products they are buying. A sales presentation accompanied by a mutual fund type prospectus, and the consequent investment aura given to an insurance product would further compound the already difficult marketing confusion that exists between investment products and insurance.

Furthermore, the state advertising rules (e.g., the recent NAIC model life insurance advertising regulation), cost disclosure rules, and rules promulgated under the unfair trade practice acts may conflict with SEC prospectus requirements, especially if the states require specific disclosure in connection with the sale of sale of VLI.

The Securities Exchange Act of 1934, among other things, enables the SEC to impose requirements on brokers selling securities, such as examinations, training and supervision. If VLI is deemed to be a "security" for the purpose of federal securities laws and "insurance" for purpose of state insurance laws, agents or brokers will be subject to two sets of licensing, examination, and conduct requirements. Failure to meet either set will preclude the selling of VLI. This is an area characterized more by potential duplication rather than conflict. The dual administrative mechanism will, however, add to the cost of the product. A state cannot very well leave this function to the SEC since most VLI agents will also need to obtain regular life insurance agent licenses.

2. <u>Both Systems Regulate Accounting.</u>

Both the Commission and the insurance departments determine the accounting rules to be used by those under their jurisdiction. The emphasis of insurance accounting is solvency or "solidity" based on the theory that the public and the policyholders are best served if insurers are maintained in such a condition that they can complete their financial and contractual obligations. Insurance accounting differs in some significant respects from that required by the SEC. The ramifications of a dual set of official accounts of equal legal standing (an uncertain assumption) cannot be predicted with accuracy. But clearly significant potential for conflict exists.

3. <u>Conflict Between State Solvency Regulation and 1940 Act Controls.</u>

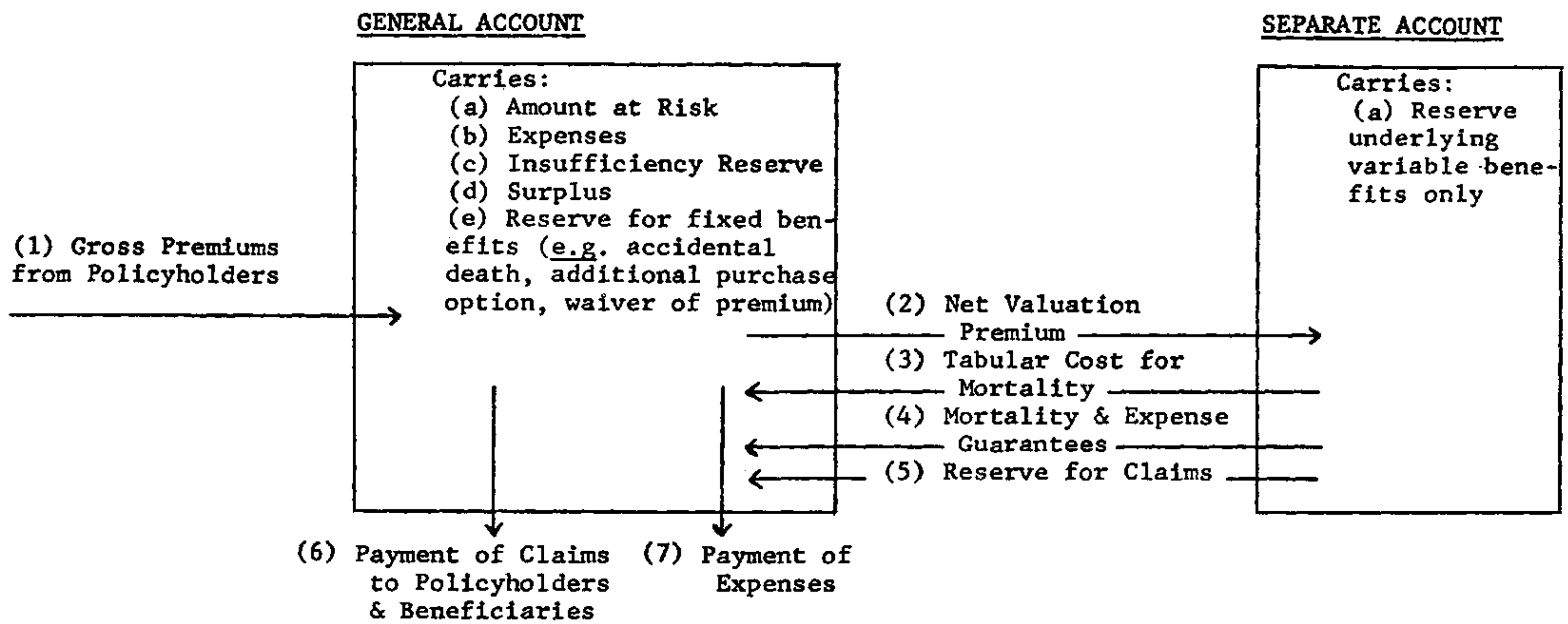
The Investment Company Act of 1940, being regulatory in nature, is the federal act that poses the most serious threat of conflict with state insurance regulation. Its applicability to VLI is predicated on the assumption that a separate account underlying VLI is a sufficiently separate entity which is an "investment company" and should be regulated as such. The SEC ignores the fact that the separate account is an integral part of the insurance operation.

In VLI, the interaction between the separate and general accounts of the insurer is such that the separate account cannot be regarded as a distinct "company." Furthermore, the operation of the VLI separate account is of real consequence to the general policyholders or stockholders of the insurer. The continuous interaction between the VLI general and separate accounts is diagramatically shown on the following page.

A primary objective of insurance regulation is assuring that the contractual obligations of the issuing company (e.g., to pay the death benefit) will be effectively carried out. The obligation is that of the entire company not just that of the separate account. State insurance regulation assumes that the assets which support the obligation belong to the company; and the company is not considered as a trustee holding assets for the benefit of policyholders. These concepts are fundamental to the regulation of insurance. It is particularly important in this context to again specifically note that all assets of the company back up VLI policies (e.g., with respect to mortality and expense guarantees and the guaranteed minimum death benefit). For this reason, state insurance regulation will look at the investment practices and management of both the separate account and the general account. Where necessary, a change in either area to protect the policyholders or beneficiaries of both can be ordered.

On the other hand, essential to the regulatory scheme of the 1940 Act is the concept of shareholder control over management and investment policy on the assumption that informed voters can take care of themselves. Reliance on the voting rights of VLI policyholders as the ultimate regulatory technique should have no application to a life insurance company which has undertaken a contractual obligation to pay a death benefit. Control over investments rested in policyholders would create a serious conflict with insurance regulation. Policyholders could require the company to turn over its separate account assets to a manager chosen by the purchasers of VLI while the company's general assets are still at risk. An insurance regulator would find it difficult to permit one group of (VLI) policyholders to be the ultimate arbiter of investment policies that can have a profound impact on other policyholders as well as upon the financial integrity of the company as a whole. Conversely, if a state insurance regulator took steps to control the management or investment policies of the separate account, he could run afoul of the 1940 Act.

This can be illustrated hypothetically. Suppose the VLI policyholders either elected new management for the separate account or overturned existing investment policy, which, in turn, led to a very highly speculative and thus unsound investment program, which, in turn, generated an investment return which fell far short of that necessary to support the guaranteed minimum benefit level through the separate account. As a consequence, the contractual burden would fall upon the general account and thus upon the general



(1) The policyholder pays a gross premium to the insurer. (2) Periodically the net valuation premium is allocated from the general to the separate account. (Based upon the policies submitted in this proceeding, such allocation may be annually, monthly or daily regardless of the time of the gross premium payment by the policyholder.) The contribution of the net valuation premiums builds the reserves for VLI - the reserves being that amount which combined with future premium will fund the total aggregate benefits payable, assuming certain mortality and investment experience. Allocations from the separate account to the general account include (3) the tabular cost (i.e. the amount to compensate the insurer for carrying the "amount at risk") (4) a charge for mortality and expense guarantees and (5) the release of reserves to the general account for the payment of claims. The insurer (6) pays all claims and (7) meets all expenses from the general account.

policyholders of the insurer. If the insurance commissioner were to attempt to remedy the situation, for example by forcing a change in investment policy or a change in management, he would run directly afoul of the securities laws. Furthermore, if the experience of the separate account were so unfavorable that the general account and even the solvency of the company were threatened, the state insurance department would be empowered (absent potential conflict with the 1940 Act) to revaluate the separate account assets on a basis different from that required under Sec. 2(a)(41) of the 1940 Act, to alter the separate accounts investment polity without the policyholder approval required by Sec. 13(a), to place liens on policies or put the insurer in receivership other than through the reorganization procedures required under Sec. 25 of the Act.

4. Other Conflicts.

Other potential conflicts exist, e.g., the 1940 Act would require election of directors of the separate account, whereas state insurance commissioners screen insurance company directors on the basis of character and fitness and have barred companies on grounds of inexperienced management; and under state laws insurance commissioners can ban a company where financial condition or method of operation may be hazardous to the public, regardless of investment policies and objectives under the 1940 Act.

5. Regulating for Excessive Sales Charges.

Under the 1940 Act, the SEC has authority to exercise control over excessive charges. However, analysis of the Act reveals its inability and inapplicability to deal with the problem of insurance "excessive" sales charges in the context of variable life insurance. There are three elements comprising the entire price of a mutual fund: (i) value of the underlying securities determined by the market, (ii) management and administrative expenses – regulated by the Investment Company Act and (iii) sales expenses – also regulated by the Investment Company Act. Thus by limiting all cost elements which are within the control of the mutual fund insurer, i.e. management, administrative and sales expenses, the 1940 Act assures that the entire cost is regulated against "excessive" loading.

In contrast, variable life insurance premiums (as do all life insurance premiums) contain inherent elements never contemplated by Congress in designing a regulatory scheme for mutual funds. These include mortality and expense guarantees required to support the risk borne by the insurer for the duration of life (e.g. 30, 40, 50 years) as well as underwriting expenses such as medical examination fees, and the cost of maintaining policies and records – all totally unrelated to any investment function. But rather, these elements are uniquely "insurance." Thus unlike the mutual fund situation, not all elements within the control of the issuer (i.e. the insurer) would be reached by the 1940 Act.

The assumption, therefore, that the SEC and the 1940 Act could effectively regulate the cost of variable life insurance to the consumer in a manner similar to that of mutual fund regulation is open to substantial question. An insurer could render imposition of the 1940 Act limitations ineffective by merely increasing those elements of the gross premium, e.g. mortality assumptions, over which the 1940 Act has no control. With respect to sales load, the 1940 Act imposes limits in terms of percentages. The dollar amount of sale compensation depends not only upon the percentage specified but also the base to which the percentage is applied. Unlike the mutual fund situation, the base in the variable life insurance situation is the gross premium, the level of which even under the 1940 Act would remain within the control of the insurer.

Consequently, the SEC could be under pressure to exercise control over the entire premium. As a result, the future could very well witness the SEC becoming involved in regulating mortality charges, underwriting expenses, etc. despite the fact that they are clearly insurance not investment concerns. In short, SEC regulation of VLI very conceivably may lead the Commission into the "guts" of an insurance company's operation including such fundamental insurance areas as the mortality tables and assumptions.

6. Understatement of Potential Conflict.

Furthermore, it should be remembered that it is impossible to predict with accuracy the rules to be issued or the positions to be taken by the Commission over the years in its attempts to exert jurisdiction over VLI. Thus, any delineation of specific conflicts or overlaps understates the potential problem. Second, a point-by-point comparison to some extent assumes that insurance regulation is static, i.e., that regulatory techniques not used now will never be used. However, insurance regulation is constantly evolving. The status quo is therefore an inadequate measure of future regulation, particularly with a product which has yet to be marketed.

7. The EVLICO Order.

In the NAIC comments submitted to the SEC and in arguments briefed for litigation by the NAIC, it was contended that SEC regulation of VLI would conflict with state regulation. This assertion was based on the anticipated regulatory pattern to be applied by the SEC. Several areas were enumerated as potential problem areas based on provisions of the securities laws which traditionally have not been subject to SEC exemptions.

The recent order of the SEC exempting Equitable VLI subsidiary (EVLICO) from certain aspects of the 1940 Act suggests the possibility of some SEC willingness to accomodate state insurance law in regulating VLI. However, the exemptive treatment embodied in the SEC order applying to the EVLICO applies to it alone. Whether or not this will be the pattern for the life insurance industry in general is currently unknown.

For those interested in the preservation of the state role as the primary regulator of the life insurance industry, the SEC action is entitled to a healthy skepticism. Once SEC regulatory control is established and accepted, there is little to check its future expansion, particularly in light of its deep interest in the life insurance industry (as will be discussed below). To the extent the EVLICO order does lessen the potential conflict, we should not overlook the possibility that it may be basically a temporary strategic ploy.[9] After VLI marketing begins under the SEC framework and the industry need to remain in good graces of SEC becomes accepted, future industry support for state assertions of conflics with their regulatory interests is likely to be slight. As regulatory conflicts between the securities laws and state laws become apparent, insurers will most likely urge resolution of the issues in a manner that will least impair their marketing of VLI. In the future, when accommodations between state and federal law are necessary, it is not difficult to envision the SEC with the upper hand if its jurisdiction is not challenged in the near future.

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9 The length of the Equitable filing, over 100 pages, gives some indication of the magnitude involved in fitting VLI under the 1940 Act. Even the EVILCO order, however, poses potential conflicts in such areas as advertising rules and disclosure requirements, sales loads, determination of cash values, conflict between the SEC concept of redemption and the insurance concept of pooling risks, etc.

B. SEC Regulation of the Life Insurance Industry.

If it is difficult to speculate as to the precise areas of potential conflict between state and federal regulation of variable life insurance both in the near and the long range future, it is even more difficult to discern the precise potential implications for the regulation of life insurance in general. More important here, however, is to ascertain (1) what is the fundamental and likely continuing attitude of the Commission and its staff towards life insurance and (2) the rational it may apply to extend its regulatory authority.

1. SEC Perspective of and Interest in Life Insurance.

The SEC is charged with responsibility for the regulation of and the maintenance of investor confidence in the national securities markets. To discharge this responsibility, the SEC believes that it must exercise control over the activities of all those who channel significant amounts of capital into the securities markets.

a. Accumulation of Assets. The Institutional Investor Study Report discloses that the SEC is interested in life insurance companies "because of the large amount of assets under their management and because they have the potential for substantially increasing the proportion of these assets held in equity securities."[10]

The SEC has identified cash value life insurance as the "most significant contributor to the industry's asset growth."[11] However, it also knows that in recent years the average premium per $1,000 of insurance in force has dramatically declined as has the life insurance industry's share of disposable personal income. The SEC Staff Study on Variable Life Insurance concluded that

> In an effort to offer the public a greater range of products to counteract this apparent trend, insurers have turned to equity based on products such as mutual funds and variable annuities.[12]

Presumably variable life insurance is simply a more recent manifestation, in the SEC view, of the same trend. In essence, the SEC appears to have concluded that life insurance companies have developed a much keener interest in asset growth and have begun emphasizing the asset accumulation and professional management of assets.

An SEC study delineated particular areas of industry activity in response to the competition of other financial and related institutions.

> (1) developing equity funding arrangements and modern flexible contracts for pension plans, (2) offering group and individual variable annuity products, (3) entering the mutual fund business, (4) preparing the way for variable life insurance, (5) further expanding their activities through subsidiaries and via the creation of holding companies, and (6) building up their investment skills, concentrating more effort on the management of invested assets and, in particular, increasing their activity in various types of equity investments.[13]

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10 Institutional Investor Study Report Securities and Exchange Commission, vol. 2, p. 505 (1971).

11 Id. p. 509.

12 Report Submitted to the Commission on January 30, 1973, p. 1.

13 Institutional Investor Study, vol. II, p. 511.

In the SEC Staff Study concerning the industry request for the exempt status of variable life insurance, the staff recognized that new net purchases of common stock by life insurance companies in 1971 amounted to $4.9 billion compared to similar purchases by mutual funds of "only $383 million."[14] The increased insurance company activity in equities is generally a result of two trends, – one the development of equity based products such as variable annuities and pension plans – and the other being the relaxed investment restrictions of the states which allow equity investments by insurers for traditional forms of life insurance. As insurance companies revise their investment strategies by turning away from secure, low yield government securities, to "riskier, but potentially more rewarding corporate issues, the quality and skill of investment management becomes increasingly important. . ."[15]

There can be no mistake in concluding that the SEC is concerned with the trend of life insurance companies to increase their accumulation of assets through movement towards greater equity ownership and the resulting appealing investment returns. This SEC concern clearly applies regardless of whether equities are accumulated in the insurers' general or separate accounts. These are areas which the SEC considers to be within its domain of influence and control. And, since the SEC views variable life insurance as "the most significant [development] in terms of potential impact upon the insurer's investment in equities,"[16] it is only natural that the SEC should intially seek control over life insurers in the variable life insurance area. This is especially true since SEC variable annuity regulation provides a precedent under which an expansion of regulatory jurisdiction can be described as merely a small logical extension of what is currently being done.

b. Professional Investment Management of Assets. According to the SEC, there are two factors that have traditionally distinguished insurance companies from investment advisory firms and bank trust departments. First, the advisory firms and trust departments offer investment management as a principal service to customers. Second, although advisory firms and trust departments are "explicitly in the business of managing other peoples' assets," the state regulatory authorities have regarded the managed assets of insurers to be those of the insurance company. Because of several recent changes in the operation of the life insurance business, including the creation of products with special investment (separate) accounts, theSEC concludes that insurers are moving "into closer competition with bank trust departments and investment advisory firms."[17] Former Chairman Ray Garrett has articulated the SEC view of regulatory demarcation lines based on the business nature of the regulated corporation:

> Today it seems less and less appropriate to allocate regulatory responsibility according to corporate entity. If a bank [or insurance company?] operates and distributes shares of something that is indistinguishable from a mutual fund, for all purposes, except legal form, should it not be subject to the same regulation as the mutual fund itself?"[18]

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14 Staff Study on VLI, p. 51.

15 Id. p. 55-56.

16 Id. p. 541.

17 Institutional Investor Study, p. 505.

18 SEC News Release, dtd. Feb. 4, 1974 at pp. 15-16.

Consequently, to the extent that the SEC perceives that insurance companies offer as a principal service management of the invested assets of others, the SEC can be expected to assert regulatory jurisdiction.

It should not be assumed that this view is limited to variable life insurance. As just noted, in the SEC traditional view a basic distinction of life insurance is that state regulatory authorities regard the managed assets of insurers to be those of the insurance company rather than those of the individual policyholder. However, even though state insurance regulators also consider separate account assets to be owned by the insurer,[19] this is ignored by the SEC. Thus, it is logical to assume that the SEC no longer considers itself compelled to recognize the historical distinction between an insurance company and an investment management firm on the basis of who is deemed to own the assets.

The implication of this conclusion, which is being implemented on an incremental basis (in variable life insurance area now), for life insurance business is monumental. Life insurance companies manage assets for the benefit of their policyholders, especially participating policyholders who have a direct monetary interest (above and beyond the continued ability of the insurer to meet its contractual obligations) in the insurer's investment results in the form of dividends. The SEC's fundamental concern over insurers accumulation of assets, their impact on the securities market, and the blurring if not elimination of the distinction between insurer and others' investment management, all suggest a long range desire to bring the life insurer under the sway of the federal securities laws. (This is buttressed by informal comments made by SEC staff personnel that even traditional life insurance is a security, and should be regulated as such. Also, it can be assumed that the SEC believes its regulatory ability is superior to that of the states.) Asserting jurisdiction over variable life insurance appears to be only the current tactic in achieving this long range plan although not widely publicized objective.

c. Disclosure. SEC interest in extending its jurisdiction may also stem from another source. In 1973, the Commission determined not to exempt variable life insurance contracts from the requirements of the Securities Act:

> The important investment features of the contract – the opportunity to participate in the investment experience of the separate account in order to achieve increased life insurance benefits including death production and cash value – require that contractholders be afforded the protections of full disclosure. . . .[20]

The same type of information identified by the SEC in variable life insurance as ripe for disclosure requirements of the securities laws have been recognized by others as relevant to traditional forms of insurance. S.2065, the truth- in-life insurance proposal of Senator Hart, would provide the consumer with

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19 Since a variable life insurance separate account is an integral part of the insurer, the insurer is acting as "custodian" (really owner) of its own assets, including those which it may have originally allocated to a separate account. Neither the "separate" account nor the variable life insurance policyholders own any assets. Commentary, NAIC Model Variable Life Insurance Regulation, Part IV, Sec. 1.

20 Securities Act Release No. 5360, Jan. 31, 1973.

> year by year information on premiums, dividends, terminal dividends, amount and cost of protection, and annual and cumulative rates of return. This year by year information for the life of the policy is needed to ferret out unusual or misleading dividend and cash value patterns or any other type of value manipulation. The annual data will also point up any abnormal front-end loading.[21]

Pressure for federal compulsion of disclosure concerning life insurance policies cannot but encourage the SEC in its expansion efforts since it considers disclosure as one of its principal investor protections. Similarly, the securities law protections afforded variable life insurance policyholders will establish a precedent for compelling similar disclosures for traditional forms of life insurance.

2. SEC Rationale for Asserting Jurisdiction.

Whatever the basis for SEC conern over and interest in life insurance, either traditional or variable, in order to assert regulatory jurisdiction there must first be a finding that a security is involved. In 1946, the Supreme Court in SEC v. Howey defined an investment contract to be:

> . . . a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . . .[22]

The SEC staff uses the Howey definition and proceeds as follows:

> The (VLI) contracts provide that the purchaser invest his money (labeled "premiums") in a common enterprise (the separate account) with the expectation of profits (from market appreciation and from dividends and interest) solely from the efforts (professional investment management) of the promoter, or a third party (the insurance companies or investment managers selected by them).[23]

The only change that would be required to make this definition applicable to fixed benefit cash value insurance, at least with respect to participating policies, would be the insertion of "general account" or "insurer" in place of "special account" as the common enterprise. Given the significant interest of the SEC in the life insurance industry, it would not appear to be a great step to conclude that the SEC either does or will view general account assets of fixed benefit cash value life insurance company as being the common enterprise of the policyholders.

One interpretation of a "common enterprise" would involve ownership of the assets. Such an interpretation, however, would raise the issue of insurer versus policyholder ownership of the assets. Instead the SEC has opted for an interpretation which skirts this issue. In the context of variable life insurance, rather than identifying the "owner" of invested assets, the SEC analysis of variable life insurance asserts that policyholders share directly in the investment experience of the separate account, and therefore carry

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21 Press Release, Senate Antitrust and Monopoly Subcommittee, p. 12, July 7, 1975.

22 328 U. S. at 298 (1946).

23 Staff Study on VLI, p. 83.

substantial investment risk. In making this determination, the SEC emphasized that the variable death benefit and variable cash value are "critical features" through which "the contractholder participates directly in the investment experience of the separate account and bears an investment risk." The sharing in the investment experience and investment risk apparently is translated into meeting the "common enterprise" element of the Howey definition of a security.

If this argument is accepted, it can easily be extended to traditional life insurance, especially participating life insurance. Life insurance dividends, which result in part from the investment experience and management of the insurer, can be applied to increase the face value of the policy as well as increase the cash value. Thus participating life insurance provides for variable death benefits and variable cash values. In essence, the variable life insurance policy reflects only an evolutionary step beyond the traditional participating policy in that benefits can decrease as well as increase due to investment experience although the decrease will only be down to the guaranteed minimum which the policy probably will typically provide (at least as to death benefits). Thus, the SEC argument predicated on the variability of benefits easily extends to finding that traditional participating life insurance, as well as variable life insurance, is a "security."[24]

It should be noted, however, that the Howey definition of a security describes a contract in which a person invests money in a common enterprise expecting profits solely from the efforts of a promoter. This definition of a security might be inapplicable to life insurance since the maturing of the contract right to any dollar benefits could result from the occurrence of the fortuitous event (i.e. death) rather than from the efforts of the promoters. But, if the SEC argument is accepted for variable life insurance (and no one is currently challenging it), then there is no significant basis for distinction to preclude applicability to traditional participating policies. Furthermore, more recent suggestions of a definition of a security criticize the Howey decision as a too narrow concept and broader definitions have been posed which, if adopted, would render traditional life insurance even more vulnerable.[25]

Once we reach the point where sharing of the investment experience and risk determines whether an insurance policy is a security, the next query is how much risk sharing is necessary to find a security. Or more precisely, how is the line drawn between insurance products that are subject to the securities laws and those that are not? A leading securities law analyst, Louis Loss has observed that "there is a continuous spectrum from a one year term life insurance policy, which is pure insurance through the various forms of straight life and endowment policies, to the annuities, both fixed and (in degrees) variable, to mutual fund shares, and ultimately common stocks which represent pure investment."[26] The essence of the problem facing state insurance regulators, assuming dual regulation is undesirable, is that SEC regulation of variable life insurance will set a precedent that may naturally lead to further regulatory intrusions simply through the exercise of SEC's

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24 Furthermore, the ability of a life insurer to meet its obligations to pay death benefits and cash values depends upon its investment results. In this sense, both participating and nonparticipating policyholders share in the investment experience and bear an investment risk.

25 See, e.g., Coffey, The Economic Realities of a "Security," 18 W. Res. L. Rev. 367, 377 (1967); Hawaii v. Hawaii Market Center, Inc. 485 P. 2d 105 (1971).

26 4 Loss, Securities Regulation 2534 (1969 Supp.).

discretion rather than that of Congress. Unless challenged, the SEC is in a position to draw its own line between "insurance" and a "security." And, as noted above, extending the concept of "security" from variable life insurance to participating life insurance is conceptually a very small step.

C. State Versus Federal Regulation.

To this point, this memorandum has focused on the potential conflict between state and federal regulation of variable life insurance and the potential extension of SEC jurisdiction to life insurance in general. Before any recommendation can be made as to whether the SEC's efforts should be resisted, a fundamental question must be asked. Would such resistence, if successful, work to the benefit or the detriment of the public interest. Since the general arguments in favor of state regulation have been detailed elsewhere,[27] it will suffice to merely summarize them here

> State regulation of the insurance business is not an end in itself. Its justification rests upon the protection which it affords the insurance consuming public consistent with other goals of public policy. The state insurance regulatory mechanism is far from perfect. But, the history of federal regulatory agencies reveals a lack of perfection at that level as well. The case for state regulation is a strong one. The system already exists. It is capable of experimentation, change and vitality. It tends to be more responsive since it is closer to the people and because of the ever present threat of federal alternative. But even more important state regulation is more consistent with the fundamental precepts of a viable federal form of government which disperses regulatory power. Thus, on the merits, the creation of an institutional insurance regulatory structure at the federal level not only is unnecessary, but also poses adverse and long range consequences for not only the insurance industry but more importantly the public interest its purpose is to serve.[28]

IV. REASONS THE NAIC SHOULD NOT LITIGATE

Litigating a fundamental issue of jurisdiction with a major and prestigious agency of the federal government will involve a lengthy and time consuming process which will probably result in a U. S. Supreme Court decision. Such litigation will require considerable staff effort and the cost of outside counsel. The cost of a declaratory judgment action is difficult to estimate. The major cost is trial preparation and actual number of days in court. (Most of the briefing work has been done in connection with the current litigation.) Much depends upon the court's and the parties' willingness to utilize the record developed during the SEC hearings. Based upon our discussion with our law firm, which has handled the current litigation up to this point, plus provision for major unanticipated expenses, an estimate of $100,000 maybe a reasonable ball park estimate. But, as the law firm points out, there could be substantial variations either up or down. Incidentally, discussion with a major client of this law firm, which also uses Wall Street firms, guessed that utilization of a large New York or Washington firm would probably double our cost.

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27 Hanson, Johnson and Dineen, Monitoring Competition: A Means of Regulating the Property and Liability Insurance Business 539-545 (1974).

28 Id. p. 545.

A second reason not to litigate is the possibility that we would not be successful. Two basic issues would be involved in a variable life insurance declaratory judgment action: (1) is variable life insurance a security under the 1933 Act and (2) is a separate account underlying variable life insurance an investment company subject to the 1940 Act? In the absence of the variable annuity cases, the prospects of success would be quite bright. In light of these cases, I would guess-estimate that the chances of success are at best 50-50 on the second issue and not quite as good on the first. However, it should be noted that the 1940 Act poses more serious problems for state insurance regulation and the industry than do the disclosure requirements of the 1933 Act. Furthermore, the makeup of the Supreme Court would appear to be more favorable to our point of view than was true in the recent past.

V. RECOMMENDATION

It is our recommendation that the NAIC commence litigation challenging the jurisdiction of the SEC as soon as feasible for the following reasons.

(1) The potential for conflict between SEC regulation of variable life insurance and state regulation of both variable life insurance and traditional insurance is very real. Although the SEC has to some extent accommodated itself to EVLICO, the potential for conflict will continue and increase. Furthermore, there is no assurance that the EVLICO pattern will remain once the SEC becomes firmly entrenched in regulating variable life insurance nor that the EVLICO pattern will be extended to other insurers.

(2) Regardless of the extent of conflict in the variable life insurance area, the more fundamental long range concerns are the implications for the entire life insurance industry. The SEC has manifested clearly its interest in and concern over life insurance. The industry's impact on the securities markets is increasing. The accumulation of assets, the shift to more equity investments, the development of more professional investment management, the desire for federally compelled disclosure, etc., may all contribute to the SEC's desire to expand its domain to insurance. Parallelling this desire is the SEC development of statutory interpretation and rationale in the variable life insurance debate which, if accepted or acquiesced in, will provide the basis for expanding SEC control over traditional life insurance. In short, there seems to be both the will and a way to achieve this result.

(3) Currently, only a handful of companies are contemplating entering into the variable life insurance market in the foreseeable future and only EVLICO is close to doing so. Nevertheless, the regulatory pattern is in the process of being established. The SEC is firmly implanting itself as the primary regulator. In doing so, it is probing the frontiers as to how far it can expand its authority to insurance. First, the SEC asserted jurisdiction over variable annuities. Now it is doing the same thing concerning variable life insurance. In the absence of the variable annuity cases, it is highly questionable whether the SEC could withstand a jurisdictional challenge as to variable life insurance. But now with the variable annuity cases and a pattern of on going variable annuity regulation, the SEC possess at least a good chance to sustain such a challenge. In view of the Commission interest in life insurance and informal staff comments as to their attitude that life insurance is a security, zeroing in on participating life insurance would be the next logical step. If the SEC establishes a pattern of regulation over variable life

insurance to which the industry's and state regulators acquiesce, the SEC will then have a base from which it can attack traditional participating life insurance. This is especially true since the rationale (as well as the underlying motivation) upon which SEC variable life insurance regulation is based extends equally well to participating insurance. In short, we are witnessing a classic example of aggregation of regulatory authority through self-definition of jurisdiction on the "installment plan." Thus, to the extent the state regulators feel that the public is not best served by SEC intrusion into regulation of life insurance, their opportunity to resist the likelihood of success will significantly narrow from both a legal and a psychological point, if the SEC alleged jurisdiction over VLI is not challenged.

(4) Applying the federal securities laws to life insurance can only be achieved through severe distortion of such laws which were enacted 35 to 40 years ago and designed to meet the then current abuses of a totally different industry. This, in itself, suggests substantial inherent regulatory conflict. Broad scale regulation of the same industry by state and federal regulators, whose basic orientation to the manner of regulation (although not necessarily objectives) significantly differ, can breed only wasteful duplication, conflict and chaos to the benefit of no one.

(5) The cost of litigation, while significant from the viewpoint of NAIC resources, is rather small in comparison to the issues involved. Furthermore, to the extent future conflict with SEC regulation can be avoided, the time and cost of intercine battles between regulatory agencies will be avoided and future regulatory costs reduced. Also, it should be noted that the duration of litigation will be spread out over a period of time, perhaps a few years (due to the length of the litigation and appeal process). Consequently, there should not be one large lump sum payment.

(6) The fact that the chances of success perhaps are not better than 50-50 should not alter a decision to litigate. Failure to litigate reduces the chances to zero and could constitute a default to the federal government to the detriment of all except the SEC.

If in making the decision to litigate or not to litigate, a mistake is to be made, it can be argued that it should be made so the adverse effect is the least. We submit that if the mistake is to litigate, the adverse effect will be much less costly to the public than if the mistake is not to litigate.

If the decision is to litigate, such action should commence as soon as possible. Otherwise, EVLICO may start marketing and the SEC may become more entrenched. Furthermore, if the NAIC litigates, it might influence individual state activity in the variable life insurance area.