S. HRG. 103–517

WHEN WILL POLICYHOLDERS BE GIVEN THE TRUTH ABOUT LIFE INSURANCE?

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

EXAMINING STATE REGULATIONS AND THE ADEQUACY OF INFORMATION AVAILABLE TO CONSUMERS OF LIFE INSURANCE

MAY 25, 1993

Serial No. J–103–15

Printed for the use of the Committee on the Judiciary

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When will policyholders be
given the truth about life

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WHEN WILL POLICYHOLDERS BE GIVEN THE TRUTH ABOUT LIFE INSURANCE?

TUESDAY, MAY 25, 1993

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 9:32 a.m., in room SR–301, Russell Senate Office Building, Hon. Howard M. Metzenbaum (chairman of the subcommittee) presiding.

Also present: Senators Thurmond, Grassley, and Specter.

OPENING STATEMENT OF HON. HOWARD M. METZENBAUM, A U.S. SENATOR FROM THE STATE OF OHIO

Senator METZENBAUM. The hearing will come to order.

Almost 1 year ago, I chaired a hearing in this room looking at sales practices in the life insurance industry. That hearing did not make the network news and was not broadcast by C–SPAN. Put bluntly, it was a pretty dull hearing.

We heard from actuaries, insurance agents, State officials, beneficiaries, and we saw pages and pages of life insurance illustrations that were practically incomprehensible, and we were given a report by the Society of Actuaries. It was a morning like many that occur in the hearing rooms of this body—tedious, technical, and thorough.

And that hearing explored a question that had been around for a long time: Do buyers of life insurance understand what they are being sold?

Industry trade journals have repeatedly detailed the lack of consumer disclosure and the abuse of unfounded projections in the life insurance business. The Federal Trade Commission issued a two-volume report in 1979 strongly criticizing sales practices in life insurance. In short, the 1992 hearing was not even original.

But this time, something surprising happened—very surprising. My office received hundreds of calls a week from people asking for information on the pricing of their life insurance policies, information they were unable to get from their own companies. We were inundated with requests for material from that hearing. After sending out over 700 packets of witness testimony, my staff began directing calls to Senate offices representing the States of each caller. Then we started getting dozens of calls a day from the offices of my colleagues trying to assist their constituents with life insurance questions. The Government Printing Office printed extra copies of the hearing transcript for sale to the public, but still the booklet was sold out within days. We continue to get calls and letters asking for help every day. Here is what the letters say.

Nandell Claxton of Georgia wrote his State Insurance commissioner: "Most common citizens just don't understand policy terms. You have to have faith," said he to his commissioner. "You have to have faith or trust that the agent is telling you the truth or explaining it correctly to you. It's bad that it takes 9 years and $23,000 before you find out you have nothing."

Leonard Jackson of Edmonds, WA, wrote: "I feel I was misled into believing that the $2,494 I rolled over from another policy would always be my money, that I could withdraw it like a savings account. After asking to withdraw money from my savings account, I was told I hadn't accumulated much cash value."

Martha Wasserman of Portage, MI, wrote: "Who would knowingly put $25,000 into a plan where they had to pay a $2,400 surrender charge to get the money out?"

Vicente Fuentebella of San Diego wrote: "Now I know how the insurance companies are making so much money at the expense of people like us who have to do a lot of research to find out how these insurance policies work."

Bruce Woodward of Texas wrote: "After paying $27,418 in premiums, I was shocked to learn that I would receive no cash upon a surrender."

I can assure all of you here today that many, many thousands of policyholders all over the country are experiencing the same shock and frustration as these constituents.

These are the facts we established a year ago. People are not being told the simple truth about their life insurance. This lack of disclosure is costing them a lot of money, and people are left without the coverage they need. Actuaries who design the policies, agents and brokers who sell the policies, the many consumers who buy the policies, and even the CEO of Massachusetts Mutual, a company making millions from producing life insurance policies all agree: Buyers of life insurance are not getting the whole story.

So why is it still going on? Executives must continue to create misleading policy illustrations because the other companies are doing it. If they don't compete on the same terms, they will lose business. So they all churn out variations of the same complicated, misleading, and confusing charts and graphs that mix promises with guesses and leave out the important facts.

Life insurance pricing is not that complicated. In exchange for a regular fee called a premium, the life insurance company agrees to pay the survivor an amount of money when the insured person dies. A premium includes charges for mortality, a fund to pay death claims, and whatever additional expenses the company sees fit to charge. To be able to pay the claims for those who die, companies must collect mortality charges each year on each policyholder. That goes for universal, variable, whole, term, or any other fancy policy a person can buy.

On many policies, companies collect surplus payments from the policyholder, overcharge, then set up surplus accounts. The surplus, called cash value, is a pot of money from which the company can later deduct each year's mortality charges and other policy expenses. In the meantime, the cash value is supposed to earn interest or investment dividends.

What nobody seems to want to tell people is that no one knows exactly how long it will take to build up enough cash value to pay the remaining premiums. They do not know, so they guess. And as long as they are making up facts, they make them sound real good.

Companies say: After 5 years, there will be enough in your cash value for you to stop paying premiums forever, or your money will earn at 10 percent, or your premium will never be more than $7.00 per thousand dollars of insurance. And very quietly, maybe hidden in a footnote or in a gobbledygook phrase, they say: Well, we are really only guessing.

They never say: We do not have any idea how much you will eventually have to pay for policyholder. They do not say: We are not telling you how much of your premium will go into your cash value, but probably none for 4 or 5 years. They do not say: All of your first-year premium will go to expenses, mostly agents' commissions. And they do not ever say: The interest or dividend we are promising you will probably drop by next year.

But these are the very things that unwary policyholders must confront. When the policyholder has to pay more premiums than he expected or notices that his cash value is not accumulating, his company will tell him: Values were not guaranteed. Translation: We were only guessing.

Some witnesses today will testify what happened when their insurance companies guessed wrong. Companies have been guessing wrong for a while now. One of our witnesses today told an industry group not long ago that less than 10 percent of life insurance in the market will perform as illustrated, and it is getting worse, not better.

The Wall Street Journal reported May 12 that life insurers would almost certainly be cutting dividends and interest rates paid to policyholders again this year. The story said: "They have fallen sharply this year, but are expected to fall even further. Every rate that is not guaranteed has to come down."

Why is this flimflammery allowed to continue? Where are the laws to prevent companies from misleading people? What is wrong with the State regulators? Why is the Congress of the United States not doing something about it? Why is the committee that has specific jurisdiction with respect to this issue not getting off its butt and doing something about it? I ask that publicly, because the committees of the Congress are doing very little to meet their responsibilities in this area.

Last September, I wrote the president of the National Association of Insurance Commissioners, the organization to which insurance commissioners from every State and Territory belong. I urged the NAIC to take immediate action. I wrote that buyers are not getting essential pricing information. They do not understand the cost of a policy. They are being misled about projected future values of policies, and they are being persuaded to cancel policies in which they have finally accumulated value to buy other poorer products.

I told the NAIC that I am alarmed by the paucity of meaningful information available to consumers and urged the commissioners to protect policy buyers. In short, I told the NAIC that consumers need clear, honest information, so they have the ability to make informed decisions.

The NAIC says it is working on the problem. The NAIC has formed two groups. One is made up of commissioners and is called the Disclosure Working Group. There is also a group made up of insurance industry representatives organized to advise the NAIC Disclosure Working Group. Commissioner Lyons is here today, and I am very pleased that he is with us to report on the NAIC's progress.

We invited some members of the Advisory Committee to testify today, too. We asked the National Association of Life Underwriters, representing over 140,000 life insurance agents to send the chairman of its Illustration Task Force. We invited the American Society of Chartered Life Underwriters, a professional society of insurance agents, to send the author of its highly touted illustration questionnaire.

At first, both organizations accepted the subcommittee's invitation. But late last week, within an hour of each other, the two agents and brokers groups withdrew their agreement to testify. They knew they were not to blame for the inadequacy of policy disclosure, but did not want to have to admit who is.

So, two national organizations of agents publicly acknowledged to the NAIC the problems we uncovered in last year's hearing. But they, like the companies they represent, are unwilling to face the pubic. In addition, the ACLI, the national trade association for life insurance companies, refused to testify last year and refused to come today.

I consider their actions reprehensible and irresponsible. The refusal of the companies and the agents to participate in today's hearing leads me to think they have something to hide. This Senator thinks they do have something to hide.

I think the life insurance industry is really not willing to stand behind its product. I do not think they are that proud of what they are doing, and that is the reason they are not here today.

And I think it is fair to say that the people who bought cash value policies since the early 1980's have already had or are about to have rude awakenings. Soon they will realize projections made when they bought their policies do not have a snowball's chance in August of coming true. Today we will see what can be done about it.

Our first witness is—oh, I am sorry; I did not see you here, Chuck. I apologize. Senator Grassley?

Senator GRASSLEY. Well, I was late getting here.

Senator METZENBAUM. Well, I apologize.

STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. As you know, Mr. Chairman, I am not a member of the subcommittee. I have followed what you are doing on this subcommittee, and I particularly want to be here today because I have two Iowans who are present, and I wanted to introduce them, and maybe to ask some questions as well.

I wish to thank the chairman for continuing this series of hearings on consumer disclosure issues in the insurance business. I share Senator Metzenbaum's desire to ensure that insurance consumers have a thorough understanding of the obligations and performances that they can expect from a prospective life insurance policy, so that they can make fully informed purchase and investment decisions.

Last year's hearing certainly drew a great deal of attention to this issue, and I know that as a consequence many Iowans have become more alert to the potential for misunderstanding that exists in this area.

I am especially glad to welcome two Iowans to the committee this morning: Mr. Keating, who ran John Hancock's office in Sioux City for nearly a decade, and Iowa's insurance commissioner, David Lyons.

David has done a spectacular job since Governor Branstad appointed him in 1990. Commissioner Lyons is a firm but fair regulator who has been able to simultaneously achieve both record consumer protection and record insurance economic development. Most Iowans know him best for the most impressive job that he did over the last year in helping to recover local government funds lost in the Iowa Trust investment scandal.

I look forward to hearing the testimony of all witnesses and for the prompt solution to the problems identified in these hearings.

Mr. Chairman, I am going to divide my time between the Aging Committee upstairs on the sixth floor and this committee. So, when time comes for me to ask questions, I am going to have my staff come up and get me.

We are also involved in an investment hearing in the Aging Committee. It involves the investment problems of senior citizens who, with lower interest rates on their CD's, are not having the income that they were planning on having. So today is kind of a day of investment hearings on the Senate side.

Senator METZENBAUM. To the extent that my friend from Iowa can be with us, we will be very happy to have you. We are pleased to have you at the opening of the hearing, and we certainly look forward to your being with us for as much time as you have.

Senator Thurmond?

OPENING STATEMENT OF HON. STROM THURMOND, A U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA

Senator THURMOND. Thank you, Mr. Chairman.

Mr. Chairman, the hearing this morning will address concerns relating to the adequacy of information disclosed to consumers in connection with the purchase of whole life insurance.

Whole life policies differ from other forms of life insurance in that they are purchased not only for their insurance benefits, but for their investment value as well. As a result, these policies are often far more complex than other forms of insurance purchased by consumers.

This subcommittee held a hearing on this issue on June 23, 1992. The issue of adequate disclosure of the important elements of life insurance policies apparently has become a matter of growing concern not because of substantial changes in the operations of insurers, but because of the sharp decline in interest rates and other investments on which much of the value of these insurance policies depends.

These changes in the market have added new difficulties for insurers and greatly increased the importance of consumers understanding clearly the variables which affect the policies.

Mr. Chairman, although you and I differ on many issues relating to the insurance industry—for example, the wisdom of substituting Federal regulation for State regulation—we do not differ on the importance of fairness to consumers.

Many consumers need to be better educated and have available clear information about the complex insurance products they are purchasing. The hearing this morning will help to educate us about these issues and to raise public awareness so that consumers will become more knowledgeable.

The National Association of Insurance Commissioners plays an important role in protecting consumers by providing model legislation for enactment and enforcement by the States. Model laws encourage desirable similarities in State legislation while preserving the important and traditional role of States in regulating insurance.

The insurance industry is an essential part of our economy. Most individuals and almost every business depend on the financial protection afforded by insurance. Obviously, there is no justification for questionable activities which, at a minimum, erode the very consumer confidence that is vital for a healthy insurance industry.

At the same time, the insurance industry should not be blamed for low interest rates and market uncertainties which have raised much of the concern with life insurance policies.

Mr. Chairman, I thank each of the witnesses for their time and effort in appearing before the subcommittee this morning. I look forward to their testimony and commend you for holding this hearing.

Senator METZENBAUM. Thank you very much, Senator Thurmond. I am very pleased to have you with us.

Our panel of witnesses was to have been Brian Brown, American Society of CLU and ChFC of Bryn Mawr, PA, and Robert Nelson, chairman of the NALU Sales Illustration Task Force, National Association of Life Underwriters of Washington.

Both of them withdrew at the last minute. Their names are on the printed list of witnesses, but they have withdrawn, period.

Our first panel consists of Mel Todd, president of Clark/Bardes, Inc., of Dallas, TX; Gloria Darleen Newberry of Parkville, MO; Wayne Bohrer of Sterling, VA; and Jerry Keating of McCook Lake, SD.

We are happy to have each of you with us. I think you have been previously told that the committee proceeds on the basis of 5-minute limits for each witness, and then we will have questions after that which will extend it to a later time.

Mr. Todd, I have you listed here first, so we will ask you to proceed.

PANEL CONSISTING OF MEL G. TODD, PRESIDENT, CLARK/BARDES, INC., DALLAS, TX; GLORIA DARLEEN NEWBERRY, PARKVILLE, MO; WAYNE BOHRER, STERLING, VA; AND JERRY KEATING, McCOOK LAKE, SD

STATEMENT OF MEL G. TODD

Mr. TODD. Thank you. Good morning. My name is Mel Todd. I am a fellow of the Society of Actuaries and a member of the American Academy of Actuaries and belong to the National Association of Life Underwriters. However, I am not representing any of these organizations at this hearing today.

I was recently employed for over 15 years by the Great-West Life Assurance Co., most recently as vice president in charge of individual life product development, pricing, marketing, and policy illustrations.

I am currently president of Clark/Bardes, Inc., a national firm specializing in the sale and administration of executive benefit programs and corporate-owned life insurance.

Over the past several years, I have been quite outspoken at several industry meetings about the problems with life insurance illustrations and whether the life insurance industry is inadvertently creating false expectations in the minds of some consumers of life insurance products.

I was asked by Senator Metzenbaum's office to testify at this hearing and have agreed because I believe more attention needs to be given to this problem at this time.

My prepared remarks are organized into three sections: a brief introduction, a description of the problem, followed by an outline of what I believe the solution to be.

INTRODUCTION

Policy illustrations continue to be the dominant tool used within the life insurance industry to compare the relative cost of death benefit protection between various companies and products. This is somewhat unfortunate, given that the only promise a life insurance company makes when it sells a product are the contractual guarantees. Policy illustrations are not promises; rather they are hypothetical illustrations of what might happen if certain, often undisclosed assumptions come true.

The biggest problem that we face in the industry is that we may be creating false expectations in the minds of the buyers of life insurance products. This is not a good company/bad company issue. All companies illustrating competitive products have been forced to play illustration games whether they realize it or not.

THE PROBLEM

The following comments are intended to help define why there is a problem with life insurance policy illustrations for most whole life and universal life polices sold today.

COMMENT 1

The demand for individual life insurance has been declining as the babyboomers age, while the supply of life insurance products has remained relatively stable. Basic economic principles suggest that whenever supply exceeds demand, weaker companies will be forced out of the business as price drops and profit margins fall. However, life insurance is unlike most other businesses, because the ultimate price of life insurance is not typically determined at the point of sale. This is what creates the potential for problems within the industry.

COMMENT 2

Life insurance consumers tend to rely on life insurance illustrations because they like to make informed buying decisions about price/value relationships and because most people tend to believe financial projections that are prepared by a computer. This is clearly inappropriate but sadly is true.

COMMENT 3

The actual ultimate price of a life insurance product purchased today will depend heavily on many factors, such as death claims, surrender rates, interest rates, and taxes, which will be experienced over the next 30 to 40 years or longer. These factors are subject to many influences outside the control of the insurance companies.

COMMENT 4

Actuaries attempt to take educated guesses about future experience factors by looking at historical results. However, the history of the life insurance industry demonstrates that historical information about experience factors, such as interest rates, have proven to be poor predictors of the future.

COMMENT 5

When determining experience factors to use in policy illustrations, no one is asking the pricing actuaries to assess the probability that the illustrated values will actually be realized. Even if asked, actuaries would differ greatly on their view of the reasonableness of policy projections, depending upon personal attitudes and the degree of optimism or pessimism that each actuary feels.

COMMENT 6

Most uninformed buyers of life insurance products mistakenly believe that one policy illustrates better than another because it either has a lower profit markup or lower expense loadings. Those same buyers may be surprised to learn that a typical after-tax profit markup on a cash value life insurance policy might translate to only 2 to 5 percent of premiums or less. This compares to an illustration environment where the most competitive products appear to have a cost that is 40 percent or more below the most expensive products.

COMMENT 7

In spite of the above comments, I believe that very few, if any, life insurance companies or pricing actuaries are deliberately attempting to mislead their agents or the buying public. Most actuaries would like nothing better than for the pricing assumptions to be validated by actual experience factors so that actual illustrated values could be realized.

THE SOLUTION

The life insurance industry offers valuable products and services to protect families and their financial wellbeing. It is rather unfortunate that the life insurance industry is gaining a poor reputation because of some recent trends.

I believe that some action needs to be taken to regulate the assumptions used in projecting product performance with life insurance policy illustrations. The likely outcome of any such regulation will be to drive the smaller and weaker life insurance companies out of business. I believe this to be true, because many of these companies are only able to compete in today's fiercely competitive marketplace through the use of aggressive illustration games. By creating a more level playing field, many consumers will tend to gravitate toward the large companies with lower unit expenses and those companies with the strongest financial ratings.

The appropriate regulatory body for policy illustration may be the National Association of Insurance Commissioners, the NAIC. The industry is perhaps already overregulated, and introducing a new Federal regulatory body at this time may not be necessary.

I would suggest that the Subcommittee on Antitrust, Monopolies and Business Rights develop a list of concerns to be presented to the NAIC to be used to develop a model bill. This bill should require full disclosure of key experience factors used to develop policy illustrations, as well as restrictions on how aggressive such key factors are allowed to be.

If appropriate action is not taken by the NAIC, I would ask the Securities and Exchange Commission to seriously look at the life insurance industry to determine whether cash value life insurance products should appropriately be regulated as a security.

That is the end of my prepared remarks. Thank you for giving me the opportunity to share my thoughts.

[The prepared statement of Mr. Todd follows:]

PREPARED STATEMENT OF MEL G. TODD

My name is Mel Todd. I am a Fellow of The Society of Actuaries, a Member of The American Academy of Actuaries and belong to The National Association of Life Underwriters. However, I am *not* representing any of these organizations at this hearing today. I was recently employed for over 15 years by The Great-West Life Assurance Company, most recently as Vice President in charge of Individual Life Product Development, Pricing, Marketing and Policy Illustrations. I am currently President of Clark/Bardes, Inc.—a national firm specializing in the sale and administration of Executive Benefit Programs and Corporate-Owned Life Insurance. Over the past several years I have been quite outspoken at several industry meetings about the problems with life insurance illustrations and whether the life insurance industry is inadvertently creating false expectations in the minds of some consumers of life insurance products. I was asked by Senator Metzenbaum's office to testify at this hearing and have agreed because I believe more attention needs to be given to this problem at this time. My prepared remarks are organized into three sections—an Introduction, a description of The Problem followed by an outline of what I believe The Solution should be.

INTRODUCTION

- Policy illustrations continue to be the dominant tool used within the life insurance industry to compare the relative cost of death benefit protection between various companies and products. This is somewhat unfortunate given that there may be no direct correlation between expectations created by policy illustrations and actual values to be delivered by the insurance companies.
- The only promise a life insurance company makes when it sells a product are the contractual guarantees. Policy illustrations are *not* promises. Rather, they are hypothetical illustrations of what *might* happen if certain (often undisclosed) assumptions come true.
- Illustration games continue to dominate the marketplace and may be getting worse. Many illustrations are either based on very aggressive assumptions or are based on historical experience that is unlikely to repeat itself in the future.
- The biggest problem that we face as an industry is that we may be creating false expectations in the minds of the buyers of life insurance products. This is not a good company/bad company issue. *All* companies illustrating competitive products have been forced to play illustration games whether they realize it or not.

THE PROBLEM

The following comments are intended to help define why there is a problem with life insurance policy illustrations for most whole life and universal life policies sold today that involve non-guaranteed elements. These comments do not apply to certain guaranteed premium term insurance policies currently available in the marketplace.

1. The demand for individual life insurance has been declining as the baby boomers age, while the supply of life insurance products has remained relatively stable. Basic economic principles suggest that whenever supply exceeds demand, weaker companies will be forced out of the business as price drops and profit margins fall. However, life insurance is unlike most other businesses because the ultimate price of life insurance is not typically determined at the point of sale. This is what creates the potential for problems within the industry.
2. Life insurance consumers tend to rely on life insurance illustrations because they like to make informed buying decisions about price/value relationships and because most people tend to believe financial projections that are prepared by a computer. This is clearly inappropriate but, sadly, is true.
3. Heavy reliance on policy illustrations as the best indicator of the price/value relationship puts tremendous pressure on *all* life insurance companies to use aggressive assumptions in policy illustrations. This gives an unfair (apparent) advantage to smaller and weaker insurers who otherwise would have difficulty competing with the larger and stronger insurance companies.
4. The actual ultimate price of a life insurance product purchased today will depend heavily on factors such as death claims, surrender rates, interest rates and taxes which will be experienced over the next 30 to 40 years or longer. These factors are subject to many influences outside the control of the insurance company.
5. Actuaries attempt to take educated guesses about future experience factors by looking at historical results. However, the history of the life insurance industry demonstrates that historical information about experience factors such as interest rates have proven to be poor predictors of the future.
6. All of this leads to an environment where actuaries are being pressured to use aggressive assumptions and policy designs in an attempt to develop competitive products. Whether the aggressive assumptions ultimately will be validated or not still remains to be seen. Early indications, however, are that actual performance of policies sold during the mid-1980's using aggressive illustrations may fall far short of original projections.
7. When determining experience factors to use in policy illustrations, no one is asking the pricing actuaries to assess the probability that the illustrated values will actually be realized. Even if asked, actuaries would differ greatly on

their view of the reasonableness of policy projections depending on personal attitudes and the degree of optimism or pessimism that each actuary feels.

8. Most uninformed buyers of life insurance products mistakenly believe that one policy illustrates better than another because it either has a lower profit markup or lower expense factors. Those same buyers may be surprised to learn that a typical after-tax profit markup on a cash value life insurance policy might translate to only 2 percent to 5 percent of premiums or less. This compares to an illustration environment where the most competitive products appear to have a cost that is 40 percent or more cheaper than the most expensive products.

9. Let's use an example to help demonstrate the sensitivity that an interest rate assumption can have on illustrated values. Assume XYZ Insurance Company has experienced the following investment performance:

   a) an *average* net yield on its invested assets of 12 percent over the past 10 years. Keep in mind we had several years of very high interest rates back in the late 1970's and early 1980's;

   b) a *current* net yield on its portfolios of assets of 10 percent. This includes current interest earnings on bonds purchased several years ago that have not yet matured; and

   c) a *new money* net yield on currently invested assets of 8 percent. This recognizes that current bond yields are at the lowest point in several years.

   Now let's assume that XYZ Insurance Company is developing a new whole life insurance product and needs to project interest rates for illustration purposes for the next 40 or 50 years. Which interest rate should be used? 8 percent, 10 percent, 12 percent or some other rate. There is no correct answer. The difference between using an 8 percent versus a 12 percent interest rate assumption can create as much as a 40 percent difference in the ultimate projected cost of the life insurance protection. However, no one (including pricing actuaries) have a crystal ball by which to accurately predict future interest rates.

10. In spite of the above comments, I believe that very few (if any) life insurance companies or pricing actuaries are deliberately attempting to mislead their agents or the buying public. Most actuaries would like nothing better than for the pricing assumptions to be validated by actual experience factors so that actual illustrated values could be realized.

THE SOLUTION

- The life insurance industry offers valuable products and services to protect families and their financial well-being. It is rather unfortunate that the life insurance industry is gaining a poor reputation because of some recent trends.
- I believe that some action needs to be taken to regulate the assumptions used in projecting product performance with life insurance policy illustrations. The likely outcome of any such regulation will be to drive the smaller and weaker life insurance companies out of business. I believe this to be true because many of these companies are only able to compete in today's fiercely competitive marketplace through the use of aggressive illustration games. By creating a more level playing field, many consumers will tend to gravitate towards the larger companies with lower unit expenses and those companies with the strongest financial ratings.
- I also believe that the industry has been unable to effectively control aggressive illustration tactics because virtually all industry groups represent a broad cross-section of insurance companies and agents and any form of regulation will naturally harm the smaller and weaker life insurance companies.
- The appropriate regulatory body for policy illustrations may be the National Association of Insurance Commissioners (NAIC). The industry is perhaps already over-regulated and introducing a new federal regulatory body at this time may not be necessary.
- I would suggest that the Subcommittee on Antitrust Monopolies and Business Rights develop a list of concerns to be presented to the NAIC to be used to develop a model bill to be adopted no later than June 30, 1994. This bill should require full disclosure of key experience factors used to develop policy illustra-

tions as well as restrictions on how aggressive such key factors are allowed to be.

- If appropriate action is not taken by the NAIC within the time frame outlined above, I would ask the Securities and Exchange Commission to seriously look at the life insurance industry to determine whether cash value life insurance products should be appropriately regulated as a security.
- That is the end of my prepared remarks. Thank you for giving me the opportunity to share my thoughts.

Senator METZENBAUM. Thank you very much, Mr. Todd, for an excellent statement.

We are going to have each of the witnesses heard first, and then I will come back and have some questions.

Ms. Newberry, we are happy to have you with us this morning.

STATEMENT OF GLORIA DARLEEN NEWBERRY

Ms. NEWBERRY. Good morning, Mr. Chairman, and members of the committee.

Until November 1991, my husband and I had term insurance, term life insurance, with Pyramid Life Insurance Co. Our agent convinced me that we should change our policies to universal life, a different type of product sold by Pyramid. She told me that universal life had a savings program and a premium that would never increase. She emphasized the savings benefit of universal life and also stated that term insurance would soon become unaffordable.

To put this in context, we also had our health insurance with Pyramid. At the same time the agent contacted us about our life insurance, she talked me into buying a secondary policy on health. A few months later, we happened to have a claim on the health insurance and were dismayed to learn that the coverage was not what we had been told.

This dissatisfaction prompted me to also question what we had been told on our life insurance policies. I tried to review our life policies but finally conceded I did not understand them at all.

For example, if we pay every premium, at age 65 my husband's death benefit is $200,000, and the guaranteed cash value will be $12,502.20. If my husband were to pass away, as his beneficiary, I would only receive the death benefit, $200,000. What happens to the $12,502.20? This is supposedly my savings.

Or how about this: It says on page 3 of my policy that in year 1, the policy value is $1,567.57. But after 19 years of payments, in policy year No. 20, the policy value will be only $1,864.16. Where does our money go?

I think this may be the most confusing. The face of my flexible premium adjustable life policy states: Planned premium, $2,600; target premium, $3,012. This seeming inconsistency is not made clear by the explanation, "Premium limitations: The sum of the total premiums paid may not exceed the greater of $52,818.48 or the sum of the level premiums of $4,629.10 annually over the life of the policy."

I still do not know what that means, but it sounds to me like our policies were going to cost a lot more than we expected. I wondered how that agreed with our agent's argument to convert our term life insurance to universal life because she said the term life would soon become unaffordable.

The agent said that universal life policy premiums would stay the same, but I came to realize that this is not true of our policies. By the time that the agent was selling me the universal life, she showed me a projection sheet showing a much larger savings at age 65. That projection was quite different from the one that was attached to our policy. That chart indicated close to $100,000 at age 65. The one attached to our policy showed only $28,428.12 at age 65.

Given our present income level, it is now obvious to me that this amount would not be enough to support in an adequate lifestyle. I would rather have been told the truth than shown a false projection sheet.

The first 3 years of the policy, it appears that we have no cash value. Surrender charges were never explained to us. Although I now feel that I understand how these policies work, I still do not understand why I am penalized with a surrender charge.

I also now know that if we took out a loan on this policy, we would have to pay it back or it would come out of the death benefit. This was never explained to me. If it is my cash value, why do I have to pay it back or be penalized on the death benefit? The agent explained that this was a life insurance and a retirement savings. It does not appear to be both to me.

Before I reported any of my apprehensions, I did phone Pyramid Life Insurance Co. and was treated as if I was an uneducated consumer who just could not understand insurance terminology. After several contacts with them and getting nowhere on getting a satisfactory explanation on how we were to live on this small amount of retirement versus the amount I was originally quoted and shown, I wrote a few letters. No one at Pyramid Life ever offered to meet with me. In fact, they avoided me.

I do realize that we were probably among the lucky ones. I have not invested a lot of time or money in this. However, I am a mother and a grandmother, and what bothers me is that I am afraid that this same misleading information may be the basis of my children's and grandchildren's retirement planning by the same unscrupulous type agents, and they may never ask questions, as I have.

Thank you for your attention.

Senator METZENBAUM. Thank you for an excellent statement, and we will have some questions. We appreciate your being with us.

Senator METZENBAUM. Mr. Wayne Bohrer of Sterling, VA.

STATEMENT OF WAYNE BOHRER

Mr. BOHRER. Thank you. My name is Wayne Bohrer, and I am accompanied today by my wife, Ruth, and we live in the Washington metropolitan area.

We are both 55 years old. Ruth is a registered nurse at Fairfax Hospital, and I am an investigator for the Drug Enforcement Administration.

I am here today to provide information on the life insurance policy which I purchased on February 12, 1985. This policy was issued by The Prudential Insurance Co. of America for the face amount of $50,000. My wife and I purchased this policy as a part of our retirement planning with the idea that it would be paid for at about the same time that I would be eligible for retirement. That plan was not to be.

We paid the premiums faithfully in accordance with our "abbreviated payment alternative" schedule issued with the policy. We understood the schedule required one payment of $1,217.50 for each of 8 years for a total of $9,744. We anticipated that no more premiums would be required, especially since no information was ever received—since no information was ever received during the 8 years that there was any problem.

Included with each annual premium notice was always the statement: Next year's annual premium will be $1,217.50. We were surprised to see this statement also included on the eighth premium notice in 1992, which we believed to be our last. Those seven words were our first and only indication that a ninth annual premium payment was going to be required. There was no explanation as to why additional premiums were being required.

We feel that the insurance company planned to collect additional premiums all along. By inserting a stock phrase in our premium notice, they were attempting to do so without alerting us to this increase in the number of annual premium payments.

We reviewed the "explanation of abbreviated payment plan" accompanying the policy and found the following disclaimer: "Since the dividends used in this illustration are based on the current scale and are not guaranteed, the possibility exists that cash premium payments may be required for more or fewer years than the period illustrated."

Mr. Chairman, I do not believe that such a vague statement is enough to warn people that their retirement is at risk.

Even after discovering the phrase in our policy that Prudential could change the rules on us, it still seemed that an explanation for the additional premium payments should have been supplied.

After contacting our insurance agent in Lancaster, PA, and corresponding with Prudential several times, I was advised that the decline in the dividend scale was the problem and that additional premiums over 5 years were required. It was going to cost us an additional $6,087.50.

They also told us that there was no guarantee that this would be enough.

This is a 63 percent increase in premium payments, and I was so unhappy that I wanted to cancel this policy. In correspondence to Prudential in February and March and April of this year, I requested that this policy be canceled and that the cash value be returned to me. And their response to my first two letters, they gave me three options, which did not include cancellation. They were, first, reduced paid-up insurance; second, extended term insurance; and third, reduce the face amount of the policy to $31,600 as of the original date of the policy, giving a full premium credit. The policy would be paid up to, but not including, February 12, 1998.

In other words, the best they can offer now is to lower the benefit by $20,000 and cover me for 5 more years. After that, when I am at an age with a higher death rate, I will have no insurance to financially protect Ruth if I die. Frankly, I would rather have my money back and see if I can get a better bargain somewhere else.

I should also note that in a notice dated March 26, 1993, I was advised that Prudential secured a loan for the ninth premium of $1,217.50 to cover the period from February 12, 1993, to February 12, 1994. Their correspondence states that the interest will be 8.430 percent. I did not request this loan, and they say it is a part of the policy.

To date, they have not responded to my third request of April 13, 1993, to cancel the policy. Ironically, earlier this month, I received a telephone call from a Nigel Darar, an insurance salesman from the Prudential field office in Ashburn, VA, where my policy is now being serviced. Mr. Darar wanted to sell me additional insurance on my policy. He knew nothing about my complaint, but offered to have his office manager, Michael Gore, look into it and give me a call. I still have heard nothing.

We thought we were buying a policy that would require no additional payments by the time of our retirement. When we found out that was not true, we asked for our cash value back. We cannot get that either. Prudential is apparently taking the money out of my cash value to pay itself the current premium and charging us over 8 percent interest. At this rate, we soon will not have any cash value left. That means the money which could have been used to buy a different insurance policy will be gone.

We are now close to retirement, and the plans we carefully laid out 9 years ago have come to nothing. If the policy we were sold had clearly spelled out that the payment schedule was only a sales gimmick, we never would have bought it. We simply would have made a different and more reliable retirement plan. The misleading insurance policy we were sold precluded us from doing that.

I hope that our appearing here today will help prevent Prudential and other insurance companies from taking advantage of other unwary buyers in the future.

I thank you for the opportunity to discuss this with you.

Senator METZENBAUM. Thank you very much, Mr. Bohrer, for an excellent statement—clear, understandable. I guess from your basis, The Rock ought to be called The Rook, because it certainly seems that you feel pretty rooked on this one.

Senator METZENBAUM. Mr. Keating, we are happy to have you with us this morning.

STATEMENT OF JERRY KEATING

Mr. KEATING. Senator, before I read my statement, I am still employed by the John Hancock through my disability program, my health insurance, and my pension. I am on 100 percent disability. And I would like to know, as far as I know, I was still employed by the John Hancock until probably 9:30 this morning, and I would like to know exactly, what guarantees do I have from this committee that I will not be harassed? I mean, my family needs that health insurance; we need that disability payment every month; and we need our retirement program.

Senator METZENBAUM. We cannot guarantee any position. But I would guess that my colleague here from South Carolina and this Senator and I think every member of this Senate would be so outraged at John Hancock if they took any action against you for testifying before a Senate committee that they would find our wrath unlimited and that we would take every step possible to protect your position.

I think the Senator from South Carolina, with whom I disagree on some issues, but I think he would agree that no witness ought to ever be penalized for appearing before a Senate committee.

And this gentleman is asking whether or not—what guarantee does he have that he will not be terminated from his employment just by reason of his appearing here.

Do I reflect the Senator's view as well?

Senator THURMOND. Yes, you do.

Senator METZENBAUM. Thank you.

Mr. Keating, please proceed, and if you have any difficulty, do not wait 1 hour after you hear from John Hancock of any termination efforts. You pick up the phone immediately and call me directly.

Mr. KEATING. OK.

Senator METZENBAUM. I will do everything humanly possible to see to it that your job is protected. But I am frank to say that although I may have some differences with John Hancock at times, I still consider them to be a responsible and respectable company, and I could not believe for a moment that they would take any action that would cause your employment to be jeopardized or lost by reason of your appearing here today. I just cannot believe that of them.

Mr. KEATING. Do you know anything about the ERISA law, Senator?

Senator METZENBAUM. Pardon?

Mr. KEATING. Do you understand anything about the ERISA law?

Senator METZENBAUM. I do. I do indeed.

Mr. KEATING. My name is Jerry C. Keating. I reside at 393 Lake Shore Drive, McCook Lake, SD. I am 55 years old, the father of 4 children, and my wife's name is Jeanette.

I began my career with John Hancock Mutual Life Insurance Co. in 1965. From 1982 to June 12, 1990, I was the staff manager in the Sioux City, IA, office. My job during this period was to office train and field train new and veteran agents. I am currently on disability caused by a heart attack.

During the first years of my employment, everything that I heard from the John Hancock home office turned out to be true, correct, just like we were told. The dividends and cash values were conservative figures and always were correct. John Hancock was truly the best place to do business and the best place to work.

Sometime in the early 1980's, we began selling a product called variable life insurance. We were told the cash value of these variable life contracts were invested in the stock market, bond market, and money markets. Every day we received information on the home office computer with glowing account facts on how much these accounts were earning—25, 30, and 35 percent interest.

This information was shown to new prospects to get them to buy variable life insurance. Also, these contracts required no premiums after 5 years. We sold these variable life policies by the hundreds. In fact, our Sioux City office was one of the leaders in the company.

Several times the other people in our office and I went to meetings where we were told nothing about the risks involved in buying this product, just how much the insured would make. We were told on one convention trip that John Hancock could pay 15 percent standing on their head.

During this period, we had a sales program called the pension-enhancement. Every pension program has different options on how much you receive from your—how much you receive in your pension check. For example, a pensioner could take his whole check every month until he dies; his monthly check would be much larger this way, but after that his wife would receive nothing. Or he could take less each month, so his wife could receive a reduced pension after he died.

Hancock's pension option would have the husband buy $50,000 or $100,000 of life insurance or whatever the amount. When he died, his wife would collect the $50,000 or $100,000 life insurance to live on. We tried to get guys to buy this as early as possible, because the premiums were cheaper and would vanish after only 5 years.

Eugene Sanderson of Sioux City, IA, bought our policy, and he changed his pension option. However, he found out that his pension would require premiums for many more than 5 years, he dropped the policy. He could not afford the $2,000 in premiums after he retired. But his wife lost her reduced pension, so she has no protection now.

Gus Konidas of Sioux City, IA, was told that he should invest in John Hancock's VLI and there would be no more premiums due after 5 years. He cashed in his policy when he found out that there would be premiums due for many years.

I personally wrote two VLI contracts on Ivan Ammar in Randolf, NE. He is the minister at the Lutheran Church there. He bought these policies for his retirement. The computer sheets showing the amount of his retirement benefits were fantastic. He paid for years, but had to drop his policies when he found out he would have to continue paying premiums after retirement.

James Mellick of Omaha, NE, was supposed to invest $10,000 per year in John Hancock's VLI. He also—he was also investing $4,000 per year for his 2 daughters Roxanne and Teri Mellick. After I went on disability, the local Hancock manager sent a new agent to Omaha to replace these policies with Hancock's flexible, variable life insurance, where the company can increase the premiums if the company does not get a better return on their money. The Mellicks were not told of any of the risk, not the first time from me not the second time. They lost everything.

Howard Graves and his wife, Joanne, of Sioux City, IA, also bought variable life insurance from me personally. They thought that there would be no cost on these after age 65 or 5 years. They were wrong.

Betty Sherr, my neighbor of McCook Lake, SD, was another. Kandyce Beauychese of Sioux City, another. Jeanette Keating, my wife, another. Holly Keating, my daughter, another. Jerry Eike, my son-in-law, another. Terry Eike, my daughter, another. Larry Eike, Jerry's brother, another.

All these people were paying from—were paying or are paying $2,000 to $4,000 per year in premiums. Joe Iner and his wife, Harriet, were paying about $10,000 per year.

These are just a few of the people who believed what was on the computer sheets as far as premiums, how long they would be required to pay, and what they would get back.

The training we received was sales training only. The home office people who came to the Sioux City, IA, office said: Don't try to become a Ph.D. in variable life insurance; just learn enough to sell it and go. This is what they told the whole office, and this was how I trained any new men that I hired: Just sell it; do not worry about it.

Just before I got sick in 1990, the company seemed to change. They started telling us about the risks.

The "rescue program" was the worst of the worst. It was the company's solution to variable life policies that had loans on them—or did not have loans on them. The management in Sioux City allowed the agents to replace every VLI policy that was written with flexible variable life insurance. This policy was something that the company could raise the premiums on or reduce the amount of insurance if they did not make enough profit. The risk was placed firmly on the shoulders of the insured.

This statement is only the tip of the problem. There are hundred and hundreds more.

And, Senator Metzenbaum, I would like to tell you, sir, if you do not get the Government to do something about this, you haven't seen nothing yet. Paying up these policies in 5 to 7 years is nickel/dime compared to what is going to happen.

Senator METZENBAUM. Thank you very much, Mr. Keating, and we will have some questions for you, and we appreciate your coming here to testify. We know that you have had a heart attack, and I am sure it is some strain for you to be with us, but we know that you feel very deeply about it, and we appreciate your testimony.

Mr. Todd, you presented a paper to the Million Dollar Roundtable last year that had the bold words printed on the first page: "The only promise a life insurance company makes when it sells a product are the contractual guarantees. Policy illustrations are not promise. Rather they are hypothetical illustrations of what might happen if certain undisclosed assumptions come true."

I say "bold", because no such statement has publicly been made by any other person representing an insurance company. In fact, you even added a footnote to your paper that your statement was not approved nor endorsed by the Roundtable, the company of which you were then a vice president, nor the Society of Actuaries to which you belong.

Now, the truth of these two sentences is irrefutable. In fact, it is reliance on that truth that companies turn to when unhappy policyholders claim they are not getting what they were told they would get.

Why do you think it is that more of your professional colleagues have not made the same statement?

Mr. TODD. I think what we need within the industry is better education. Some of the difficulties that we have within the industry is that the actuaries that design and price the products and insurance companies tend to be somewhat isolated from the sales organization and the people that are making representations about what is being sold.

You know, the reason I had made those statements and those comments at the Million Dollar Roundtable is because I do believe that we need better education within the industry. I believe that insurance companies need to be more open and more honest and provide more disclosure to not only the buying public, but the sales representatives that are out selling the products. And so I feel strongly about those statements, and that is all I have to say.

Senator METZENBAUM. Did you get any response or criticism or comment from any of your colleagues or any of the companies?

Mr. TODD. Interestingly enough, I had started speaking quite openly about some of the concerns and problems that I see within the industry back a few years ago. And originally I had expected to get somewhat of a negative backlash. But all I can say is, that has not occurred.

I would say that most life insurance companies and most life insurance agents want to do the right thing. They want to make a good and fair and open and honest disclosure to the consumers of life insurance products. So for the most part, the feedback that I have received, because of the fact that I have been quite outspoken within the industry, has been very positive and very encouraging.

Senator METZENBAUM. Why do you think the companies use these figures and charts that really are sheer puffery or sheer speculation or sheer hope without making it very clear in bold type that you cannot count upon these figures; they are just what we are guessing will be the costs in the future or the benefits in the future?

Mr. TODD. The difficulty that we have within the industry is that insurance companies have been struggling, trying to figure out ways to sell their life insurance products without such heavy reliance on policy illustrations.

Unfortunately what is happening within the marketplace and the industry is that the buying public tends to place very emphasis and a lot of credibility on policy illustrations, and, in fact, there is a lot of spreadsheeting going on within the industry where consumers, in making a buying decision, like to make an informed buying decision and like to pay as little as they can to purchase goods and services.

And unfortunately in the insurance industry, the policy illustrations is the vehicle that is most often used to create expectations about what the ultimate price of life insurance is going to be.

Because of that, insurance companies find that unless they are also able to generate illustrations that create what is considered to be a competitive product in the marketplace, they find that their sales will drop off quite significantly. And we are in an environment where the supply of life insurance exceeds the demand for life insurance.

So insurance companies struggle with trying to figure out ways of being more open and honest in their disclosure to the ultimate consumer, but at the same time generate the sales that they need in order to run a viable business.

Senator METZENBAUM. Do you not think that many policyholders, before they buy a policy, they look at those assumptions, they look at those figures, and in their head do they not say: Well, I know that they are not necessarily guaranteeing these, but John Hancock or the Pru or the Equitable or the Metropolitan, whatever the company may be, they would not use these figures unless they really believe them; they must be very accurate?

And is there not a psychological impact on the buyer, even if the buyer is told that these are what the company expects them to be, but cannot make any guarantees? Do you not think that there is a tremendous reputation that these companies have and that the policyholder sort of says: Well, they really would not be stating anything if they did not believe it 100 percent? And yet the fact is, they do not believe it 100 percent. Do you think that is true?

Mr. TODD. Oh, I agree that there is a lot of truth in that statement.

Yes, I was at the end of the insurance industry where I had responsibility to not only price the products, but to develop the assumptions and the disclosures and the illustrations and everything else. And some of the difficulties that the insurance industry faces is that up until very recently insurance companies tended to project out dividends using certain sets of assumptions. But up until the last 5 or 6 years perhaps, insurance companies always tended to outperform those projections.

Now, they did primarily because we were in an environment for 25 or 30 years where interest rates tended to go up, where mortality tended to improve, and insurance companies were able to manage their affairs such that they were always able to meet or exceed their dividend projections.

So, regardless of the statements that are included on illustrations about dividends not being guaranteed and the strength of the wording in the insurance contracts about dividends not guaranteed, insurance company actuaries went around for many years saying: Be careful, dividends are not guaranteed, they can go up or down. But their actions showed the marketplace that, in fact, dividends only tended to ever go up, and it created an environment where as interest rates began to fall and mortality has not been improving as well as it did previously, and expenses have gone up and taxes have gone up, dividends now are in a decline, and a lot of people are having a difficult time accepting that.

And so part of the problem is really the environment, the way I see it, the fact that we went through the period of time where a lot of life insurance salespeople were led to believe, presumably because of the actions of insurance companies, that dividends really can only do one of two things: They can go up or remain the same. They really did not expect dividends to realistically have a chance of dropping. But because of the environment, because of the experience factors, virtually all insurance companies, dividends are dropping, and that is part of the difficulties that we are facing today.

Senator METZENBAUM. You said at the same meeting: "The illustration game has really turned into a high-stakes game of deception, and competitive insurance products currently in the marketplace have a less than 10 percent chance of meeting their illustrated values."

Why do responsible companies continue to produce them? Or maybe you have already answered that question.

Mr. TODD. Well, you see, I was at Great-West Life at the end of the spectrum, trying to determine what it is that we needed to do in order to run a viable business and sell a decent volume of sales. And Great-West Life, in fact, has seen its market share diminish considerably over the last few years, partly because we were unwilling to play some of the aggressive illustration games going on in the marketplace.

And life insurance companies are in somewhat of a difficult business. They have got quite a large overhead, quite an expensive operation that they are running, and unless they can continue to sell large volumes of sales, they will find themselves quickly being driven out of business.

And all I would say is that insurance companies and actuaries do not want to mislead anybody. That is not anybody's intention. However, the competitive forces within the marketplace keep driving companies to a position where they are making more and more aggressive assumptions in their illustrations, and they are trying to reveal that by stronger disclosure on illustrations and stronger disclosure in policy sales literature to try to educate the consumer that the projections, in fact, are not guaranteed, and they are subject to change.

But, unfortunately, I think people tend to put a lot of reliance on numbers generated from a computer, and they tend to believe those numbers, and that is the problem that we have within the marketplace.

Senator METZENBAUM. At a recent meeting of underwriters, Thomas Wheeler, a chief executive officer of Massachusetts Mutual, said in the last decade: "Some companies encourage churning", meaning rolling over whole life business into universal life. Not only did these companies swap high-margin products for low-margin ones, they often incurred additional acquisition costs.

Do you agree with Mr. Wheeler's remarks?

Mr. TODD. Yes, I do.

Senator METZENBAUM. Mrs. Newberry, you and your husband had one type of life insurance policy, and your insurance agent convinced you to buy a different, more confusing type of policy. Is that correct, as I understand it?

Ms. NEWBERRY. That is correct, yes.

Senator METZENBAUM. You thought the replacement policy was guaranteed to cost you a level amount each year, but later realized the premium could change.

Now were you not told exactly what was guaranteed and what was subject to change about the replacement policy?

Ms. NEWBERRY. No, sir. We were told that our premiums would remain the same. At the time the policy came, I, like most consumers, I feel, put the policy away in the safe. I did not even look at it, because it had been explained upfront at the time I purchased it, I thought, what would happen.

It was only at a later date that I pulled it out of the safe and started studying it and realized that none of what I had been told was true.

Senator METZENBAUM. I am sure you do not know the answer to this, but how many pages would you guess are in the insurance policy?

Ms. NEWBERRY. 20. I'm guessing.

Senator METZENBAUM. 20?

Ms. NEWBERRY. Maybe. I do not know.

Senator METZENBAUM. All fine print?

Ms. NEWBERRY. All fine print, most of it fine print.

Senator METZENBAUM. But when the insurance agent delivered it to you, you believed him? You thought he was an honest, reputable fellow?

Ms. NEWBERRY. It was not delivered to me; it was mailed to me with a sheet to sign and return.

Senator METZENBAUM. And you thought that you had a policy that you would not have to have any changes on and that you could count upon, what the agent had represented, 20 pages of fine type print, and you decided: I am not going to read that; I am sure it is OK. And you put it away?

Ms. NEWBERRY. Well, yes, but I feel that a lot——

Senator METZENBAUM. I think you did what most people do.

Ms. NEWBERRY [continuing]. Of consumers do that.

Senator METZENBAUM. Pardon?

Ms. NEWBERRY. I think a lot of consumers do that, Senator Metzenbaum.

Senator METZENBAUM. I do not think a lot. I think 99.9 percent, including this Senator, do exactly that. And when you go back to read it, I have found in the past that you usually found that in paragraph 3, it refers—it says something like "except as provided in paragraph 11(d)(1)," and then you run back to 11(d)(1) to read that, and then you have to go back and pick up your train of thought, and finally by the time you get through about three or four pages, you say: Oh, the hell with it; I am not going to——

Ms. NEWBERRY. That is right.

Senator METZENBAUM. Is that about right?

Ms. NEWBERRY. That is about right.

Senator METZENBAUM. You mentioned surrender charges. On many investment-type vehicles, one sees words to the effect of: There may be substantial penalty for early withdrawal.

Did you see any such disclaimer written on your policy or explained to you by your agent?

Ms. NEWBERRY. Nothing was explained to me about surrender charges, and I saw nothing.

Senator METZENBAUM. Do you remember if there was anything in the policy about that?

Ms. NEWBERRY. In fine print, I found, when I was going through the policy, that there was something, yes. But upfront, I did not know that.

Senator METZENBAUM. And would you say—it was in fine print; was it right upfront, or was it somewhere in the back of the policy?

Ms. NEWBERRY. No, it was in the back of the policy.

Senator METZENBAUM. You told us that you believed the cash value accumulated under your policy was your money, something like a savings account that your insurance company was investing for you, money that you would receive as a side benefit to a death claim or from which you could borrow. You now know that that is not correct; is that so?

Ms. NEWBERRY. No, that is so. If I had kept the term policy of $200,000 and put the additional amount in the bank, I could have drawn the money out of the bank without surrender charges.

Senator METZENBAUM. I am sorry. I did not get that. You could have what?

Ms. NEWBERRY. Had I kept the term policy of $200,000 and not changed it over to universal life, and I had I taken the difference in premiums and put them in a savings account, then I would have had the money in the bank, plus the death benefit on my husband.

Senator METZENBAUM. You told us the forecasts you were shown on buying the new policy anticipated a much greater return than the projection attached to your policy. Did you realize the sales prediction was not what you were actually buying?

Ms. NEWBERRY. At the time I bought it, I believed the agent, and I thought that I would—that the projection sheet was correct. She did not leave the original projection sheet with me.

Senator METZENBAUM. Thank you. My time has expired.

Senator Thurmond?

Senator THURMOND. Mr. Todd, I am very interested in your statement. On the last page of your statement, I believe you give "The Solution," as you called it.

Mr. TODD. Yes.

Senator THURMOND. Would you mind restating for the record in simple words from your experience in the insurance business what you feel is a solution to this problem?

Mr. TODD. Well, I believe the problem——

Senator THURMOND. Speak so we can all hear you, please.

Mr. TODD. Pardon me?

Senator THURMOND. Speak so we can all hear you into the microphone.

Mr. TODD. OK, I believe that the solution to the problem lies in some form of regulation of policy illustrations that insurance companies are allowed to provide to potential consumers of insurance products, and I believe that the appropriate place for that regulation to occur is perhaps the National Association of Insurance Commissioners. And I believe that the form of the regulation needs to be basically twofold.

One is the disclosure of the key assumptions utilized to project potential values for the next 30 or 40 years or longer, and the second is some restrictions placed on what types of assumptions are able to be used, both in terms of the levels of interest rates, the types of mortality rate assumptions that can be used, and others. And I believe that is appropriate in order to create a more level playing field within the industry and to try to break the cycle that we are in of insurance companies trying to find ways of developing better looking illustrations in order to enhance their sales activities.

Senator THURMOND. Are you in a position to take this up within NAIC and see if they can act on it without the Federal Government going into this field?

Mr. TODD. Well, I am not personally. I believe that is the correct answer for the industry as I have studied these issues over time.

I am here primarily as an independent concerned professional in the insurance industry, who is concerned about some of the activities and some of the misuses of policy illustrations in the marketplace. But, no, I would not personally take that challenge on in order to try to convince the NAIC as to what it is that needs to be done.

Senator THURMOND. Do you think it is a matter for the NAIC to act on instead of the Federal Government? And who do you think should take this up within NAIC? Do they have representatives present here yet? Please raise your hand and let me see where you are.

Do you gentlemen represent the NAIC?

Senator METZENBAUM. The answer is, Senator Thurmond, Commissioner Lyons of the Insurance Department of Iowa is the chairman of the Disclosure Task Force of the NAIC. He will be up——

Senator THURMOND. You heard what Mr. Todd had to say?

Mr. LYONS. Yes; yes, sir.

Senator THURMOND. Thank you, Mr. Todd.

Ms. Newberry and Mr. Bohrer, the frustration revealed by your testimony makes it clear that many consumers do not adequately understand important elements of their life insurance policies.

Do you believe that more complete disclosure about the financial risk involved in life insurance policies would have helped you avoid the problems that you experienced? Would written disclosures be adequate if they were sufficiently clear, or are oral explanations also needed?

I would be glad to hear from both of you.

Ms. NEWBERRY. I feel that a written disclosure would be sufficient if it were written in words that the average consumer can understand, and we were told upfront to be sure and read this, that it would explain the policy.

Otherwise, I feel that it should be done orally.

Senator THURMOND. You are not including the fine print which people frequently do not bother to read; is that correct?

Mr. BOHRER. Correct, and I feel that a false projection is worse than no projection. I mean, I just think they should tell you the truth.

Senator THURMOND. Mr. Bohrer?

Mr. BOHRER. Well, I feel that the disclaimer that I found in my policy was really misleading.

Senator THURMOND. Speak into the microphone, please.

Mr. BOHRER. I found that the disclaimer in my policy was really misleading. And I had checked on the disclaimer throughout the 8 years that I was paying premiums. And I was assured that the premiums would be enough as I went along.

The disclaimer spelled out that it was an accurate estimate of how much—or the amount of premiums it would take to secure the policy. And the disclaimer said that it may take more years, or it may take fewer years. And these words were repeated by the insurance agent from time to time during my contacts with him over the years.

And I feel that there needs to be and must be more accurate information supplied at the time that you are considering purchasing an insurance policy.

Senator THURMOND. As I understand from you all, you feel that the wording in the policies should be so the average person can understand it and printed large enough so they can read it, and not just in fine print which people generally do not read; is that correct?

Mr. BOHRER. I have not read my entire policy. It is in fine print, and I would say it contains more pages than 20 or 25. It is probably 30 or 35 pages. And I have yet to read it all. I have not read every paragraph in that policy.

Senator THURMOND. Mr. Keating, it is my understanding from your testimony that neither you nor your customers realized that the illustrations you used to sell whole life insurance policies were not based on guaranteed returns, but on variable interest rates and investments which were uncertain. My question is: Do you feel that your insurance company hid this fact from you and your customers during the 1980's, or was it disclosed in the written policies?

Mr. KEATING. No, I do not believe John Hancock Co. withheld anything from myself or other staff managers or agents. But the meetings that we held—and there were many—these were sales meetings. They were always sales meetings. We did not talk about risks. When you have got a piece of literature that actually shows that your stock account is returning 25 and 30 percent interest, that is what you are interested in. You are interested in things that are going to help you market that policy.

And believe me, you had better market those policies, or you will not have a job.

Senator THURMOND. I just asked Mr. Todd his opinion as to the solution to this problem that you all are experiencing.

In a very few words, could you give us your solution?

Mr. KEATING. No; I do not have any solution.

Senator THURMOND. Do you feel the NAIC should work out something?

Mr. KEATING. I do not know anything about the NAIC?

Senator THURMOND. How is that?

Mr. KEATING. I do not know anything about that organization. I mean, I know they are the insurance commissioners. But I do not feel that the insurance commissioners—that is what you were talking about, right?

I do not believe the insurance commissioners—most of those insurance commissioners are going to get jobs with some—in some executive capacity with an insurance company when their term with the Insurance Commission is completed. I do not believe they are going to do too much to solve this problem.

Senator THURMOND. Mr. Todd, do you see any way to avoid placing the performance risk of investments and interest rates on policyholders in these economically uncertain times?

Mr. TODD. The risk associated with the future investment performance are ultimately passed along to the consumer, and so the whole question that we are talking about here is really one of education. I am not sure whether that has answered your question or not.

Senator THURMOND. Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you, Senator Thurmond.

Senator Specter, we are happy to have you with us this morning.

Senator SPECTER. Thank you, Mr. Chairman.

Senator METZENBAUM. Do you have any questions, or do you want to wait?

Senator SPECTER. I would just say at the outset, Mr. Chairman, that I think these are important hearings. I wanted to stop by. I have staff here.

As you know, there are so many contemporaneous hearings that I will not be able to stay too long, but I think they are important, and I will review the transcript.

Senator METZENBAUM. Thank you very much. We are happy to have you with us to the extent that you can stay.

Senator SPECTER. Thank you.

Senator METZENBAUM. Mr. Bohrer, you testified the disclaimer in your policy was insufficient to warn you that the amount of your premiums could go up. And when they did increase, the explanation was inadequate.

So I asked your State commissioner, Steven Foster, who is also president of the NAIC, to draft and work to pass a law that would guarantee that you and other consumers could make informed life insurance purchases.

Do you think if such a law had been in effect, you would have benefited from such a law; you would have known more about what you were buying?

Mr. BOHRER. Well, yes, if the law would have described or would have insured that I would have known what the policy really was, yes.

Had I known that the policy was as it is today, I would not have purchased the policy.

Senator METZENBAUM. You would not have purchased it?

Mr. BOHRER. No. I would have wanted a better guarantee for retirement purposes.

Senator METZENBAUM. I noticed when you talked about canceling the policy and taking the cash value, whatever it was, were you not concerned at that point that you were just going to lose what you had paid in already and that you were just going to be hurt financially, or did you think that your first loss would be the cheapest loss, and that they more you put in——

Mr. BOHRER. Well, I have been working with and corresponding with Prudential since February 1992 when I first got that indication in my premium notice that additional premiums would be necessary. So it has been over a year that I have been corresponding with them. And I have been trying to get my money back out of the policy and at least to get the cash value out of the policy.

I feel this way about the insurance company at this point. I am not sure what else is in my policy that would be a disclaimer in the case they were to pay a death benefit. I do not know that my wife would receive what the face value of the policy is. I lack confidence at this point in the insurance policy, and I would rather just have back out what I have invested and take that for what I can make out of it in another investment or another policy that I could understand better.

I feel that I need to get something back out of the policy in order to go on from here.

Senator METZENBAUM. In some previous hearings, we have talked about insurance companies printing in bold face the specifics of what the rights and obligations—rights of the insured, obligations of the company—are.

And I remember hearing some years ago—and I do not remember the name of the company, but I think it was an Iowa-based company that had changed their format, so that the policies would be—so that the specific terms and the most important portions of the policy were printed in very boldfaced type that was easy to read.

Do you think that would have been helpful to you?

Mr. BOHRER. Yes, that would have been helpful. I think the insurance policies need to be—need to use fewer words, and I think they need to be not in such small print, and I think they ought to be very clear as to what the policies are, what they will deliver, and what the costs may be.

I had no idea that my insurance premiums were going to increase by 63 percent. Had they been closer to the 8 years that had been schedules, 1 or 2 years, I probably would have gone on and paid them, the difference, realizing, well, OK, that is close. But since it was an additional 5 years and increase of 63 percent in premiums, no guarantee that that was going to be enough—in fact, they said: We do not know—then I said: I do not want any part of this.

Senator METZENBAUM. Mr. Todd, do you know of any insurance companies that have boldfaced language right up front, so that a policyholder knows what he or she is getting?

Mr. TODD. The policy contracts on the face page of the contract are required to provide certain disclosures about the type of policy and some of the risks associated with them. And on a State-to-State basis, different States have different requirements. Some States require certain statements to be in boldface, printed in red, on the face of the policy contract, and others have different types of requirements.

The policy contracts, for the most part, need to be filed and approved by the State Insurance Departments, and they need to satisfy a lot of requirements in terms of specific wordings and specific policy provisions, which is one of the reasons that the insurance contracts tend to be as long and as wordy as they are.

In terms of the policy illustrations themselves, I do know that most life insurance companies have been moving toward providing fuller disclosure and more description about the types of risks associated with their contracts, and they have been trying to—or trying to reformat the illustrations to try to avoid creating any misperception or misconception on behalf of the ultimate consumer of the products.

Whether those efforts will ultimately be successful or not, I think, still remains to be seen. But this is an issue that the insurance industry is deeply concerned about. The insurance industry has been around for many, many years and expects to be around for many, many more years to come, and nobody wants to mislead the buying public, and companies want to do the right thing, and they want to have satisfied buyers of their product.

Senator METZENBAUM. Mr. Todd, I wish I believed that. I have been investigating the insurance industry for almost as long as I have been in the Senate. And over a period of time, I have had committees meeting and working with the head of the Pru sitting in, with the head of State Farm Mutual sitting in, and others.

And I do think that some insurance companies are well-intentioned. But the fact is, they do not file—they do not have those 20- and 30-page-fine-print documents because any insurance department requires them to do that. You know, 99 out of 100 instances, insurance companies file a copy of their policy with the Insurance Department and sell. And the Insurance Department does not look it over and say: Well, in paragraph 13(a)(1), you did not state it exactly correctly.

They do not do that. That is just not the way it happens in the real world. And my concern is that over a period of time, the insurance industry, which has had an opportunity to get its act cleaned up—and it is really a very respectable industry in the minds of almost all Americans—but the fact is, when it comes to selling policies, there is an element of deceit. There is an element of only telling half the information. There is an element of almost having—well, holding back, holding back, just as they held back on these two people over here. They told them part of the story, but they did not tell them all.

In fact, as Mr. Keating points out, the same thing is true in the policies he was selling. They did not tell the whole story.

And I have difficulty in understanding why an industry that has as fine a reputation as it does really does not live up to its reputation.

Mr. Bohrer, let me ask you a couple more questions.

You told us your insurance company is apparently dipping into your cash value to pay itself premiums. Did you know that they could legally do that when you bought the policy?

Mr. BOHRER. I knew that there was—it had been explained to me, although I did not understand the circumstances under which they could do it, that there was a loan possibility under the policy. I do not want that. I do not want to continue the premiums at all. And apparently, I have no say in that. That is going to continue as a part of the policy. And I do not want that. I would just rather cancel the policy and get away from it at this point.

Senator METZENBAUM. Thank you.

Mr. Keating, I understand you are currently involved in a legal conflict with your employer, John Hancock, over the amount of your disability and retirement pay. Maybe some would claim that that conflict colors your view of John Hancock, but I did not get that from your testimony, frankly.

So you will understand if I ask you this question. If you were not in that lawsuit, would you in any way change the truth of your testimony today?

Mr. KEATING. No.

Senator METZENBAUM. I did not think your answer would be different.

You heard me say a little while ago that agents' groups have refused to send a witness to testify here today. Why do you think an official agents' group, representing men and women like yourself, would not want to appear here today to talk about the policies they sell?

Mr. KEATING. Well, they are probably scared of their jobs.

Senator METZENBAUM. That they could be terminated, that an agent has to be concerned about whether or not John Hancock or the Pru or Metropolitan or Equitable, whatever the case may be, will continue to permit that agent to represent the company?

Mr. KEATING. That is right.

Senator METZENBAUM. And an agent can be——

Mr. KEATING. I am concerned about them harassing me on my disability insurance.

You mentioned something about my disability program at John Hancock. I asked you if you understood anything about the ERISA law. I am sure you do. But I have in writing an SPD, which is a supplemental plan document that any insurance company or anybody that provides benefits for their employees must put out yearly, and it is supposed to be simplified so the employees can understand it without going into some big, thick, confusing contract.

My SPD said that if I got sick, I would be paid $1,683 a week if I was sick. Now that is per week. It sounds like a lot, but I earned a lot when I was working. That is one of the reasons I worked, 14, 16 hours a day, was so to provide for my family's financial future security.

I had a heart attack. I found out that this was wrong. I was going to get paid $900 a week, and it ruined my family's financial future forever.

And then I have to hire attorneys to fight this $50 billion organization, who has—the ERISA law was passed to protect people and their pension programs and their benefits programs.

And back in Iowa and all over the United States, there are thousands and thousands of people who were promised that if they worked for companies for their lifetime, that they would get life paid-up benefits. Their health insurance would be guaranteed for life. And you know what is happening about that. People are losing their health insurance. And this ERISA law is protecting these companies when they are supposed to be protecting people like me.

It is not doing the job. There need to be changes in this ERISA law.

Senator METZENBAUM. Mr. Keating, another hat I wear is chairman of the Labor Subcommittee. I am certainly familiar with the ERISA law. And I would say to you that if you need any help in connection with your problem, I would suggest that you speak with the director of that subcommittee.

Mr. KEATING. Thank you. I will be sure to get their telephone numbers for my attorney.

Senator METZENBAUM. I will be glad to help in any way possible.

Mr. KEATING. Thank you.

Senator METZENBAUM. Have you heard of any pressure on representatives of agents' groups not to appear today?

Mr. KEATING. I got a call from an attorney in Sioux City. It was not my attorney. And he told me that—we were talking about me appearing here, and he told me that he had checked some people in the industry. Now I have no idea who. And he told me that the people that were—now I do not know if he—he told me that these people would be sending written statements, but they would not appear before this subcommittee, because your subcommittee was

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considered to be—how the hell did he describe that—I cannot remember what he said, but——

Senator METZENBAUM. It was not a very complimentary——

Mr. KEATING. No, it was not. It was not at all. [Laughter.]

Senator METZENBAUM. But I suppose that is all in the eyes of the beholder.

Did he say that our subcommittee would be on a witch hunt?

Mr. KEATING. Witch hunt! That is it! I told your lady back there.

Senator METZENBAUM. Well, I guess finding out what insurance companies do to rip off policyholders would be considered by some a witch hunt.

Mr. KEATING. Well, like Mel said, I do not believe that that is intentional. But there is so much competition for business, it is just unbelievable.

But do you remember what happened with the Medicare supplement plans?

Senator METZENBAUM. Yes.

Mr. KEATING. There was articles that I read where some people had purchased 10 and 12 of these Medicare supplement policies.

And then was it the Government that stepped in and said that everybody that sells a Medicare supplement is going to sell exactly the same Medicare supplement, and the only thing that is going to be different is the premium; was that the Federal Government that did that, right?

So anyway, this all happened after I got sick, and I am not familiar with them. But as I understand it, each Medicare Supplement A—everybody puts out an A, whether it is Blue Cross or John Hancock or Prudential—every Medicare supplement that is described by the letter A is the same, and the only difference is the premium.

And maybe you should do that with the life industry, too. Every $10,000 life insurance policy that anybody sells is going to be the same; the only difference would be the premium. And if you are talking about $100,000, it will be the same way; the only difference would be the amount of the premium.

So there would be no competition except companies would attempt to cut down their costs to compete.

Senator METZENBAUM. Let me go back—thank you. I think your point has some validity to it.

Let me ask you a question. This lawyer who called you, is he your lawyer?

Mr. KEATING. No; no, he is the lawyer of Eugene Sanderson, one of the guys that is suing John Hancock.

Senator METZENBAUM. He is the lawyer for another guy who is suing John Hancock?

Mr. KEATING. Yes.

Senator METZENBAUM. I see. And you know him, so it would not be unusual for him to call you?

Mr. KEATING. No; it is unusual for him to call me.

Senator METZENBAUM. I guess I would ask you, how do you explain the fact that he was——

Mr. KEATING. I do not know.

Senator METZENBAUM. How did he know you were going to testify? Who suggested to him that he call you?

Mr. KEATING. Well, I do not know. He just called me up, and we got into a conversation about this. And then he called me later on, maybe the next day, and he said that he had information from the industry that some of the people that were going to appear here were going to back out. We knew that before your lady did, your assistant did. They were going to only send written statements, and they would not appear here, because this Senator Metzenbaum and the committee is nothing but a witch hunt.

Senator METZENBAUM. Well, he——

Mr. KEATING. And as far as I am concerned, it is——

Senator METZENBAUM. Well, he certainly had inside information.

Mr. KEATING. He sure did.

Senator METZENBAUM. He knew what was going on.

And I gather, Mr. Todd, you heard the same thing?

Mr. TODD. Well, I did not hear quite the same thing. I did speak with a representative of NALU, and we had a nice discussion about the hearing today and left it at that.

Senator METZENBAUM. And what?

Mr. TODD. Left it at that.

Senator METZENBAUM. Was it sort of suggested maybe it would be just as well that you not appear?

Mr. TODD. No, actually it was not.

Senator METZENBAUM. OK; and, Mr. Keating, in order to be sales manager of your office, you had to be a pretty good salesman.

I take it, you believed in your product?

Mr. KEATING. Absolutely, 100 percent, more than 100 percent.

Senator METZENBAUM. If you had known about the potential financial jeopardy to your clients in the policies you were selling, would you have insisted that the company make those risks clearer to you and to them, and would you have also not permitted the members of your own family to buy the policies?

Mr. KEATING. That is right, absolutely right.

Senator METZENBAUM. You testified that——

Mr. KEATING. Well, my family—and I was paying those premiums. I was buying programs for my children.

Senator METZENBAUM. What you were telling people that were buying policies from you, you actually believed. You had no reason not to believe.

Mr. KEATING. 100 percent. The only reason I did not have one on my life is because I am overweight, bad heart, diabetes, and arthritis.

Senator METZENBAUM. You testified that your company produced a policy in which they said the premium would vanish in only a few years. You had been selling insurance for over 25 years, and you understandably believed that. The other agents in this country believed it, too.

The buyers of the policy relied on the illustrations and what the agents told them, so that they believed it.

When the company did not continue to earn the high figures in the financial markets, they did not take the loss themselves; they simply demanded additional years of premiums.

Do you think the policies made this clear, or in any way did you have any way of knowing that this could happen to the policyholders?

Mr. KEATING. I never—I never dreamed that anything like this would happen.

But those policies are—you could read a policy for the next 30 years, and you would never understand what it said.

Senator METZENBAUM. I am very grateful to all of you as witnesses, and your stories are, indeed, very compelling, and I think it takes a good deal of courage to come before a Senate committee and tell your stories.

My reaction, frankly, is to write the chief executive officers of each of the companies that you spoke of and say to them: How do you explain this?

But the problem that I face is that the problems that you have enunciated here today are not limited. I have such a tremendous group of letters on this same problem that I think I would end up writing to almost every insurance company in the country that sells this kind of policy, because there are many other policies and hundreds of thousands of other individuals that are in your same position.

And I am frank to say that I do not believe that we can solve it by one company or another making a case-by-case solution. We need our Government to protect you and other insurance consumers.

The NAIC has talked about providing that protection. I think they are well-intentioned as a group. I think they are moving in the right direction. But I think that the timetable is long and tedious, and meanwhile more and more policyholders are being left high and dry.

I believe that in some areas we could use Federal regulation. But I do not really care whether it is Federal regulation or State regulation. There is something wrong when people such as yourselves wind up getting the short end of the stick, wind up not having any recourse in our society, wind up jeopardizing your entire economic future as you grow older. And you speak as representatives of millions of other people in this country.

Mr. Todd, I think it takes a lot of courage on your part to come and be before us today, and the same for you, Mr. Keating. We are very, very grateful to you for your participation and your involvement, and we hope to be able to keep in touch with you, and we hope that in some not far distant future we will be able to do something, so that what has happened to you will not be happening to other people in our society.

Thank you very much for your appearance.

Our next witnesses, which we are very happy to receive today, are Commissioner David Lyons. Mr. Lyons is with the Iowa Insurance Department. He is chairman of the Disclosure Task Force of the National Association of Insurance Commissioners and is, himself, commissioner of Insurance in the State of Iowa.

And we have Mark Rakich, California Department of Insurance, Sacramento, CA. I want to say to you, Mr. Rakich, I am very grateful to you for being with us, as Commissioner Lyons as well. And I know that you, Mr. Rakich, are here on behalf of Commissioner Garamendi from California, and I do not think there is any commissioner in the country who is trying harder to protect the policyholders of this country. He has been very aggressive, very courageous, and he has appeared before this committee previously, and we know that it was at some inconvenience to yourself that he arranged for you to be here today, and we are very happy to welcome you this morning.

Mr. RAKICH. Thank you, Senator.

Senator METZENBAUM. Mr. Lyons, we have you listed first on the list, and we will be very pleased to hear from you.

PANEL CONSISTING OF DAVID J. LYONS, COMMISSIONER, IOWA INSURANCE DEPARTMENT, AND CHAIRMAN, DISCLOSURE TASK FORCE, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, WASHINGTON, DC; AND MARK RAKICH, CALIFORNIA DEPARTMENT OF INSURANCE, SACRAMENTO, CA

STATEMENT OF DAVID J. LYONS

Mr. LYONS. Thank you, Mr. Chairman.

My name is David Lyons. I am recording secretary for the National Association of Insurance Commissioners and the commissioner of Insurance for the State of Iowa. I also serve, as you noted, as the chairman of the NAIC's Life Insurance Committee, which has jurisdiction over several insurance consumer disclosure issues including life policy illustrations, which has been the subject of a lot of discussion this morning.

I appreciate this opportunity to appear before the subcommittee. You have been kind enough to make us aware of your concerns in the area of consumer disclosure for life insurance consumers. It is clear that we share a common concern, and that truly is a common concern—consumer protection.

Each and every State insurance regulator lives by these words day-in and day-out: Consumer protection is our job. Informed consumers are the cornerstone of effective consumer protection. This is particularly true in relation to life insurance with its proliferation of complex products over the past decade.

And, Mr. Chairman, as they say in baseball—and I understand you have an interest in baseball these days—you cannot tell the players without a scorecard? Well, it is far too easy for consumers these days to lose track of balls and strikes on how their insurance product works for them, and that is leading to the type of problems we have heard about this morning.

Access to information is the true key. The NAIC has long been working to improve the availability and quality of information consumers receive. Our activities have included the development of consumer information guides as well as the adoption of numerous model laws and regulations.

Nearly two decades ago in December 1975, the NAIC first adopted the life insurance disclosure model regulation, which is now the law of the land in 41 States. It set forth requirements for policy summaries and some general rules for disclosure. In December 1983, the model was extensively amended to allow consumers to compare the yields of different types of life insurance policies.

A buyer's guide was added in 1976. Thirty-two States now require that it be provided to consumers during the sale of insurance.

In 1983, it was upgraded to include information on universal life and other new developments in the insurance world.

As new products were introduced to the marketplace, new needs for consumer protection arose. So in June 1989, our life insurance committee adopted disclosure statements to help consumers compare different types of interest-sensitive products. The forms were then tested with consumers, and revisions were made in December 1989 based upon that consumer input. These disclosure forms were then added to the NAIC universal life model regulation.

In 1990, we established a working group to look at issues related to senior citizens. This group developed a form to disclose to consumers over age 60 the possibility that premiums for small term life insurance might exceed death benefit at a certain point.

In 1991, the form was revised and a free-look period on limited benefit policies was extended to 30 days to allow for additional time for review.

In 1992, we developed a guide to buying life insurance after age 60 to explain the disclosure form itself.

Variable life insurance products have also gained our attention. In June of 1986, an illustrations guide for variable life insurance was adopted. The very next year, we took further steps to provide even more disclosure on this issue. As with all areas of insurance regulation, however, our focus is not on what we did yesterday; it is on what we will do tomorrow.

We have established a working group to address concerns regarding life insurance marketing. This group has met on several occasions and has actively submitted input from all sources, including all identified consumer groups. So far we have received several statements, unfortunately none yet from the consumer representatives, but we do expect them, and it is my intent as chairman of the parent committee of this working group to see that we develop draft language for implementation this year.

In addition, I hope this hearing itself sheds light, a spotlight, on the issue to encourage the States to focus greater attention on adopting the consumer protection measures which have already been developed by the NAIC.

Mr. Chairman, you and your fellow subcommittee members could be of great help in this effort. Contacting State legislators, contacting State Governors, and contacting constituents back home is of use to all of the commissioners in the NAIC to give them the support they need back home for the adoption of necessary disclosure model regulations, and I urge you, if you have not already contacted them, to contact them as soon as possible.

Giving consumers clear, relevant, and complete information plays an important role in any market, particularly in one as complex as insurance, and it is extra complex in the area of life insurance. The NAIC has long recognized this fact, and I think our record reveals our commitment to consumer information.

Yet as with all aspects of insurance regulation, our task is never-ending. The NAIC will continue to press ahead with our efforts to assure that insurance consumers have the tools that they need to make informed choices. While the task is not an easy one, it is one for with State insurance regulators, I believe, with our extensive experience on disclosure and our commitment to consumer protection, are well-suited.

Thank you, Mr. Chairman.

[Mr. Lyons submitted the following:]

PREPARED STATEMENT OF DAVID J. LYONS ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

INTRODUCTION

Mr. Chairman, members of the Subcommittee, my name is David Lyons. I am the Recording Secretary of the National Association of Insurance Commissioners (NAIC) and the Commissioner of Insurance for the State of Iowa. I also serve as the Chairman of the NAIC's Life Insurance Committee, which has jurisdiction over several consumer disclosure issues, including life policy illustrations.

As you know, the NAIC is the oldest association of state public officials, whose members are the chief insurance regulatory officials of the 50 states, the District of Columbia, and four U.S. possessions. The NAIC is grateful for the opportunity to appear before this subcommittee to discuss the important issue of insurance consumer disclosure. We are particularly grateful for the thoughtful oversight of this subcommittee over the last year to such related issues as life policy illustrations and assumption reinsurance.

Today, I will discuss the role of consumer disclosure in the insurance market and the challenges faced by regulators in assuring that consumers are provided with enough information to make an informed choice. I will also describe the activities of state regulators and the NAIC in improving insurance consumer disclosure in a number of areas.

THE CHALLENGES OF INSURANCE CONSUMER DISCLOSURE

Informed choices by purchasers play a vital role in every competitive market. What is particularly challenging for insurance consumers, however, is that insurance products, and especially life insurance products, by their nature, are very difficult to understand. The complexity has increased in the last decade with the proliferation of a host of new and elaborate life insurance products.

The inherent complexity of modern life insurance policies and the rapidly evolving nature of the market has posed similar challenges for insurance regulators. While, as you will hear in a moment, the NAIC has been quite active in the regulation of insurance consumer disclosure and has accomplished a great deal, we can and will be doing more.

NAIC ACTIVITIES REGARDING CONSUMER DISCLOSURE

The NAIC has been quite active in recent years in improving the access that consumers have to the information they need to make informed choices about insurance. Our activities have included the adoption of model laws and regulations for enactment by the states and the development of consumer information guides for several types of insurance. I now will discuss some of the more significant developments in insurance consumer disclosure.

Life insurance policy illustrations

The NAIC has long shared this subcommittee's interest in accurate and fair consumer disclosure in the sale of life insurance products. In December 1975, the NAIC first adopted the Life Insurance Disclosure Model Regulation, now adopted in 41 states. That regulation briefly set forth requirements for a policy summary and some general rules for disclosure. In December of 1983 the model was extensively amended to provide for various indices to assist consumers in comparing the yield of different types of policies.

A Buyer's Guide was added in June 1976, now required to be provided to consumers in 32 states. In 1983, the Buyer's Guide was amended to include information on universal life and other new developments. Under the model regulation, an insurer must provide a prospective purchaser the Buyer's Guide, along with a policy summary, before it accepts the applicant's initial premium or premium deposit, unless the purchaser is provided with an unconditional refund provision of at least ten days, in which case the Guide and summary must be delivered no later than the delivery of the policy. The model regulation, including the Buyer's Guide, is Attachment A, and an optional, alternative version of the model is Attachment B.

In June 1989 the Life Insurance Committee adopted disclosure statements to assist consumers in comparison of different types of interest-sensitive insurance products. After adoption the forms were tested with consumers and revisions made in December 1989 according to the comments received. The aim of the working group was to make the statements easy to understand and distribute them to consumers early enough in the purchase process to aid in meaningful comparison. Changes to the models were made to indicate that the disclosures should be delivered at the time of application or within 15 working days thereafter. The group identified several abuses which they attempted to address. The disclosure forms were also added to the Universal Life Model Regulation, which is Attachment C.

In 1990 a working group was appointed to look at issues specifically related to senior citizens. This working group developed a form to disclose to consumers over age 60 the possibility that premiums might exceed death benefit at a certain point. In 1991 the form was revised and the free look period on limited benefit policies extended to 30 days. Changes were made to the disclosure model to require notice and delivery of the form. In 1992 a Guide to Buying Life Insurance After Age 60 was adopted to explain the disclosure form. This guide is Appendix F in Attachment A and Appendix D in Attachment B.

In addition to the changes to the Life Insurance Disclosure Model Act and the Universal Life Model Regulation, the Life Insurance (A) Committee has also adopted two related documents. In December 1990 a Bulletin on Illustrated Interest Projections was adopted. The purpose of the bulletin is to help insurers to conform with NAIC Rules Governing the Advertising of Life Insurance (Attachment D), the disclosure regulation, and the NAIC Unfair Trade Practices Act.

In June of 1986 an Illustrations Guideline for Variable Life Insurance was adopted (Attachment E). It contains a set of suggestions for illustrations for variable life products. The Market Conduct Surveillance Task Force amended the Rules Governing the Advertising of Life Insurance in 1987 to provide more disclosure.

As we advised you in our letter of October 23, 1992, which we would like incorporated into the record by reference, we have established a working group to address the concerns you addressed in your letter of September 18, 1992. That working group has met on several occasions since it was created, and has solicited input from all sources, including consumer groups, and so far has received several statements, but none yet from consumer representatives. Among the proposals my department has suggested to the working group for inclusion in a draft regulation are:

- a limit on the number of pages in the policy illustration to perhaps two pages;
- that one page could be a consumer-friendly chart, with the other page being a narrative explaining the assumptions used for the nonguaranteed parts, such as interest rates assumed, mortality assumed, expense components or others as appropriate;
- a requirement that in the event the illustration provided does not meet the nonguaranteed assumptions, a new illustration be provided to the insured when those assumptions are not met; and
- to the extent possible, a requirement that the illustration provide a standard definition of terms and standard definitions of footnotes used in illustrations.

While it is too early to say whether these or other suggestions will or will not be included in an NAIC draft, it is my intent as Chairman of the parent committee of the working group to urge that we develop draft language this year.

I must say, however, that the adoption by the NAIC of new protections for consumers, without more, will not suffice. To adequately protect American insurance consumers, the states will need to focus greater attention on adopting the consumer protections already developed by the NAIC. While nearly all states have adopted the Life Disclosure Regulation and most states have adopted the Buyer's Guide, the states need to do a better job of incorporating the more recent enhancements in these models. It is my earnest hope, Mr. Chairman, that one of the results of the hearings this subcommittee is higher visibility for this issue leading, in turn, to broader public support for the need for the modernization of the laws and regulations governing the marketing of life insurance products.

Assumption reinsurance

Another issue involving insurance consumer disclosure in which this subcommittee has expressed an interest is that of assumption reinsurance. An assumption reinsurance agreement is a contract which transfers insurance obligations and/or risks of existing or in-force contracts of insurance from one insurer to another which is intended to result in the establishment of direct liability by the assuming insurer to the policyholders and the extinguishment of the transferring insurer's obligations under the contracts.

Assumption reinsurance agreements can serve valuable social functions. Should an insurer encounter financial difficulty which would be relieved in part by the transfer of a block of business to a healthier insurer, it is in the clear interest of a policyholder of the troubled company that the transfer be made. Not only does such a transfer increase the likelihood that the promises made by the insurer to the policyholder will be kept, but it also increases the likelihood that the service needs of the consumer will be met.

Also, in the situation where an insurer who once made the business decision to enter a line of insurance but who subsequently, for any of a variety of reasons, has decided that it is not advisable to continue in that line of insurance, desires to transfer the business already written in that line to an insurer that is interested in writing that line of insurance. In such a situation, the policyholder may be better served by the assuming insurer, who has a more vital, ongoing interest in conducting business in that line of insurance.

The consumer protection problem in such transactions are two-fold. First, consumers have a basic right not only to know what is happening to their insurance contract, but to know enough about what is happening to protect their interests. The second, related problem occurs when the consumer ends up worse off as a result of a transfer, as in the case where the assuming insurer is or becomes impaired financially, or where guaranty fund protection is lessened by virtue of the transfer. The NAIC is sensitive to these concerns, and has grappled for some time with the development of an effective means of providing consumers with protections against such hazards. We have taken extensive testimony from consumer representatives, industry groups, and other interested parties and have listened closely to the concerns expressed on all sides.

Mr. Chairman, I believe we are very near the resolution of this debate. At the NAIC Summer National Meeting to be held next month, the NAIC Reinsurance Task Force will consider recommending the adoption of the Assumption Reinsurance Model Act. In a nutshell, the proposal takes a two-pronged approach to protecting the interests of a policyholder whose contract is the subject of a proposed assumption reinsurance agreement. First, the act would require the prior approval of the state insurance commissioner for any assumption reinsurance transaction. Further, this approval could be granted only if the assuming insurer is licensed in the commissioner's state and is subject to all other requirements of the act with respects to residents of the state, such as guaranty fund coverage. In the Commissioner's decision whether to approve the transfer, the commissioner would consider the financial condition of both companies, the competence, experience, and integrity of the management of the assuming insurer, the assuming insurer's plan for administration of the block of business, the fairness of the transfer, and the adequacy of the notice to policyholders.

The second prong of the proposed act hinges on disclosure to the consumer of the proposed assumption reinsurance agreement. Under the act, the transferring insurer would be required to provide to each policyholder and each policyholder's agent or broker a notice of transfer. That notice would provide the consumer with, among other things, very detailed information as to the financial condition of the assuming insurer and the fact that the policyholder has the right to either consent to or reject the transfer. After no fewer than thirty months after the first notice, a second notice must be sent to the policyholder. If, after an additional six months, or three years after the first notice, the policyholder has not given express consent to the transfer, consent will be deemed to have been given. It is important to note that express consent, as opposed to implied consent, is the NAIC's preferred mechanism for exercising a consumer's approval of a policy transfer. We believe that this approach goes the extra mile—with two notices over a three-year period—to encourage such consent.

Should the Reinsurance Task Force approve the act next month, it will be advanced for consideration by the Special Insurance Issues Committee and then the Executive Committee and full NAIC for final adoption.

Credit insurance

Yet another issue in which the NAIC is looking at insurance consumer disclosure as a means of improving market regulation is that of credit insurance. As you know, credit insurance is insurance sold in connection with a specific loan or other credit transaction.

Continued abuses in the credit insurance marketplace have caused state insurance regulators to initiate an investigation into the marketing and pricing of various credit insurance products. In the course of that investigation, the NAIC Committee on Credit Insurance, which I chair, has conducted a number of hearings, beginning in November 1990; in which the views of consumers, industry representatives, and members of the academic community have been heard. While the Committee has been working on a wide range of reforms designed to enhance the existing consumer protections, one component of the reforms is an enhancement of the NAIC Model Act and Regulation on Credit Insurance.

The NAIC Credit Life Insurance and Credit Accident and Health Insurance Model Act was amended in 1988 to its current form. There are various disclosure requirements built into the act. The insurer is required to provide either a policy, in the case of individual insurance, or a certificate, in the case of group insurance, to the debtor. There are various requirements concerning disclosure that enables the debtor to identify the insurer, policy terms and conditions, premiums and other important information. The act sets forth deadlines for delivery of the policy or certificate.

The NAIC Credit Life Insurance and Credit Accident and Health Insurance Model Regulation, like the act, was amended in 1988 to its present form. The regulation provides for disclosure of various information to the debtor. Thirty-eight states and the District of Columbia have adopted the NAIC model act.

The work of the Committee on Credit Insurance has produced proposed amendments to the model act which would expand significantly upon the information required to be disclosed to the prospective purchaser of credit insurance. The additional information that would be required to be disclosed includes:

- the fact that the debtor is not required to purchase insurance to obtain the loan;
- where multiple credit insurance coverages are being offered, whether the debtor has the right to purchase the coverages separately, or must purchase them as a package;
- the fact that the debtor is eligible for all coverages with regard to employment, health and or other conditions;
- the fact that the purchase of credit insurance may not be necessary in the event that the debtor has other policies which cover the transaction; and
- the debtor has a minimum 30-day free-look period in which the coverage may be canceled by the debtor, with any premiums paid to be refunded.

These proposed revisions will be the subject of a meeting of the NAIC Committee on Credit Insurance next month at the NAIC's Summer National Meeting.

CONCLUSION

Mr. Chairman, empowering consumers with clear, relevant, and complete information about purchase decisions can play an important role in any market. This is particularly true with respect to a complex product like insurance. The NAIC has long recognized this fact, and our record reveals our commitment to assuring the disclosure of such information to consumers in a broad array of situations.

Our task is far from complete. As I have explained today, state insurance regulators and the NAIC continue to press ahead in our effort to assure that informed insurance consumers have the tools they need to make informed choices about whether to buy insurance, what type of insurance to buy, and from whom they should purchase insurance. While the task is not an easy one, it is one for which state insurance regulators, with our extensive expertise and our commitment to consumer protection, are well suited.

ATTACHMENT A

LIFE INSURANCE DISCLOSURE MODEL REGULATION

Table of Contents

Section 1. Authority

This rule is adopted and promulgated by the commissioner of insurance pursuant to Section 4A(1) of the Unfair Trade Practices Act of the Insurance Code.

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

Section 2. Purpose

A. The purpose of this regulation is to require insurers to deliver to purchasers of life insurance information which will improve the buyer's ability to select the most appropriate plan of life insurance for the buyer's 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 a violation of this regulation or any other [state] statute or regulation.

Section 3. Scope

A. Except for the exemptions specified in Section 3B, this regulation shall apply to any solicitation, negotiation or procurement of life insurance occurring within this state. Section 5C only shall apply to any existing nonexempt policy held by a policyowner residing in this state. This regulation shall apply to any issuer of life insurance contracts including fraternal benefit societies.

B. Unless specifically included, this regulation shall not apply to:

(1) Annuities;

(2) Credit life insurance;

(3) Group life insurance (except for disclosures relating to preneed funeral contracts or prearrangements as provided herein. These disclosure requirements shall extend to the issuance or delivery of certificates as well as to the master policy);

(4) Life insurance policies issued in connection with pension and welfare plans as defined by and which are subject to the federal Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. Section 1001 *et seq.* as amended; or

(5) Variable life insurance under which the amount or duration of the life insurance varies according to the investment experience of a separate account.

Section 4. Definitions

For the purposes of this regulation, the following definitions shall apply:

A. Buyer's Guide. A Buyer's Guide is a document which contains, and is limited to, the language contained in Appendix A to this regulation or language approved by the commissioner.

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

C. Contribution Principle. The contribution principle is a basic principle of dividend determination adopted by the American Academy of Actuaries with respect to individual life insurance policies. The Academy report, *Dividend Recommendations and Interpretations* (November 1985), describes this principle as the distribution of the aggregate divisible surplus among policies in the same proportion as the policies are considered to have contributed to divisible surplus. In a broad sense, the contribution principle underlies the essential equity implied by participating business.

D. Cost Comparison Indexes.

(1) Surrender Cost Comparison Index—Illustrated Basis. The Surrender Cost Comparison Index—Illustrated Basis is calculated by applying the following steps:

(a) Determine the cash surrender value, if any, available at the end of the tenth and twentieth policy years, based on the company's current rate schedule.

(b) For participating policies, add the terminal dividend payable upon surrender, if any, to the accumulation of the annual cash dividends at five percent (5%) interest compounded annually to the end of the period selected and add this sum to the amount determined in Step (a).

(c) Divide the result of Step (b) (Step (a) for nonparticipating policies) by an interest factor that converts it into an equivalent level annual amount that, if paid at the beginning of each year, would accrue to the value in Step (b) (Step (a) for nonparticipating policies) over the respective periods stipulated in Step (a). If the period is ten (10) years, the factor is 13.207 and if the period is twenty (20) years, the factor is 34.719.

(d) Determine the equivalent level premium by accumulating each annual premium payable for the basic policy or rider, based on the company's current rate schedule, at five percent (5%) interest compounded annually to the end of the period stipulated in Step (a) and dividing the result by the respective factors stated in Step (c). (This amount is the annual premium payable for a level premium plan.)

(e) Subtract the result of Step (c) from Step (d).

(f) Divide the result of Step (e) by the number of thousands of the equivalent level death benefit, using the company's current rate schedule to determine the amount payable upon death for purposes of Section 4H(1), to arrive at the Surrender Cost Comparison Index–Illustrated Basis.

(2) Surrender Cost Comparison Index–Guaranteed Basis. The Surrender Cost Comparison Index–Guaranteed Basis is calculated by applying the steps indicated in (1) above but assuming that the company charges the maximum premiums and provides the minimum cash values and, for purposes of Section 4H(1), provides the minimum death benefits allowed by the policy, and, if the policy is participating, pays no dividends.

(3) Net Payment Cost Comparison Index–Illustrated Basis. The Net Payment Cost Comparison Index–Illustrated Basis is calculated in the same manner as the comparable Surrender Cost Comparison Index–Illustrated Basis except that the cash surrender value and any terminal dividend are set at zero.

(4) Net Payment Cost Comparison Index–Guaranteed Basis. The Net Payment Cost Comparison Index–Guaranteed Basis is calculated in the same manner as the comparable Surrender Cost Comparison Index–Guaranteed Basis except that the cash surrender value is set at zero.

E. Current Dividend Scale. The current dividend scale is a schedule that exhibits dividends to be distributed if there is no change in the basis of these dividends after the time of illustration.

F. Current Rate Schedule. The current rate schedule is a schedule showing the premiums that will be charged or the cash values or death or other benefits that will be available if there is no change in the basis of these items after the time of illustration.

G. Discontinuity Index. The discontinuity index is the sum of the backward second differences squared in the yearly prices of death benefits (per 1,000) for policy years through twenty-three (23). Examples of calculations appear in Appendix B of this regulation.

H. Equivalent Level Death Benefit. The equivalent level death benefit of a policy or term life insurance rider is an amount calculated as follows:

(1) Accumulate the amount payable upon death, regardless of the cause of death, at the beginning of each policy year for ten (10) and twenty (20) years at five percent (5%) interest compounded annually to the end of the tenth and twentieth policy years respectively.

(2) Divide each accumulation of Step (1) by an interest factor that converts into one equivalent level annual amount that, if paid at the beginning of each year, would accrue to the value in Step (1) over the respective periods stipulated in Step (1). If the period is ten (10) years, the factor is 13.207 and if the period is twenty (20) years, the factor is 34.719.

I. Generic Name. A generic name is a short title that is descriptive of the premium and benefit patterns of a policy or a rider.

J. Investment Generation Method. The investment generation method is the method of determining dividends so that dividends for policies issued in specified years or groups of years reflect investment earnings on funds attributable to those policies.

K. Nonguaranteed Factor. A nonguaranteed factor is any premium, benefit, or other item entering into the calculation of the Surrender Cost Comparison Index–Illustrated Basis that can be changed by the company without the consent of the policy owner.

L. Policy Data. The policy data is a display or schedule of numerical values, both guaranteed and nonguaranteed, for each policy year or a series of designated policy years of the following information: illustrated annual, other periodic, and terminal dividends; premiums; death benefits; cash surrender values and endowment benefits.

M. Policy Summary. The policy summary is a written statement describing the elements of the policy, including, but not limited to:

(1) A prominently placed title as follows: STATEMENT OF POLICY COST AND BENEFIT INFORMATION.

(2) The name and address of the insurance agent or, if no agent is involved, a statement of the procedure to be followed in order to receive responses to inquiries regarding the Policy Summary.

(3) The full name and home office or administrative office address of the company in which the life insurance policy is to be or has been written.

(4) The generic name of the basic policy and each rider.

(5) The following amounts, where applicable, for the first five (5) policy years and representative policy years thereafter sufficient to clearly illustrate the premium and benefit patterns; including, but not necessarily limited to, the years for which Cost Comparison Indexes are displayed and the earlier of at least one age from sixty (60) through sixty-five (65) and policy maturity:

(a) The annual premium for the basic policy;

(b) The annual premium for each optional rider;

(c) The amount payable upon death at the beginning of the policy year regardless of the cause of death, other than suicide or other specifically enumerated exclusions, which is provided by the basic policy and each optional rider; with benefits provided under the basic policy and each rider shown separately;

(d) The total cash surrender values at the end of the year with values shown separately for the basic policy and each rider;

(e) The cash dividends payable at the end of the year with values shown separately for the basic policy and each rider (dividends need not be displayed beyond the twentieth policy year);

(f) Any endowment amounts payable under the policy which are not included under cash surrender values above;

(g) If the policy has a nonguaranteed factor, the maximum premium, minimum amount payable upon death, minimum cash value, and minimum endowment amounts allowed by the policy. These amounts may be shown in addition on the basis of the company's current rate schedule and current dividend scale.

(6) The effective policy loan annual percentage interest rate, if the policy contains this provision, specifying whether this rate is applied in advance or in arrears. If the policy loan interest rate is adjustable, the policy summary shall also indicate that the annual percentage rate will be determined by the company in accordance with the provisions of the policy and the applicable law.

(7) The Cost Comparison Indexes for ten (10) and twenty (20) years but in no case beyond the premium-paying period. Indexes shall be shown on the Guaranteed Basis as defined in Sections 4D(2) and 4D(4) and, if there are dividends or a Nonguaranteed Factor, shall also be shown on the illustrated basis as defined in Sections 4D(1) and 4D(3). Separate indexes shall be displayed for the basic policy and for each optional term life insurance rider. Such indexes need not be included for optional riders which are limited to benefits; such as accidental death benefits, disability waiver of premium, preliminary term life insurance coverage of less than twelve (12) months and guaranteed insurability benefits; nor for any basic policies or optional riders covering more than one life.

(8) A policy summary which includes dividends shall also include a statement that dividends are based on the company's current dividend scale and are not guaranteed.

(9) If the policy has a nonguaranteed factor, a statement indicating that the insurer reserves the right to change the nonguaranteed factor at any time and for any reason. However, if the insurer has agreed to limit this right in any way; such as, for example, if it has agreed to change a nonguaranteed factor only at certain intervals or only if there is a change in the insurer's current or anticipated experience; the statement may indicate any such limitation on the insurer's right.

(10) This statement in close proximity to the Cost Comparison Indexes:

"An explanation of the intended use of these indexes is provided in the Life Insurance Buyer's Guide."

(11) The date on which the policy summary is prepared.

The policy summary must consist of a separate document. All information required to be disclosed must be set out in such a manner as not to minimize or render any portion thereof obscure. Any amounts which remain level for two (2) or more years of the policy may be represented by a single number if it is clearly indicated what amounts are applicable for each policy year. Amounts in Item (5) of this section shall be listed in total, not on a per thousand nor per unit basis. If more than one insured is covered under one policy or rider, death benefits shall be displayed separately for each insured or for each class of insureds if death benefits do not differ within the class. Zero amounts shall be displayed as a blank space.

N. Portfolio Average Method. The portfolio average method is the method of determining dividends so that, except for the effect of policy loans, dividends reflect investment earnings on funds attributable to all policies whenever issued.

O. Preneed Funeral Contract or Prearrangement. An agreement by or for an individual before that individual's death relating to the purchase or provision of specific funeral or cemetery merchandise or services.

P. Yearly Price of Death Benefits. The yearly price of death benefits per $1,000 is calculated by applying the following formula:

$$YP = (P-Ov-(CVCv-CVP))/(F(.001))$$

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

P = Annual premium

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

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

D = Annual dividend

F = Face amount

v = 1/(1.05)

Section 5. Duties of Insurers

A. Requirements Applicable Generally

(1) The insurer shall provide, to all prospective purchasers, a Buyer's Guide and a policy summary prior to accepting the applicant's initial premium or premium deposit; provided, however, that:

(a) If the policy for which application is made or its policy summary contains an unconditional refund provision of at least ten (10) days, the Buyer's Guide and policy summary must be delivered with the policy or prior to delivery of the policy.

(b) If the equivalent level death benefit of the policy for which application is made does not exceed $5,000, the requirement for providing a policy summary will be satisfied by delivery of a written statement containing the information described in Section 4M, Items (2), (3), (4), (5a), (5b), (5c), (6), (7), (9), (10), and (11).

(2) In the case of universal life and indeterminate premium products, the Statement of Policy Information for Applicant illustrated in Appendix D must be delivered at the time of application or within fifteen (15) working days thereafter, but at least five (5) days before delivery of the policy.

If the policy is delivered sooner than five (5) days after delivery of the disclosure statement, the free-look period shall be extended to fifteen (15) days. In the event the disclosure statement is not delivered at the time of application, the disclosure shall be accompanied by a statement that it is delivered for the express purpose of allowing comparison with other policies.

(3) In the case of a solicitation by direct response methods, the insurer shall provide the Statement of Policy Information for Applicant prior to accepting the applicant's application; provided however, that if the policy for which application is made contains an unconditional refund provision of at least ten days, the Statement of Policy Information for Applicant may be delivered with the policy.

(4) If any prospective purchaser requests a Buyer's Guide, a policy summary or policy data, the insurer shall provide the item or material requested. Unless otherwise requested, the policy data shall be provided for policy years one through twenty, and for indeterminate premium and universal life products shall substantially conform to the illustration in Appendix D.

(5) If the Discontinuity Index of any policy exceeds:

(a) Any of the test limits for discontinuity set forth in Appendix C herein, the insurer shall, prior to the sale of any such policy, provide to the commissioner a statement identifying as accurately as possible the specific policy premium or benefit causing the policy's Discontinuity Index to exceed the test limits. Upon request of the commissioner, the insurer shall also provide to the commissioner the policy data for policy years one through thirty (30), and the Discontinuity Index and its component calculations.

(b) The test limit set forth in Appendix C herein for the applicant's issue age, the insurer shall provide:

(i) The following statement displayed prominently on the policy summary and on all other sales material that show or incorporate a Cost Comparison Index: "This policy has an unusual pattern of premiums or benefits that may make comparison with the cost indexes of other policies unreliable. You should discuss this with your agent or this company. A statement of year-by-year information is available."

(ii) If the prospective purchaser requests it, a statement identifying as accurately as possible the specific policy premium or benefit causing the policy's Discontinuity Index to exceed the applicable test limit.

B. Requirements Applicable to Participating Policies. If a life insurance company illustrates policyholder dividends that are calculated in a manner or on a basis that:

(1) Deviates substantially from the contribution principle, the policy summary and all other sales material showing illustrated policyholder dividends must display prominently the following statement: "The illustrated dividends for this policy have not been determined in accordance with the contribution principle. Contact this company for further information."

(2) Uses the portfolio average method, the policy summary and all other sales material showing illustrated policyholder dividends must include the following statement: "Illustrated dividends reflect current investment earnings on funds applicable to all policies and are based on the current dividend scale. Refer to your Buyer's Guide for further information."

(3) Uses the investment generation method, the policy summary and all other sales material showing illustrated policyholder dividends must include the following statement: "Illustrated dividends reflect current investment earnings on funds attributable to policies issued since 19[ ] and are based on the current dividend scale. Refer to your Buyer's Guide for further information."

Drafting Note: Insert at [ ] the earliest year of the issue-year grouping used to determine the investment earnings on currently issued policies.

(4) Uses any combination of the portfolio average method and the investment generation method, the policy summary and all other sales material showing illustrated policyowner dividends must include an appropriate statement, analogous to the statements required by Sections 5B(2) and 5B(3), indicating how current investment earnings are reflected in illustrated dividends.

C. Requirements Applicable to Existing Policies.

(1) If a policy owner residing in this state requests it, the insurer shall provide policy data for that policy. Unless otherwise requested, the policy data shall be provided for twenty consecutive years beginning with the previous policy

anniversary. The statement of policy data shall include cash dividends according to the current dividend scale, the amount of outstanding policy loans, and the current policy loan interest rate. Policy values shown shall be based on the dividend option in effect at the time of the request. The insurer may charge a reasonable fee, not to exceed $[insert amount], for the preparation of the statement.

(2) If a life insurance company:

(a) Deviates substantially from the contribution principle, it shall annually advise each affected policy owner residing in this state that the dividend paid that year was not determined in accordance with the contribution principle and that the policy owner may contact the company for further information.

(b) In determining dividends, as of the effective date of this regulation, using the investment generation method, it shall, within eighteen (18) months of such date, advise each affected policy owner residing in this state that the dividend for the policy reflects current investment earnings on funds applicable to policies issued from 19[ ] through 19[ ]. This requirement shall not apply to policies for which the amount payable upon death under the basic policy as of the date when advice would otherwise be required does not exceed $5,000.

Drafting Note: Insert at [ ] the applicable years of issue.

(c) Changes its method of determining dividend scales on existing policies from or to the investment generation method; it shall, no later than when the first dividend is payable on the new basis, advise each affected policy owner residing in this state of this change and of its implication on dividends payable on affected policies. This requirement shall not apply to policies for which the amount payable upon death under the basic policy as of the date when advice would otherwise be required does not exceed $5,000.

(3) If the insurer makes a material revision in the terms and conditions under which it will limit its right to change any nonguaranteed factor; it shall, no later than the first policy anniversary following the revision, advise accordingly each affected policy owner residing in this state.

Section 6. Special Plans

This section modifies the application of this regulation as indicated for certain special plans of life insurance:

A. Enhanced Ordinary Life Policies.

(1) An enhanced ordinary life policy is a participating policy which has the following characteristics for all issue ages:

(a) The basic policy has a guaranteed death benefit that reduces after an initial period of one or more years to a basic amount; and

(b) A special dividend option that provides

(i) A combination of immediate paid-up additions and one-year term insurance; or

(ii) Deferred paid-up additions;

either of which on the basis of the current dividend scale will provide a combined death benefit (reduced basic amount plus paid-up additions plus one-year term insurance) at least equal to the initial face amount.

(2) The crossover point of an enhanced ordinary life policy is the first policy anniversary at which the sum of the reduced basic amount and paid-up additions equals or exceeds the initial death benefit. For these policies:

(a) The cash value of benefits purchased by dividends payable on or before the crossover point is included in the cash surrender value for the purpose of Section 4D(1)(a);

(b) The death benefit purchased by dividends payable on or before the crossover point is included in the amount payable upon death for the purpose of Section 4H(1);

(c) Dividends payable after the crossover point are assumed to be paid in cash for the purpose of Section 4D(1)(b).

B. Flexible Premium and Benefit Policies. For policies commonly called "universal life insurance policies," which:

(1) Permit the policy owner to vary, independently of each other, the amount or timing of premium payments, or the amount payable on death; and

(2) Provide for a cash value that is based on separately identified interest credits and mortality and expense charges made to the policy.

All indexes and other data shall be displayed assuming specific schedules of anticipated premiums and death benefits at issue.

In addition to all other information required by this regulation, the policy summary shall indicate when the policy will expire based on the interest rates and mortality and other charges guaranteed in the policy and the anticipated or assumed annual premiums shown in the policy summary.

C. Multitrack Policies. For policies which allow a policyowner to change or convert the policy from one plan or amount to another, the policy summary:

(1) Shall display all indexes and other data assuming that the option is not exercised; and

(2) May display all indexes and other data using a stated assumption about the exercise of the option.

D Policies with Any Rate Subject to Continued Insurability. For policies which allow a policyowner a reduced premium rate if the insured periodically submits evidence of continued insurability, the policy summary:

(1) Shall display cost indexes and other data assuming that the insured always qualifies for the lowest premium;

(2) Shall display cost indexes and other data assuming that the company always charges the highest premiums allowable; and

(3) Shall indicate the conditions that must be fulfilled for an insured to qualify periodically for the reduced rate.

E. Individualized Policy Information

(1) In addition to all other information required by this regulation, in those situations specified in Section 8I, the information illustrated in Appendix E shall be prepared on an individual basis.

(2) If an insurer uses a form other than the Financial Review of This Policy form, that form shall be approved for use by the state insurance department. An insurer may use the appropriate box or boxes from the top of the disclosure form for the specific policy being illustrated without seeking state insurance department approval for this change in the form.

(3) If cost of insurance, nonguaranteed dividends or benefits or potential preferential tax implications are presented in the policy, advertising, marketing materials, or verbally explained to the consumer, the agent, or company if a direct marketer, shall attach all those materials or representations to the Financial Review of This Policy form before issuance of the policy if not previously provided.

(4) If any method other than the Financial Review of This Policy form is used to explain the death benefit, a copy of the illustration signed by the applicant and the agent must be attached to the form.

(5) The information contained in Appendix E must be furnished to the applicant no later than the point of issue of the policy.

(6) The original of the individual information form shall be delivered simultaneously with the policy at issue and a copy shall be retained by the insurer as long as the policy remains in force, plus two (2) years.

Drafting Note: This language cannot be construed to limit the ability of a regulator or a consumer to hold the insurer responsible for the actions of an agent in any misrepresentations on the disclosure form.

F. For all other special plans of life insurance, an insurer shall provide or deliver both a policy summary substantially similar to that described in Section 4M and a Buyer's Guide. Use of those materials shall be deemed to be substantial compliance with this regulation unless the commissioner makes a finding that such disclosure materials misrepresent a material term or condition of the contract or omit a material fact.

Section 7. Preneed Funeral Contracts or Prearrangements

The following information shall be adequately disclosed at the time an application is made, prior to accepting the applicant's initial premium or deposit, for a preneed funeral contract or prearrangement as defined in Section 4O above which is funded or to be funded by a life insurance policy:

A. The fact that a life insurance policy is involved or being used to fund a prearrangement as defined in Section 4O of this regulation;

B. The nature of the relationship among the soliciting agent or agents, the provider of the funeral or cemetery merchandise or services, the administrator and any other person;

C. The relationship of the life insurance policy to the funding of the prearrangement and the nature and existence of any guarantees relating to the prearrangement;

D. The impact on the prearrangement

(1) Of any changes in the life insurance policy including but not limited to, changes in the assignment, beneficiary designation or use of the proceeds;

(2) Of any penalties to be incurred by the policyholder as a result of failure to make premium payments;

(3) Of any penalties to be incurred or monies to be received as a result of cancellation or surrender of the life insurance policy;

E. A list of the merchandise and services which are applied or contracted for in the prearrangement and all relevant information concerning the price of the funeral services, including an indication that the purchase price is either guaranteed at the time of purchase or to be determined at the time of need;

F. All relevant information concerning what occurs and whether any entitlements or obligations arise if there is a difference between the proceeds of the life insurance policy and the amount actually needed to fund the prearrangement as defined in Section 4O;

G. Any penalties or restrictions, including but not limited to geographic restrictions or the inability of the provider to perform, on the delivery of merchandise, services or the prearrangement guarantee;

H. The fact that a sales commission or other form of compensation is being paid and if so, the identity of such individuals or entities to whom it is paid.

Section 8. General Rules

A. Each insurer shall maintain, at its home office or principal office, a complete file containing one copy of each document authorized and used by the insurer pursuant to this regulation. Such file shall contain one copy of each authorized form for a period of three (3) years following the date of its last authorized use unless otherwise provided by this regulation.

B. An agent shall inform the prospective purchaser, prior to commencing a life insurance sales presentation, that he or she is acting as a life insurance agent and inform the prospective purchaser of the full name of the insurance company which the agent is representing to the buyer. In sales situations in which an agent is not involved, the insurer shall identify its full name.

C. Terms such as financial planner, investment advisor, financial consultant, or financial counseling shall not be used in such a way as to imply that the insurance agent is primarily engaged in an advisory business in which compensation is unrelated to sales unless such is actually the case.

D. Any reference to a dividend or nonguaranteed factor must include a statement that such item is not guaranteed and is based on the company's current dividend scale or current rate schedule. If a dividend or nonguaranteed factor would be reduced by the existence of a policy loan, a statement to this effect must be included in any reference to such dividend or nonguaranteed factor.

E. A system or presentation which does not recognize the time value of money through the use of appropriate interest adjustments shall not be used for comparing the cost of two (2) or more life insurance policies. Such a system may be used for the purpose of demonstrating the cash-flow pattern of a policy if the presentation is accompanied by a statement disclosing that the presentation does not recognize that, because of interest, a dollar in the future has less value than a dollar today.

F. A presentation of costs or benefits, other than that required pursuant to this regulation, shall not display guaranteed and nonguaranteed factors as a single sum unless they are shown separately in close proximity thereto.

G. Any statement regarding the use of the Cost Comparison Indexes shall include an explanation to the effect that the indexes are useful only for the comparison of the relative costs of two (2) or more similar policies.

H. A Cost Comparison Index which reflects a dividend or nonguaranteed factor shall be accompanied by a statement that it is based on the company's current dividend scale or current rate schedule and is not guaranteed.

I. Whenever a policy is issued for delivery in this state to an applicant at age sixty (60) or over, which limits death benefits during a period following the inception date of the policy or where the accumulated premiums exceed the death benefit at any point during the first ten (10) years, then the form labeled Appendix E and guide labeled Appendix F to this regulation or a form and guide containing substantially similar information and approved by the commissioner of insurance shall be completed by the insurer and delivered simultaneously with the policy and the free-look period shall be extended to thirty (30) days.

Drafting Note: States have the option of choosing an earlier time for required delivery, such as at point of solicitation.

J. Prior to taking an application for a policy which is subject to the disclosure requirements of Section 8I, the insurer must provide the applicant with a prominent notice in the following form, or in a form containing substantially similar information approved by the commissioner:

NOTICE TO APPLICANTS AGE SIXTY (60) OR OVER

With your policy, you may receive a "Financial Review of This Policy" form showing premiums and benefits for a ten (10) year period. You should review the form and your policy, and decide if the policy is suitable for you. If you are not entirely satisfied, please review the cancellation provision on the form for directions on obtaining a full refund of any premiums paid.

Section 9. Failure to Comply

Failure of an insurer to provide or deliver a Buyer's Guide, a policy summary or policy data as provided in Sections 5 and 6 shall constitute an omission which misrepresents the benefits, advantages, conditions or terms of an insurance policy.

Section 10. Separability

If any provisions of this rule be held invalid, the remainder shall not be affected.

Section 11. Effective Date

This rule shall become effective [insert a date at least 6 months following adoption by the regulatory authority].

APPENDIX A

LIFE INSURANCE BUYER'S GUIDE

The language in the Buyer's guide is limited to that contained in the following pages of this Appendix, or to language approved by [title of supervisory authority]. However, companies can vary the type style and format and are encouraged to enhance the readability, design, and attractiveness of the Buyer's Guide.

The face page of the Buyer's Guide shall read as follows:

Life Insurance Buyer's Guide

This guide can help you get the most for your money when you shop for life insurance. It can help you answer questions about:

- Buying Life Insurance
- Deciding How Much you Need
- Finding a Low Cost Policy
- Things to Remember

Prepared by the National Association of Insurance Commissioners

The National Association of Insurance Commissioners is an association of state insurance regulatory officials. This association helps the various Insurance Departments to coordinate insurance laws for the benefit of all consumers.

This Guide Does Not Endorse Any Company or Policy

Reprinted by. . .

Buying Life Insurance

When you buy life insurance, you want coverage that fits your needs and doesn't cost too much.

First, decide how much you need - and for how long - and what you can afford to pay.

Next, find out what kinds of policies are available to meet your needs and pick the one that best suits you.

Then, find out what different companies charge for that kind of policy - for the amount of insurance you want. You can find important cost differences between life insurance policies by using cost comparison indexes as described in this guide.

It makes good sense to ask a life insurance agent or company to help you. An agent can be particularly useful in reviewing your insurance needs and in giving you information about the kinds of policies that are available. If one kind doesn't seem to fit your needs, ask about others.

This guide provides only basic information. You can get more facts from a life insurance agent or company or at your public library.

What About Your Present Policy? Think twice before dropping a life insurance policy you already have to buy a new one.

- It can be costly because much of what you paid in the early years of the policy you now have was used for the company's expense of selling and issuing the policy. This expense will be incurred again for a new policy.
- If you are older or your health has changed, premiums for the new policy will often be higher.
- You may have valuable rights and benefits in your present policy that are not in the new one.
- You might be able to change your present policy or even add to it to get the coverage or benefits you now want.

Check with the agent or company that issued your present policy - get both sides of the story. In any case, don't give up your present policy until you are covered by a new one.

How Much Do you Need?

To decide how much life insurance you need, figure out what your dependents would have if you were to die now, and what they would actually need. Your new policy should come as close to making up the difference as you can afford.

In figuring what you **have**, count your present insurance - including any group insurance where you work, social security or veteran's insurance. Add other assets you have - savings, investments, real estate, and personal property.

In figuring what you **need**, think of income for your dependents - for family living expenses, educational costs and any other future needs. Think also of cash needs - for the expenses of a final illness and for paying taxes, mortgages or other debts.

What Is the Right Kind?

All life insurance policies agree to pay an amount of money when you die. But all policies are not the same. Some provide permanent coverage and others temporary coverage. Some build up cash values and others do not. Some polices combine different kinds of insurance, and others let you change from one kind of insurance to another. Your choice should be based on your needs and what you can afford.

A wide variety of plans is being offered today. Here is a brief description of two basic kinds - term and whole life - and some combinations and variations. You can get detailed information from a life insurance agent or company.

Term Insurance covers you for a term of one or more years. It pays a death benefit only if you die in that term. Term insurance generally provides the largest immediate death protection for your premium dollar.

Most term insurance policies are renewable for one or more additional terms even if your health has changed. Each time you renew the policy for a new term, premiums will be higher. Check the premiums at older ages and how long the policy can be continued.

Many term insurance policies can be traded before the end of a conversion period for a whole life policy - even if you are not in good health. Premiums for the new policy will be higher than you have been paying for the term insurance.

Whole Life Insurance covers you for as long as you live. The common type is called straight life or ordinary life insurance - you pay the same premiums for as long as you live. These premiums can be several times higher than you would pay at first for the same amount of term insurance. But they are smaller than the premiums you would eventually pay if you were to keep renewing a term policy until your later years.

Some whole life policies let you pay premiums for a shorter period such as 20 years, or until age 65. Premiums for these policies are higher than for ordinary life insurance since the premium payments are squeezed into a shorter period.

Whole life policies develop cash values. If you stop paying premiums, you can take the cash - or you can used the cash value to buy continuing insurance protection for a limited time or a reduced amount. (Some term policies that provide coverage for a long period also have cash values.)

You may borrow against the cash values by taking a policy loan. Any loan and interest on the loan that you do not pay back will be deducted from the benefits if you die, or from the cash value if you stop paying premiums.

Combinations and Variations. You can combine different kinds of insurance. For example, you can buy whole life insurance for lifetime coverage and add term insurance for the period of your greatest insurance need. Usually the term insurance is on your life - but it can also be bought for your spouse or children.

Endowment insurance policies pay a sum or income to you if you live to a certain age. If you die before then, the death benefit is paid to the person you named as beneficiary.

Other policies may have special features which allow flexibility as to premiums and coverage. Some let you choose the death benefit you want and the premium amount you can pay. The kind of insurance and coverage period are determined by these choices.

One kind of flexible premium policy, often called universal life, lets you vary your premium payments every year, and even skip a payment if you wish. The premiums you pay (less expense charges) go into a policy account that earns interest and charges for the insurance are deducted from the account. Here, insurance continues as long as there is enough money in the account to pay the insurance charges.

Variable life is a special kind of insurance where the death benefits and cash values depend upon investment performance of one or more separate accounts. Be sure to get the prospectus provided by the company when buying this kind of policy. The method of cost comparison outlined in this Guide does not apply to policies of this kind.

Finding a Low Cost Policy

After you have decided which kind of life insurance is best for you, compare similar polices from different companies to find which one is likely to give you the best value for your money. A simple comparison of the premiums is not enough. There are other things to consider. For example:

- Do Premiums or benefits vary from year to year?
- How much cash value builds up under the policy?
- What part of the premiums or benefits is not guaranteed?
- What is the effect of interest on money paid and received at different times on the policy?

Cost Comparison Index numbers, which you get from life insurance agents or companies, take these sorts of items into account and can point the way to better buys.

Cost Comparison Indexes. There are two types of cost comparison index numbers. Both assume you will live and pay premiums for the next 10 or 20 years.

1. The Surrender Cost Comparison Index helps you compare costs over a 10 or 20 year period assuming you give up (surrender) the policy and take its cash value at the end of the period. It is useful if you consider the level of cash values to be of special importance to you.

2. The Net Payment Cost Comparison Index helps you compare costs over a 10 or 20 year period assuming you will continue to pay premiums on your policy and do not take its cash value. It is useful if your main concern is the benefits that are to be paid at your death.

The two index numbers are the same for a policy without cash values.

Guaranteed and Illustrated Figures. Many policies provide benefits on a more favorable basis than the minimum guaranteed basis in the policy. They may do this by paying dividends, or by charging less than the maximum premium specified. Or they may do this in other ways, such as by providing higher cash values or death benefits that the minimums guaranteed in the policy. In these cases the index numbers are shown on both a guaranteed and currently illustrated basis. The currently illustrated basis reflects the company's current scale of dividends, premiums or benefits. These scales can be changed after the policy is issued, so that the actual dividends, premiums or benefits over the years can be higher or lower than those assumed in the indexes on the currently illustrated basis.

Some policies are sold only on a guaranteed or fixed cost basis. These polices do not pay dividends; the premiums and benefits are fixed at the time you buy the policy and will not change.

Using Cost Comparison Indexes. The most important thing to remember is that a policy with smaller index numbers is generally a better buy than a similar policy with larger index numbers.

Compare index numbers only for similar policies - those which provide essentially the same benefits, with premiums payable for the same length of time. Make sure they are for your age, and for the kind of policy and amount you intend to buy. Remember that no one company offers the lowest cost at all ages for all kinds and amounts of insurance.

Small differences in index number should be disregarded, particularly where there are dividends or nonguaranteed premiums or benefits. Also, small differences could easily be offset by other policy features, or difference in the quality of service from the agent or company. When you find small differences in the indexes, your choice should be based on something other than cost.

Finally, keep in mind that index numbers cannot tell you the whole story. You should also consider:

- The pattern of policy benefits. Some policies have low cash values in the early years that build rapidly later on. Other policies have a more level cash value build-up. A year-by-year display of values and benefits can be very helpful. (The agent or company will give your a Policy Summary that will show benefits and premiums for selected years.)

- Any special policy features may be particularly suited to your needs.

- The methods by which nonguaranteed values are calculated. For example, interest rates are an important factor in determining policy dividends. In some companies dividends reflect the average interest earning on all policies whenever issued. In others, the dividends for policies issued in a recent year, or a group of years, reflect the interest earnings on those policies; in this case, dividends are likely to change more rapidly when interest rates change.

Things to Remember

- Review your particular insurance needs and circumstances. Choose the kind of policy with benefits that most closely fit your needs. Ask an agent or company to help you.

- Be sure that the premiums are within your ability to pay. Don't look only at the initial premium, but take account of any later premium increase.

- Ask about cost comparison index numbers and check several companies which offer similar policies. Remember, smaller index number generally represent a better buy.

- Don't buy life insurance unless you intend to stick with it. It can be very costly if you quit during the early years of the policy.

- Read your policy carefully. Ask your agent or company about anything that is not clear to you.

- Review your life insurance program with your agent or company every few years to keep up with changes in your income and your needs.

APPENDIX B

Examples of Calculations of the Discontinuity Index

Example 1

The first example is a participating whole life policy issued to a male aged 35. The calculation is made on a per $1,000 basis:

		Illustrated		
Policy Year	Guaranteed Cash Value	Annual Dividend	Terminal Dividend	Premium
1	0.00	0.00	0.00	21.40
2	8.77	2.40	0.00	21.40
3	31.27	2.65	0.00	21.40
4	54.28	2.90	0.00	21.40
5	77.82	3.16	0.00	21.40
6	94.24	3.16	0.00	21.40
7	110.93	3.16	0.00	21.40
8	127.88	3.41	0.00	21.40
9	145.09	3.41	0.00	21.40
10	162.54	3.66	8.00	21.40
11	180.22	4.16	8.00	21.40
12	198.11	4.67	8.00	21.40
13	216.20	5.17	8.00	21.40
14	234.46	5.68	8.00	21.40
15	252.88	6.18	8.00	21.40
16	271.43	6.69	8.00	21.40
17	290.10	7.19	8.00	21.40
18	308.87	7.95	8.00	21.40
19	327.73	8.46	8.00	21.40
20	346.65	9.47	25.00	21.40
21	365.62	10.48	25.00	21.40
22	384.60	11.49	25.00	21.40
23	403.57	12.50	25.00	21.40
24	422.50	13.51	25.00	21.40
25	441.37	14.52	25.00	21.40
26	460.14	15.53	25.00	21.40
27	478.78	16.54	25.00	21.40
28	497.28	17.55	25.00	21.40
29	515.60	18.56	25.00	21.40
30	533.70	19.57	25.00	21.40

The yearly prices, (backward) second differences in yearly prices, and their squares for this policy are:

Policy Year	(1) Yearly Price	(2) Second Difference in Yearly Price	(3) Second Difference Squared
1	21.40	—	NA
2	10.76	—	NA
3	-2.13	-2.25	NA
4	-1.79	13.23	NA
5	-1.44	.01	NA
6	6.46	7.55	NA
7	6.98	-7.38	NA
8	7.29	-.21	.0441
9	7.85	.25	.0625
10	.59	-7.82	61.1524
11	8.72	15.39	236.8521
12	8.88	-7.97	63.5209
13	9.06	.02	.0004
14	9.28	.04	.0016
15	9.52	.02	.0004
16	9.78	.02	.0004
17	10.08	.04	.0016
18	10.15	-.23	.0529
19	10.47	.25	.0625
20	-5.84	-16.63	276.5569
21	11.05	33.20	1,102.2400
22	10.98	-16.96	287.6416
23	10.93	.02	.0004
24	10.91	.03	NA
25	10.91	.02	NA
26	10.94	.03	NA
27	11.00	.03	NA
28	11.06	.00	NA
29	11.15	.03	NA
30	11.27	.03	NA

Column (2) is calculated by subtracting the change observed in the yearly price in year t-1 from the change observed in the yearly price in year t. For example, the second difference of -16.63 in year 20 is calculated:

$$
\begin{aligned}
-16.63 &= (-5.84 - 10.47) - (10.47 - 10.15) \\
&= -16.31 - .32 \\
&= -16.63
\end{aligned}
$$

Column (3), second difference squared, is the square of the figure in column (2). The sum of the squared second differences between years 8 and 23 is 2028. This sum exceeds by 1528 the test limit for issue age 35 of 500.

Example 2

The second example is a guaranteed cost policy issued to a male aged 25. The calculation is made on a per $1,000 basis:

Policy Year	Guaranteed Cash Value	Illustrated Annual Dividend	Illustrated Terminal Dividend	Premium
1	0.00	0.0	0.0	11.34
2	0.00	0.0	0.0	11.34
3	0.20	0.0	0.0	11.34
4	9.77	0.0	0.0	11.34
5	19.84	0.0	0.0	11.34
6	30.23	0.0	0.0	11.34
7	40.95	0.0	0.0	11.34
8	52.01	0.0	0.0	11.34
9	63.41	0.0	0.0	11.34
10	75.17	0.0	0.0	11.34
11	87.27	0.0	0.0	11.34
12	99.71	0.0	0.0	11.34
13	112.48	0.0	0.0	11.34
14	125.54	0.0	0.0	11.34
15	138.90	0.0	0.0	11.34
16	152.53	0.0	0.0	11.34
17	166.43	0.0	0.0	11.34
18	180.59	0.0	0.0	11.34
19	195.03	0.0	0.0	11.34
20	224.12	0.0	0.0	11.34
21	230.80	0.0	0.0	11.34
22	253.71	0.0	0.0	11.34
23	268.85	0.0	0.0	11.34
24	284.20	0.0	0.0	11.34
25	299.73	0.0	0.0	11.34
26	315.43	0.0	0.0	11.34
27	331.29	0.0	0.0	11.34
28	347.29	0.0	0.0	11.34
29	363.43	0.0	0.0	11.34
30	379.67	0.0	0.0	11.34

Policy Year	(1) Yearly Price	(2) Second Difference in Yearly Price	(3) Second Difference Squared
1	11.34	—	NA
2	11.34	—	NA
3	11.32	-.02	NA
4	2.06	-9.24	NA
5	2.21	9.41	NA
6	2.39	.03	NA
7	2.57	.00	NA
8	2.76	.01	.0001
9	2.96	.01	.0001
10	3.16	.00	.0000
11	3.40	.04	.0016
12	3.65	.01	.0001
13	3.93	.03	.0009
14	4.26	.05	.0025
15	4.59	.00	.0000
16	4.97	.05	.0025
17	5.37	.02	.0004
18	5.78	.01	.0001
19	6.19	.00	.0000
20	-7.08	-17.68	187.1424
21	15.65	36.00	1,296.0000
22	.51	-37.87	1,434.1369
23	9.00	23.63	558.3769
24	9.52	-7.97	NA
25	10.08	.04	NA
26	10.66	.02	NA
27	11.26	.02	NA
28	11.88	.02	NA
29	12.51	.01	NA
30	13.18	.04	NA

The sum of the squared second differences between years 8 and 23 for example two is 3476. It exceeds by 3176 the test limit for issue age 25 of 300.

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APPENDIX C

Test Limits for Discontinuity

Drafting Note: The test limits for discontinuity contained in this Appendix were developed by the NAIC Advisory Committee on Manipulation to be applicable to the traditional type of whole life policy. Corresponding test limits need to be developed for other plans. Also, further refinement in the test limits for issue ages over 45 appears necessary.

Issue Age	Test Limit	Issue Age	Test Limit
25 and under	300	36	515
26	325	37	528
27	348	38	541
28	371	39	552
29	392	40	563
30	413	41	572
31	432	42	581
32	451	43	588
33	468	44	595
34	485	45 and over	600
35	500		

APPENDIX D

POLICY INFORMATION FOR APPLICANT - UNIVERSAL LIFE POLICY

This information is being provided to help you to understand this policy and to compare it to similar policies, so you can choose the one that is best for you. If you have questions about this form, be sure to ask your agent for an explanation.

[Name of Insurance Company]
[Address of Insurance Company]

Policy Name: [insert name]
Form Number: [insert number]

A policy for [Name of Insured(s)]
Social Security Number(s): [Insert number]
Date of Birth: [Insert DOB]

Applied for on [insert date]

Your Agent is [Name of Agent]
[Agent's Address]
[Agent's Telephone Number]

POLICY APPLIED FOR

Type of Universal Life Insurance Policy: ________ Flexible Premium ________ Fixed Premium

[A flexible premium policy means that you may vary the premiums paid subject to any minimum and maximum payments stated in the policy. If you do not pay enough to cover the cost of insurance, part of your cash value will be used. Some policies can lapse without value if premiums are not paid.]

[A fixed premium policy means that you have agreed to pay a scheduled premium on each due date.]

The first year death benefit applied for is $[insert amount]. The death benefit option applied for is [describe the option].

The first year annual premium is $[insert amount].

You have agreed to pay premiums [insert frequency] and each premium payment is scheduled to be $[insert amount].

This information does not include any riders for which you may apply with this policy. Riders give you extra benefits not included in the basic policy. Riders may affect your premium and cash values. Ask your agent for a full explanation of any riders.

Risk Classification Information (as applied for):
M_____ F_____ Age_____ Smoker_____ Non-Smoker_____ Other_____ (Specify) _______________

YOUR POLICY CHARGES

The *mortality charge* is the amount used to pay for the basic insurance death benefit. The current mortality charge is $[insert amount] for the first year, so this much of your first year premium pays for the death benefit. This amount may increase as you get older. In addition, the mortality charge can change. The maximum mortality charge for your current age is $[insert amount]. The company reviews mortality charges every [insert frequency].

The company's fee for *administration* of this policy may change from time to time. The current fee is $[insert amount] per [insert period], so this much of your yearly premium pays for the company's administrative costs. The maximum fee that can be charged is $[insert amount] per [insert period].

Expense Deductions (front end loads) These are additional charges that may be deducted from your premium. The amount of the charge may change depending on how long the policy has been in force. The amount currently being charged in the first year is [insert dollar amount or percentage], and the maximum charge permitted in the first year is [insert dollar amount or percentage].

Surrender charges (back end loads) are charges you may pay when your policy is surrendered. The current charge is [insert dollar amount or percentage] and the maximum charge permitted is [insert dollar amount or percentage]. Surrender charges are assessed for [insert number] years [in decreasing amounts].

YOUR POLICY CREDITS

The part of your premium not used for the above charges earns interest for you. It is the cash surrender value which you can take if you should cancel this policy.

The company has the right to change the interest rates credited to amounts paid into this policy to reflect current investment earnings. The company reviews interest rates every [insert time period]. We guarantee our rates will not go below [insert amount] %.

This policy's interest rate [is/is not] interest indexed. Interest indexing means that the interest rate credited to the amounts paid in to the policy follows a formula based on changes in the [insert index].

OTHER IMPORTANT INFORMATION ABOUT THIS POLICY

The company will pay an endowment benefit to the insured if the policy is still in force, and the insured is living and attains the age of [insert number]. This is called the "maturity age." This means the company will pay your [death benefit amount] [cash surrender value] when you have reached the maturity age, instead of waiting until you die.

If interest rates and charges were to be consistent with those illustrated in Chart A, the expenses of the policy could cause it to terminate before the maturity age. This policy would terminate at age [insert number].

Under the Chart A assumptions, the level annual premium required to provide the first year death benefit to maturity age is $[insert amount].

Based on the current assumption used to develop Chart B, the policy [would/would not] terminate before the maturity age. [If it would, indicate the policy year in which it would terminate.]

ILLUSTRATION OF POLICY VALUES

Chart A shows the guaranteed minimum interest rate and how your cash value would grow if the illustrated premium and interest rate were credited every year. Chart B shows how your cash value will grow if the interest rate remains at the level currently being paid. In both cases, the effect of any riders added to the policy is not shown.

CHART A

The following values are based on the interest rates which are guaranteed by the company and based on your timely payment of the premiums in Column 1 as applied for. If you pay a different premium in any year, results will differ.

CHART B

The following values are based on the current interest rates which the company is crediting on this policy form. Interest rates may increase or decrease from this rate. Also this chart assumes you pay the premiums shown in Column 1 as applied for.

	CHART A 1	CHART A 2	CHART A 3	CHART A 4	CHART B 1*	CHART B 2	CHART B 3	CHART B 4	
Policy Year	Annual Premium	Death Benefit	Interest Rate	Cash Surrender Value at Year End	Annual Premium	Death Benefit	Interest Rate	Cash Surrender Value at Year End	Policy Year
[1]									[1]
[2]									[2]
[3]									[3]
[4]									[4]
[5]									[5]
[6]									[6]
[7]									[7]
[8]									[8]
[9]									[9]
[10]									[10]
[11]									[11]
[12]									[12]
[13]									[13]
[14]									[14]
[15]									[15]
[16]									[16]
[17]									[17]
[18]									[18]
[19]									[19]
[20]									[20]

[Fill in other years as needed at five year intervals]

AGE									AGE
[60]									[60]
[65]									[65]
[70]									[70]

[To year of termination or maturity age]

*The first year annual premium includes any additional amounts to be deposited as applied for.

In addition to interest rates, changes in mortality and expense charges may affect the illustrations in Chart B. Current charges are used to determine the values in Chart B. The maximum guaranteed charges are used to determine the values in Chart A.

DISCLAIMER NOTICE REGARDING TAX LAW

The information in this "Policy Information for Applicant" is not intended to be used in tax planning nor is it intended for the purpose of providing tax advice. The possibility of future changes in tax laws must be recognized and taken into consideration.

POLICY INFORMATION FOR APPLICANT - INDETERMINATE PREMIUM LIFE POLICY

This information is being provided to help you understand this policy and to compare it to similar policies, so you can choose the one that is best for you. If you have questions about this form, be sure to ask your agent for an explanation.

[Name of Insurance Company]
[Address of Insurance Company]

Policy Name: [insert name]
Form Number: [insert number]

A policy for [Name of Insured(s)]
Social Security Number(s): [Insert number]
Date of Birth: [Insert DOB]

Applied for on [insert date]

Your Agent is [Name of Agent]
[Agent's Address]
[Agent's Telephone Number]

This information does not include any extra benefit riders which you may apply for with this policy. Riders may affect your premium and cash values. Ask your agent for a full explanation of any riders.

The death benefit applied for is $[insert amount]. The death benefit option applied for is [describe the option]. The first year annual premium is $[insert amount].

You have agreed to pay premiums [insert frequency] and each premium payment is scheduled to be $[insert amount].

Risk Classification Information (as applied for):
M_____ F_____ Age_____ Smoker_____ Non-Smoker_____ Other_____ (Specify) ______________

OTHER IMPORTANT INFORMATION ABOUT THIS POLICY

The company has the right to change the amounts of premiums required under this policy. The company reviews amounts of premiums every [insert frequency]. Amounts of premium required will not exceed the amounts shown in Column 2 of the "Illustration of Policy Values." [If there are any other limitations on the company's right to change premiums explain here.]

[If policy is a participating policy include this statement: There may be dividends paid to the policy owner. The "Illustration of Policy Values" does not include any dividends.]

ILLUSTRATION OF POLICY VALUES

The following values are based on your timely payment of the premiums required.

(1) Age	(2) Maximum Annual Premium (Guaranteed Assumptions)	(3) Possible Annual Premium (Current Assumptions)	(4) Death Benefit	(5) Cash Surrender Value at Year End
[1]	______	______	______	______
[2]	______	______	______	______
[3]	______	______	______	______
[4]	______	______	______	______
[5]	______	______	______	______
[6]	______	______	______	______
[7]	______	______	______	______
[8]	______	______	______	______
[9]	______	______	______	______
[10]	______	______	______	______
[11]	______	______	______	______
[12]	______	______	______	______
[13]	______	______	______	______
[14]	______	______	______	______
[15]	______	______	______	______
[16]	______	______	______	______
[17]	______	______	______	______
[18]	______	______	______	______
[19]	______	______	______	______
[20]	______	______	______	______

[Fill in other years as needed at five year intervals]

DISCLAIMER NOTICE REGARDING TAX LAW

The information in this "Policy Information for Applicant" is not intended to be used in tax planning nor is it intended for the purpose of providing tax advice. The possibility of future changes in tax laws must be recognized and taken into consideration.

INSTRUCTIONS FOR FILLING IN "POLICY INFORMATION FOR APPLICANT - UNIVERSAL LIFE POLICY"

The completed policy information statement may be delivered at, or before, the time an application is made. If the completed policy information statement is not delivered at the time of application, it must be delivered within fifteen working days after application is made, but at least five days before delivery of the policy except as provided in the next sentence. If the policy is delivered sooner than five days after the completed policy information statement is delivered, then the free-look period shall be extended to fifteen days. This policy information statement is required in connection with all applications for universal life policies, except where the policy is solicited by direct mail.

If any of the information on this policy information statement changes between the date when it is delivered and the date the policy is delivered, then a revised policy information statement based on the changed information must be delivered at the same time as the policy. In any such case, a written notice shall be furnished which outlines the major reason for the change. For example, the notice might state that the "Interest Rate" shown in Chart B has changed. As another example, the applicant could have applied as a standard risk and after underwriting been found to be a substandard risk requiring higher mortality charges.

"Joint Life Policy": If the policy applied for is a joint policy, fill in the name, social security number, and date of birth of both persons under "Name of Insured." Also, fill in the blanks under "Risk Classification Information" on that sheet in duplicate with appropriate information on the sex, smoking status and age for each person, and indicating identity for each classification.

POLICY APPLIED FOR

"Risk Classification Information (as applied for)" - If the insurance company does not distinguish between smokers and non-smokers for the policy applied for, check neither "smoker" or "non-smoker." Instead, fill in "composite" following the word "other" in the line below.

If the insured applies for a policy on a substandard basis, this should be disclosed following the word "other."

YOUR POLICY CHARGES

All of the information in this section continues to assume that the policy does not contain any extra benefit riders that require an additional premium or additional periodic change.

Mortality Charge - Fill in the blank with the current mortality charge for Year 1. The paragraph also includes wording where it can be indicated whether the maximum mortality charge increases each year. All blanks in this paragraph must be filled in on the basis of an annual mortality charge, even if the insurance company actually makes calculations monthly. (In such cases, the annual mortality charge would be twelve times the applicable monthly charge.)

The paragraph also provides for information on the maximum mortality change.
Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" for Year 1 must be calculated consistently with the amount filled in for this blank - subject to the two notes in the paragraph which follows.

Note, that if a negative Year 1 cash surrender value is generated by the calculation, the illustrated "Cash Surrender Value at Year End" for Year 1 in Chart A must be shown as zero. Note also that some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. In such cases, the illustrated "Cash Surrender Value at Year End" for Year 1 in Chart A must be filled in consistently with the provisions in policy language.

Since Chart B illustrates current values, the "Cash Surrender Value at Year End" for Year 1 must be calculated consistently with the amount filled in as the current mortality change, - subject to the two notes in the paragraph above which refers to Chart A, and are also true of Chart B.

Fee for Administration - The policy information statement contains blanks for both the current and the maximum fee for administration. For the purpose of filling in these blanks, a "fee for administration" refers to any type of charge made by the insurance company, other than a mortality charge, which is applied whether or not a premium is paid and which is required to maintain the policy in force. If the policy language makes no provision for a fee for administration, these blanks must be filled in with appropriate wording such as "none."

If there are such fees, the fill-in must describe those fees on a current basis and indicate the frequency with which the fee is charged. If the fee is only charged for a limited period, indicate that here. Thus, in the case of a universal life policy on which the current fee was $5 each month for the first five years only, the paragraph could say: $5 each month for the first five years, no fee thereafter."

In some cases, the policy language may provide for such a fee, but it is not currently being charged by the insurance company. In the case of such a policy, this paragraph could state: "No fee is currently being charged; however, policy language permits such a fee during the first five years."

Since Chart B illustrates current values, the "Surrender Value at Year End" amounts must be calculated consistently with the current fee for administration, if there is such a fee. However, this is subject to the two notes in the paragraph which follows.

Note that if any negative cash surrender values are generated by the calculations, the illustrated "Cash Surrender Value at Year End" in Chart B must be shown as zero for such years. Note also that some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. In such cases, the illustrated "Cash Surrender Value at Year End" in Chart B must be filled in consistently with the provisions in the policy language.

Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" amounts must be calculated consistently with the maximum fee for administration, if there is such a fee. However, this is subject to the two notes in the paragraph above which described Chart B, and are also true of Chart A.

"Expense Deductions (Front End Loads)" - The policy information statement contains blanks for both the current and the maximum expense deductions. For the purpose of filling in these blanks, an "expense deduction" refers to a charge which is deducted by the insurance company when premiums are paid - but not otherwise.

These expense deductions are sometimes called "front end loads" because they are deducted immediately after premiums are paid. Therefore, they affect the amount earning interest under the policy while that policy is maintained in force.

If the policy language makes no provision for an expense deduction, these blanks must be filled in with appropriate wording such as "none."

Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" amounts for year one must be calculated consistently with the maximum expense deductions, if there are such deductions. However, this is subject to the two notes in the paragraph which follows.

Note that if any negative cash surrender values are generated by the calculations, the illustrated "Cash Surrender Values at Year End" in Chart A must be shown as zero for such years. Note also that some fixed premium universal life policies define cash surrender values as the larger of two separate quantities. In such cases, the illustrated Surrender Values at Year End in Chart A must be filled in consistently with the provisions in the policy language.

Since Chart B illustrates current values, the "Cash Surrender Value at Year End" amounts for year one must be calculated consistently with the current expense deductions, if there are such deductions. However, this is subject to the two notes in the paragraph above which referred to Chart A, and are also true of Chart B.

"Surrender Charges (Back End Loads)" - The policy information statement contains blanks for both the current and the maximum surrender charge. For the purpose of filling in these blanks, a "surrender charge" refers to a charge which is deducted by the insurance company if the policy is surrendered for its cash surrender value - but not otherwise.

The surrender charges are sometimes called "back end loads" because they do not affect the amount earning interest under the policy, while that policy is maintained in force.

If the policy language makes no provision for a surrender charge, this blank must be filled in with appropriate wording such as "none." If the charges decrease as the years pass, indicate how at the end of the paragraph. For example the paragraph could say: "Year 1 - $400, Year 2 - $375, reducing by $25 each year until it reaches 0 at Year 13."

A surrender charge must be disclosed if the policy contains a provision that this surrender charge can be charged under certain conditions, even if it is waived by the insurance company under other conditions. (Such provisions are commonly called "bail-out" provisions.)

Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" amounts must be calculated consistently with the maximum surrender charges, if there are such charges. However, please see the two notes in the paragraph which follows.

Note that if any negative cash surrender values are generated by the calculations, the illustrated "Cash Surrender Values at Year End" in Chart A must be shown as zero for such years. Note also that some fixed premium universal life policies define cash surrender values as the larger of two separate quantities. In such cases, the illustrated Surrender Values at Year End in Chart A must be filled in consistently with the provisions in the policy language.

Since Chart B illustrates current values, the "Cash Surrender Value at Year End" amounts must be calculated consistently with the current surrender charges, if there are such charges. However, please see the two notes in the paragraph above which referred to Chart A, and are also true of Chart B.

YOUR POLICY CREDITS

The fill-ins should be consistent with Charts A and B to the extent applicable.

OTHER IMPORTANT INFORMATION ABOUT THIS POLICY

Maturity Age - This must be filled in consistently with the policy language.

If, under the assumptions of Chart A, termination would occur during one of the years illustrated in that chart, indicate year.

If, under the Assumptions of Chart B, termination would occur during one of the years illustrated in that chart, indicate year. Since Chart B is based on current assumptions, the policy year of termination under chart B may be a later year than the policy year of termination under Chart A.

ILLUSTRATION OF POLICY VALUES

If "flexible premium policy" is checked, Charts A and B are based on a policy with level annual premiums and level death benefits, except that there may be an additional amount assumed to be deposited in year one as illustrated in Charts A and B. This policy is assumed not to contain any extra benefit riders that require an additional premium or additional periodic charge. This policy is also assumed not to have any policy loans against it at any time.

If "fixed premium policy" is checked, Charts A and B are based on a policy with annual premiums and death benefits consistent with automatic options in the language of the policy applied for. This policy is assumed not to contain any extra benefit riders that require an additional premium or periodic charge. This policy is also assumed not to have any policy loans against it at any time.

"Age 60" - Both Chart A and Chart B contains lines for "Age 60" in the "Year" columns. "Age 60" refers to the year that the insured would have attained age 60 by the end of that year. For example, if the issue age of the insured is filled in as 34, "Age 60" refers to the year that the insured would have attained age 60 at the end of that year. If the issue age is 34, "Age 65" would refer to the 31st year. The same rule will hold true for the other ages required to be listed.

"Chart A" - Chart A is an illustration on a "Guaranteed Basis, "assuming that the insurance company consistently credits interest at the minimum rate permitted by the language in the policy, and that all charges and deductions are the maximums permitted by the policy language. However, as stated above, it is assumed that the policy contains no extra benefit riders requiring an additional premium or periodic charge.

The following instructions apply to Chart A if "flexible premium policy" is checked.

(1) The "Annual Premium" must be a level amount equal to the "First Year Annual Premium" shown, except that the "Annual Premium" must be shown as zero if there is no death benefit provided by the policy during that year, provided, however, that there may be an additional amount assumed to be deposited in year one as illustrated in Charts A and B.

(2) The "Death Benefit" shall be an amount equal to the "First Year Death Benefit" (but increased if the amount earning interest under the policy is so large that an increase in death benefit is generated by the policy language). However, if a death benefit equal to the "First Year Death Benefit" cannot be provided for the entire year, the death benefit for that year shall be filled in as the "First Year Death Benefit" followed by a slash mark and a zero. The "Policy Information for Applicant" form may provide, but is not required to provide, an explanatory footnote to indicate how long into that particular year the "First Year Death Benefit" could be provided. The "Death Benefit" shall be shown as zero for any subsequent years.

(3) The "Interest Rate" column must disclose the applicable guaranteed interest rate, used in calculating the amounts in the "Cash Surrender Value at Year End" column. These guaranteed interest rates must be consistent with the guaranteed interest rates described in the policy. However, these guaranteed interest rates must be filled in on an annual interest rate basis. An equivalent annual interest rate must be filled in, if the "Cash Surrender Value at Year End" is determined by making monthly calculations for each twelve months.

(4) The "Cash Surrender Value at Year End" must be filled in as the amount which would actually be paid as a cash surrender value. If the cash surrender value would be negative at the end of any year which is illustrated, the "Cash Surrender Value at Year End" must be shown as zero for that year. Some universal life policies contain provisions for surrender charges which are deducted under certain conditions, but not under others. (Such provisions are commonly called "bail-out" provisions.) The surrender values for policies containing such provisions must be illustrated assuming that the insurance company can and will deduct the maximum surrender charge.

(5) The lines for "Age 60," "Age 65" and "Age 70" and on must be filled in unless the following sentence applies. This is not required if either (a) the "Death Benefit" is filled in as zero in Chart A for the twentieth year or (b) the "Death Benefit" would go down to zero before the year in which insured would attain age 60 at the end of the year. Guaranteed assumptions are used in testing for this possibility. Please see the note above in these instructions describing "Age 60," for additional information concerning these lines.

To fill in Chart A if "fixed premium policy" is checked, use the same principles described above for a flexible premium policy with the following three exceptions. First, the "Annual Premium" column must be filled in using annual premiums actually described in the universal life fixed premium policy, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of premiums. Second, the "Death Benefits" column must be filled in using the appropriate actual death benefits provided under the policy in each year, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of death benefits and also assuming that the premiums are paid consistently with the amounts of premiums shown in the "Annual Premiums" column. Third, some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. The "Cash Surrender Value at Year End" column must be filled-in consistently with any such provision in the policy language.

"Chart B" - Chart B is an illustration on a "Current Basis," assuming that the company consistently credits interest at current interest rates, and all charges and deductions are also on a current basis These current interest rates, current charges and deductions are not guaranteed. The insurance company has the right to change these current interest rates, charges and deductions to the extent described in the contract. However, as stated above, it is assumed that the policy contains no extra benefit riders requiring an additional premium or periodic charge.

The following instructions apply to Chart B if "flexible premium policy" is checked.

(1) The "Annual Premium" must be a level amount equal to the "First Year Annual Premium" shown, except that the "Annual Premium" must be shown as zero if there is no death benefit provided by the policy during that year, provided, however, that there may be an additional amount assumed to be deposited in year one as illustrated in Charts A and B. Since Chart B is based on current assumptions, the "Annual Premium" will in some cases become zero in a later year under Chart B than under Chart A.

(2) The "Death Benefit" shall be an amount equal to the "First Year Death Benefit" (but increased if the amount earning interest under the policy is so large that an increase in death benefit is generated by the policy language). However, if a death benefit equal to the "First Year Death Benefit" cannot be provided for the entire year, the death benefit for that year shall be filled in as the "First Year Death Benefit" followed by a slash mark and a zero. The "Policy Information for Applicant" form may provide, but is not required to provide, an explanatory footnote to indicate how long into that particular year the "First Year Death Benefit" could be provided. The "Death Benefit" shall be shown as zero for any subsequent years. Since Chart B is based on current assumptions, the "Death Benefit" may become zero in a later year under Chart B than Chart A.

(3) The "Interest Rate" column must disclose the applicable interest rate, used in calculating the amounts in the "Cash Surrender Value" at Year End" column. No increase in this interest rate can be illustrated for future years, unless such an increase is specifically described and guaranteed in the policy language. However, the current interest rates must be filled in on an annual interest rate basis. An equivalent annual interest rate must be filled in, if the "Cash Surrender Value at Year End" is determined by making monthly calculations for each twelve months.

(4) The "Cash Surrender Value at Year End" is the amount which would actually be paid as a cash surrender value. Chart B is intended to illustrate cash surrender values on a current basis, and not on the basis of non-guaranteed future improvements that may be anticipated or hoped for. No enhancement or increment can be illustrated in Chart B unless such enhancement or increment is specifically described and guaranteed in the policy language. If the cash surrender value would be negative at the end of any year which is illustrated, the "Cash Surrender Value at Year End" must be shown as zero for that year. Some universal life policies contain provisions for surrender charges which are deducted under certain conditions, but not under others. (Such provisions are commonly called "bail-out" provisions.) The surrender values for policies containing such provisions must be illustrated assuming that the insurance company can and will deduct the current surrender charge.

(5) The lines for "Age 60," "Age 65" and "Age 70" and on must be filled in unless the following sentence applies. This is not required either if (a) the "Death Benefit" is filled in as zero in Chart B for the twentieth year, or (b) the "Death Benefit" would go down to zero before the year in which the insured would attain age 60 at the end of the year. Current assumptions are used in testing for this possibility. Please see the note above in these instructions, describing "Age 60" for additional information concerning these three lines.

To fill in Chart B if "fixed premium policy" is checked, use the same principles described above for a "flexible premium policy" with the following three exceptions: First, the "Annual Premium" column must be filled in using annual premiums actually described in the universal life fixed premium policy, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of premiums. Second, the "Death Benefits" column must be filled in using the appropriate actual death benefit provided under the policy in each year, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of death benefits and also assuming that the premiums are paid consistently with the amounts of premiums shown in the "Annual Premiums" column. Third, some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. The "Cash Surrender Value at Year End" column must be filled in consistently with any such provision in the policy language.

INSTRUCTIONS FOR FILLING IN "POLICY INFORMATION FOR APPLICANT - INDETERMINATE PREMIUM LIFE PLANS"

The completed policy information statement may be delivered at, or before, the time an application is made. If the completed policy information statement is not delivered at the time of application, it must be delivered within fifteen working days after application is made, but at least five days before delivery of the policy except as provided in the next sentence. If the policy is delivered sooner than five days after the completed policy information statement is delivered, then the free-look period shall be extended to fifteen days. This policy information statement is required in connection with all applications for indeterminate premium life policies, except where the policy is solicited by direct mail.

If any of the information filled in on this policy information statement changes between the date when it is delivered and the date the policy is delivered, then a new revised policy information statement based on the changed information must be delivered at the same time as the policy. In any such case, a written notice shall be furnished which outlines the major reason for the change. For example, the applicant could have applied as a standard risk and after underwriting been found to be a substandard risk requiring higher premium rates.

"Joint Life Policy": If the policy applied for is a joint policy, fill in the name, social security number and date of birth of both persons under "Name of Insured." Also, fill in the blanks under "Risk Classification Information" on that sheet in duplicate with appropriate information on the sex, smoking status and age for each person and indicating identity for each classification.

"Risk Classification Information (as applied for)" - If the insurance company does not distinguish between smokers and non-smokers for the policy applied for, check neither "smoker" or "non-smoker." Instead, fill in "composite" following the word "other" in the line below.

If the insured applies for a policy on a substandard basis, this should be disclosed following the word "other."

OTHER IMPORTANT INFORMATION ABOUT THIS POLICY

"The company reviews amounts of premiums every _____." - This blank must be filled in with a period of time, such as "month," "quarter" or "year." Of course, the fill-in must be appropriate for the manner in which the insurance company makes calculations under the policy applied for.

If there are any limitations on the company's right to change premiums, describe any such limitations which may apply. This would include calling attention to any provision in the policy language which could prevent the insurance company from charging the maximum premiums shown in the illustration on Page 2 of the policy information sheet.

ILLUSTRATION OF POLICY VALUES

The values in this illustration are based on a policy with annual premiums and death benefits consistent with automatic options in the language of the policy applied for. This policy is assumed not to contain any extra benefit riders that require an additional premium or periodic charge. This policy is also assumed not to have any policy loans against it at any time.

Maximum Annual Premiums (Guaranteed Assumptions) - The blanks in this column must be filled in with the maximum annual premium which is allowed under the policy language for the basic policy, but not including the additional premium for any extra benefit riders. For Year 1, this must be equal to the "First Year Annual Premium" shown elsewhere on Page 1 of the policy information statement.

Possible Annual Premium (Current Assumptions) - the blanks in this column must be filled in with the amount of annual premium which would be charged under the insurance company's current non-guaranteed premium rate schedule, but not including the additional premium for any extra benefit riders. For Year 1, this must be equal to the "First Year Annual Premium" shown elsewhere on Page 1 of the policy information statement.

The "Death Benefit" column must be filled in with the amount of death benefit provided at the beginning of the year under the basic policy, but not including the death benefit for any riders that require an additional premium. For Year 1, this must be identical to the "Death Benefit," shown elsewhere on Page 1 of the policy information statement.

The "Cash Surrender Value at Year End" column must be filled in with the amount which would actually be paid as a cash surrender value, under the basic policy. The cash value of any extra benefit riders, requiring an extra premium, is not included. If the cash surrender value would be negative at the end of any year which is illustrated, the "Cash Surrender Value at Year End" must be shown as zero for that year.

APPENDIX E

FINANCIAL REVIEW OF THIS POLICY

NOTICE: You have thirty (30) days to review your policy and, if not entirely satisfied, to return it for a full refund of any premium paid.

[THIS IS A GUARANTEED ISSUE POLICY OFFERED WITHOUT AN ATTEMPT TO CALSSIFY RISKS BY DETERMINING YOUR STATE OF HEALTH. PREMIUMS MAY HAVE BEEN LOWER IF HEALTH INFORMATION HAD BEEN OBTAINED.]

THIS IS A POLICY ISSUED ON THE BASIS OF THE ANSWERS TO THE HEALTH QUESTIONS SET FORTH IN THE APPLICATION. PREMIUMS MAY HAVE BEEN LOWER IF FURTHER HEALTH INFORMATION HAD BEEN OBTAINED.]

THIS IS A POLICY WHERE THE ACCUMULATED PREMIUM EXCEEDS THE DEATH BENEFIT IN TEN YEARS OR LESS.]

Applicant Information:

NAME: ______________________________ AGE: ____ SEX: ____

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

____

____

End of Policy Year	1 Premiums	2 Premiums Accumulating Interest at 5%*	3 Death Benefits**	4 Cash Surrender Value	5 Coulmn 3 Minus Column 2 Net Gain (Net Loss)
1					
2					
3					
4					
5					
6					
7					
8					
9					
10					

Definitions: The following terms used in the above chart are defined as:

1. **Premiums** - Amount you must pay each year to keep this policy in force.
2. **Premiums Accumulating Interest at 5%** - The amount which could be earned if, instead of purchasing insurance, the dollars were left to accumulate at 5% interest.
3. **Death Benefits** - The amount that will be paid upon your death exclusive of any supplementary benefits.
4. **Cash Surrender Value** - The amount the insurance company will pay you if you surrender your policy to the company for cash
5. **Net Gain or Loss** - This column shows whether your money would have earned more or less at 5% interest than your life insurance benefit.

*Note: This figure does not take into account the cost of insurance, any dividends or additional benefits which are not guaranteed under the policy, nor potential preferential tax implications.

[**Agent/Company: If death benefits have been explained in any manner other than shown on the above chart (through use of CPI index, dividends, or other non-guaranteed increase or a reduction in premium), a copy of the illustration signed by the applicant and agent must be attached.]

APPENDIX F

GUIDE TO BUYING LIFE INSURANCE AFTER AGE 60

This guide is designed to help you review your life insurance policy. Like many financial products, life insurance is regulated to protect buyers. It's not possible to discuss all of the consumer protections in this guide. Also, they vary from state to state. This guide discusses two items of particular importance to older buyers, the "free look" period and the Financial Review of This Policy form.

You will also receive a Life Insurance Buyer's Guide. It has additional information you may wish to review. Both guides were prepared by the National Association of Insurance Commissioners, an association of state insurance officials. Neither guide endorses any company or policy.

"Free Look" Period

With every new policy, your state requires insurance companies to provide policyholders with a "free look" period. During that period you can reconsider your decision to purchase the policy. Your policy has a 30-day "free look" period. If you choose to cancel during the "free look" period, the company must refund the premium paid (premiums are the amount you pay for coverage). The clock starts ticking when you receive the policy.

The "free look" period is the time for you to decide if the life insurance policy meets your needs.

Financial Review

To help you make a financial evaluation of your policy, before you make your final decision to keep it, insurance regulations in your state require life insurance companies to furnish some buyers over age 60 with a financial review of their policy. This review displays your policy's premiums, death benefits (the amount your beneficiary, the person you designate, receives after death) and cash values (the amount available if you cancel). Not every buyer over 60 will receive this form. Persons receiving the form purchased a policy where:

- Premiums for the policy, plus 5 percent interest, compounded annually, exceed death benefits at some time during the first 10 years; or

- Death benefits are limited for some period after the policy is issued (for example, a policy that limits death benefits for the first two years).

Drafting note: State law may require full death benefits for accidental death.

The review form is an individual analysis of your policy. It's displayed on a form called a "Financial Review of This Policy." The review is designed to help you decide if this policy makes financial sense for you and your family.

This guide uses two examples to let you see how the review form works with two different policies. These are real policies purchased by people over age 60. The policy you buy will almost surely be different from these two. Nevertheless, these illustrations should help you evaluate your policy.

Marvin Policyholder

Marvin Policyholder is 77 years old and bought an increasing benefit life policy. Even though he pays premiums over a 10-year period, his death benefits begin on day one. The policy returns an increasing death benefit as long as Marvin pays his annual premium of $507.38 ($5,073.80 over 10 years). The death benefit starts at $1,500.00 and increases by $75.00 each year. Marvin received a copy of his policy and the review form at the same time.

Forms may vary from state to state, but Marvin's looked like this:

FINANCIAL REVIEW OF THIS POLICY

Notice: You have thirty (30) days to review your policy and, if not entirely satisfied, to return it for a full refund of any premiums paid.

[ ] This is a guaranteed issue policy offered without an attempt to classify risks by determining your state of health. Premiums may have been lower if health information had been obtained.

[x] This is a policy issued on the basis of the answers to the health questions set forth in the application. Premiums may have been lower if further health information had been obtained.

[x] This is a policy where the accumulated premium exceeds the death benefit in 10 years or less.

Applicant information:

Name: **Marvin Policyholder** Age: 77 Sex: M
List other personal information used in determining the premium for this policy:

End of Policy Year	1 Premiums	2 Premiums Accumulating Interest at 5%*	3 Death Benefits	4 Cash Surrender Value	5 Column 3 minus Column 2 Net Gain (Net Loss)
1	$507.38	$532.74	$1500.00	$45.66	$967.26
2	$507.38	$1092.12	$1575.00	$206.79	$482.88
3	$507.38	$1679.47	$1650.00	$374.59	$(29.47)
4	$507.38	$2296.19	$1725.00	$550.79	$(571.19)
5	$507.38	$2943.75	$1800.00	$737.55	$(1143.75)
6	$507.38	$3623.68	$1875.00	$938.06	$(1748.68)
7	$507.38	$4337.60	$1950.00	$1157.15	$(2387.60)
8	$507.38	$5087.23	$2025.00	$1402.34	$(3062.23)
9	$507.38	$5874.33	$2100.00	$1684.77	$(3774.33)
10	$507.38	$6700.79	$2175.00	$2020.76	$(4525.79)

Definitions: The following terms used in the above chart are defined as:

1. **Premiums** - Amount you must pay each year to keep this policy in force.
2. **Premiums Accumulating Interest at 5%** - The amount which could be earned if, instead of purchasing insurance, the dollars were left to accumulate at 5% interest.
3. **Death Benefits** - The amount that will be paid upon your death exclusive of any supplementary benefits.
4. **Cash Surrender Value** - The amount the insurance company will pay you if you surrender your policy to the company for cash.
5. **Net Gain or Loss** - This column shows whether your money would have earned more or less at 5% interest than your life insurance benefit.

*Note: This figure does not take into account the cost of insurance, any dividends or additional benefits which are not guaranteed under the policy, nor potential preferential tax implications.

If death benefits have been explained in any manner other than shown on the above chart (through use of CPI index, dividends, or other non-guaranteed increase or a reduction in premium), a copy of the illustration signed by the applicant and agent must be attached.

At the top of the form (below the line discussing the 30-day "free look" period) are three boxes. The insurance company checked the second box because Marvin's policy was underwritten. He was required to answer several health questions on his application.

The third box was checked because Marvin's premiums at 5 percent compound interest, exceed death benefits before the end of 10 years. This occurs in the third year. Whenever premiums accumulated at 5 percent interest exceed benefits within the first 10 years of a policy, the insurance company is required to check this box.

Next comes Marvin's name, age, and so on. Below that are six columns of information about his policy. Columns 1, 2, 3, and 5 explain in more detail the relationship between the actual premiums Marvin paid, and what would have been the result if he had put money in a 5 percent compound interest account instead. It also displays how the death benefits increase.

<u>End of Policy Year</u>--This column gives the time frame on which columns 1 through 5 are based. That is, how do premiums and benefits, and cash surrender values, all of which change, compare at the end of each year for 10 years.

<u>Premiums</u>--This column (Number 1) shows that Marvin pays $507.38 a year for each of the 10 years shown in the chart. At the end of the 10-year period, Marvin has paid $5073.89.

<u>Premiums Accumulating at 5%</u>--Here the form (column Number 2) provides Marvin with another way of looking at his life insurance policy. If his premium dollars were deposited every year in a savings instrument, an annuity or other financial product, earning 5 percent compound interest instead of buying this policy, how would they perform?

Life insurance really isn't a savings investment. For example, Marvin's eligible for $1500 in death benefits on day one even though he paid only $507.38. In addition, these benefits aren't taxed. Both of these could be to his advantage. On the other hand he also needs to look at how much it costs for these death benefits over time.

Death Benefits–Column Number 3 indicates the amount of the death benefits his policy provides as long as Marvin pays his premiums. Benefits with Marvin's policy increase every year during the first 10 years by an amount of $75. This amount increases over the life of the policy.

Cash Surrender Value–This column (Number 4) tells Marvin how much he would receive if he cancels his policy. This amount increases over the life of the policy. Not all policies, however, provide a cash surrender value*.

*** Term insurance, for example, does not. See Life Insurance Buyer's Guide for more information.**

Net Gain, Net Loss–The last column (Number 5) provides Marvin with cost-benefit information. It is a comparison of columns 2 and 3. Notice the column changes every year. Column 5 tells Marvin:

- For the first two years, his policy has a net gain ($967.26 in year one, and $482.88 in year two);

- In the third year, however. there is a net loss. His policy reports a net loss every year after that. Whenever there is a loss, it is reported inside parenthesis such as ($29.47).

This is important information. Marvin needs to weigh this comparison with his reasons for buying life insurance and then decide if this policy best meets his needs.

Marla Policyholder

Now let's look at a policy purchased by Marla Policyholder. She is a 65 year old woman who purchased a guaranteed issue policy. This means no health questions are asked. Her policy's death benefits are reduced for the first two years. Death benefits are $470 at the end of the first year, and $940 at the end of the second. After the third year, however, they rise to $3880.

Her financial review looked like this:

FINANCIAL REVIEW OF THIS POLICY

Notice: You have thirty (30) days to review your policy and, if not entirely satisfied, to return it for a full refund of any premiums paid.

[x] This is a guaranteed issue policy offered without an attempt to classify risks by determining your state of health. Premiums may have been lower if health information had been obtained.

[ ] This is a policy issued on the basis of the answers to the health questions set forth in the application. Premiums may have been lower if further health information had been obtained.

[ ] This is a policy where the accumulated premium exceeds the death benefit in 10 years or less.

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Application Information:

Name: **Marla Policyholder** Age: 65 Sex: F
List other personal information used in determining the premium for this policy:____________________

End of Policy Year	1 Premiums	2 Premiums Accumulating Interest at 5%*	3 Death Benefits	4 Cash Surrender Value	5 Column 3 minus Column 2 Net Gain (Net Loss)
1	$235.20	$241.52	$470.40	$0.00	$228.88
2	$235.20	$495.12	$940.80	$72.00	$445.68
3	$235.20	$761.40	$3880.00	$96.00	$3118.60
4	$235.20	$1041.00	$3880.00	$120.00	$2839.00
5	$235.20	$1334.56	$3880.00	$140.00	$2545.44
6	$235.20	$1642.80	$3880.00	$160.00	$2237.20
7	$235.20	$1966.48	$3880.00	$176.00	$1913.52
8	$235.20	$2066.32	$3880.00	$184.00	$1813.68
9	$235.20	$2663.16	$3880.00	$188.00	$1216.84
10	$235.20	$3037.84	$3880.00	$184.00	$842.16

Definitions: The following terms used in the above chart are defined as:

1. **Premiums** - Amount you must pay each year to keep this policy in force.
2. **Premiums Accumulating Interest at 5%** - The amount which could be earned if, instead of purchasing insurance, the dollars were left to accumulate at 5% interest.
3. **Death Benefits** - The amount that will be paid upon your death exclusive of any supplementary benefits.
4. **Cash Surrender Value** - The amount the insurance company will pay you if you surrender your policy to the company for cash.
5. **Net Gain or Loss** - This column shows whether your money would have earned more or less at 5% interest than your life insurance benefit.

*Note: This figure does not take into account the cost of insurance, any dividends or additional benefits which are not guaranteed under the policy, nor potential preferential tax implications.

If death benefits have been explained in any manner other than shown on the above chart (through use of CPI index, dividends, or other non-guaranteed increase or a reduction in premium), a copy of the illustration signed by the applicant and agent must be attached.

As you can see, Marla's policy is very different. The major differences are: (1) death benefits exceed premiums accumulating at 5 percent for all 10 years, and (2) death benefits are limited for the first 2 years.

Box number one is checked because this is a guaranteed issue policy. No health questions were asked of Marla. Therefore, the second box wasn't checked. This third box wasn't checked because benefits exceed premiums accumulating at 5 percent for all 10 years. Let's now look at how the policy compares in the five columns of information.

Premiums–Marla pays $235.20 a year for 10 years for a total of $2352.00.

Premiums Accumulating at 5%–The amount in this column is less than the amount if death benefits are payable in each of the first ten policy years.

Death Benefits–Marla's death benefits are reduced for the first two years and then are $3,880.00 for the next eight years.

Cash Surrender Value–Cash surrender values are low with Marla's policy.

Net Gain, Net Loss–Marla's policy consistently reports a net gain for the first 10 years. This means her life insurance death benefits are greater than premiums accumulating at 5 percent interest for the first 10 years.

Part of the difference between Marvin and Marla's policies is tied to the fact that Marla is younger and she's a woman. Life insurance premiums are usually based on age and sex.

The difference between these policies is also related to the fact that different companies offer different policies. It's up to you to choose what's best for you. You should review your reasons for buying life insurance, your age, and health. In addition, a careful financial review of your policy is needed. This guide is designed to help you review your life insurance policy.

You should also read your policy carefully before deciding to keep it. If you have any questions or if anything is unclear, contact your agent, the insurance company, or your state insurance commissioner.

Legislative History (all references are to the Proceedings of the NAIC).

1976 Proc. I 7, 10-11, 381, 521, 523-527 (adopted).
1976 Proc. II 15, 17, 397, 542, 545-552 (reprinted with technical amendments and Buyer's Guide).
1978 Proc. I 13, 15, 348, 472 (corrected).
1984 Proc. I 6, 31, 375, 496, 497-510 (amended and named changed from Life Insurance Solicitation to Life Insurance Disclosure Model Regulation).
1988 Proc. I 9, 19-20, 599-600, 625-626 (amended).
1988 Proc. II 5, 12, 478, 490, 503-510 (amended, regulation reprinted).
1989 Proc. II 13, 23, 414-415, 419-422, 428-429, 430-442 (amended).
1990 Proc. I 6, 27, 438-439, 450-451, 453-463 (amended).
1991 Proc. I 9, 17, 540, 549-557, 558-559 (amended, regulation reprinted, Appendix E adopted).
1992 Proc. I 86, 94, 860, 868, 869-878 (amended and regulation reprinted).
1993 Proc. I (amended).

The following have all been superseded by the Model Regulation above.

a. *Deceptive Practices in Life Insurance Model Regulation:*
1973 Proc. II 18, 21, 471, 532-533, 541-543 (adopted).
1974 Proc. I 12, 14, 405, 440, 442-443 (amended).

b. *Life Insurance Cost Comparison (Interest Adjusted Index) Model Regulation:*
1973 Proc. II 18, 21, 471, 532-533, 538-540 (adopted).
1974 Proc. 12, 14, 405, 440, 442 (corrected).

OPTIONAL FORM OF THE LIFE INSURANCE DISCLOSURE MODEL REGULATION WITH YIELD INDEX

Table of Contents

Introductory Statement

Optional Form of The Life Insurance Disclosure Model Regulation With Yield Index

This is an optional version of the NAIC Life Insurance Disclosure Model Regulation for the use of individual states that wish to require the disclosure of the life insurance yield comparison index (YI). This optional form incorporates the formulas and calculation methods developed by the NAIC Yield Index Advisory Committee and included in that committee's report dated November 7, 1987 (see NAIC Proceedings 1987 Vol. 1 page 616 through 645). Since it is very important that yield indexes be calculated in a uniform manner, states that elect to require these indexes are urged not to deviate from these formulas and methods.

The advent of new life insurance plans has resulted in insurers placing more emphasis in their advertising, as well as in their policy design, on the cash value build-up and the policy's interest element. Requiring insurers to deliver to life insurance purchasers life insurance yield comparison index figures will provide purchasers with a comparison measure which reflects the insurance protection and cash accumulation features of life policies. The index will also be helpful in evaluating life insurance advertising which includes a numerical percent figure or illustrates dollar returns.

The attached optional form would require disclosure of yield comparison indexes in place of the surrender cost comparison indexes currently required by the model regulation. The ranking of companies is virtually the same under both indexes, thus permitting the latter to be dropped if yield comparison indexes are required.

States considering the possibility of requiring yield comparison indexes should in addition to reviewing the report of the Yield Index Advisory Committee, also review the report of the Committee on Life Insurance of the American Academy of Actuaries dated June 1, 1988 (see NAIC Proceedings 1988 Vol. II pages 512 through 559) and further comments by the Yield Index Advisory Committee (see NAIC Proceedings 1988 Vol. II pages 560 and 561).

Section 1. Authority

This rule is adopted and promulgated by the commissioner of insurance pursuant to Section [cite Section 4A(1) of the Unfair Trade Practices Act] of the Insurance Code.

Editor's Note: Insert the title of the chief insurance regulatory official whenever the word "commissioner" appears.

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 the buyer's 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 a violation of this regulation or any other [state] statute or regulation.

Section 3. Scope

A. Except for the exemptions specified in Subsection 3B, this regulation shall apply to any solicitation, negotiation or procurement of life insurance occurring within this state. Subsection 5C only shall apply to any existing nonexempt policy held by a policyowner residing in this state. This regulation shall apply to any issuer of life insurance contracts including fraternal benefit societies.

B. Unless specifically included, this regulation shall not apply to:

(1) Annuities;

(2) Credit life insurance;

(3) Group life insurance (except for disclosures relating to preneed funeral contracts or prearrangements as provided herein. These disclosure requirements shall extend to the issuance or delivery of certificates as well as to the master policy);

(4) Life insurance policies issued in connection with pension and welfare plans as defined by and which are subject to the federal Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. Section 1001 *et seq.* as amended;

(5) Variable life insurance under which the amount or duration of the life insurance varies according to the investment experience of a separate account.

Section 4. Definitions

For the purposes of this regulation, the following definitions shall apply:

A. Buyer's Guide. A Buyer's Guide is a document which contains, and is limited to, the language contained in Appendix A to this regulation or language approved by the insurance commissioner.

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

C. Contribution Principle. The contribution principle is a basic principle of dividend determination adopted by the American Academy of Actuaries with respect to individual life insurance policies. The Academy report, *Dividend Recommendations and Interpretations* (November 1985), describes this principle as the distribution of the aggregate divisible surplus among policies in the same proportion as the policies are considered to have contributed to divisible surplus. In a broad sense, the contribution principle underlies the essential equity implied by participating business.

D. Current Dividend Scale. The current dividend scale is a schedule that exhibits dividends to be distributed if there is no change in the basis of these dividends after the time of illustration.

E. Current Rate Schedule. The current rate schedule is a schedule showing the premiums that will be charged or the cash values or death or other benefits that will be available if there is no change in the basis of these items after the time of illustration.

F. Equivalent Level Death Benefit. The equivalent level death benefit of a policy or term life insurance rider is an amount calculated as follows:

(1) Accumulate the amount payable upon death, regardless of the cause of death, at the beginning of each policy year for five (5), ten (10) and twenty (20) years at five percent (5%) interest compounded annually to the end of the fifth, tenth and twentieth policy years respectively.

(2) Divide each accumulation of Step (1) by an interest factor that converts into one equivalent level annual amount that, if paid at the beginning of each year, would accrue to the value in Step (1) over the respective periods stipulated in Step (1). If the period is five (5) years, the factor is 5.802, if the period is ten (10) years, the factor is 13.207; and if the period is twenty (20) years, the factor is 34.719.

G. Generic Name. A generic name is a short title that is descriptive of the premium and benefit patterns of a policy or a rider.

H. Investment Generation Method. The investment generation method is the method of determining dividends so that dividends for policies issued in specified years or groups of years reflect investment earnings on funds attributable to those policies.

I. Comparison Indexes.

Drafting Note: The formulas which follow are geared to an "at issue" situation, with x = issue age and t = policy year. Consistent formulas for an in-force policy can be obtained using x = attained age at beginning of calculation period and t = policy year since beginning of calculation period.

(1) Net Payment Cost Comparison Index—Illustrated Basis

The Net Payment Cost Comparison Index—Illustrated Basis is calculated by applying the following steps:

(a) For participating policies accumulate the annual cash dividends at five percent (5%) interest compounded annually to the end of the period selected.

(b) Divide the result of Step (a) 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 (a) over the period selected. If the period is five (5) years the factor is 5.802, if the period is ten (10) years the factor is 13.207, and if the period is twenty (20) years the factor is 34.719.

(c) Determine the equivalent level premium by accumulating each annual premium payable for the basic policy or rider, based on the company's current rate schedule, at five percent (5%) interest compounded annually to the end of the period stipulated in Step (a) and dividing the result by the respective factors stated in Step (b). (This amount is the annual premium payable for a level premium plan.)

(d) Subtract the result of Step (b) from Step (c).

(e) Divide the result of Step (d) by the number of thousands of the equivalent level death benefit, using the company's current rate schedule to determine the amount payable upon death for purposes of Section 4F(1), to arrive at the Net Payment Cost Comparison Index—Illustrated Basis.

(2) Net Payment Cost Comparison Index—Guaranteed Basis. The Net Payment Cost Comparison Index—Guaranteed Basis is calculated by applying the steps indicated in (1) above but assuming that the company charges the maximum premiums and, for purposes of Section 4F(1), provides the minimum death benefits allowed by the policy and, if the policy is participating, that the company pays no dividends.

(3) Life Insurance Yield Comparison Index—Illustrated Basis. The Life Insurance Yield Comparison Index—Illustrated Basis is calculated by applying the following steps:

(a) Determine the illustrated cash value and illustrated death benefit for each of the first twenty (20) policy years.

(b) Obtain the standardized value of death protection for each of the first twenty (20) policy years.

(c) The Life Insurance Yield Comparison Index—Illustrated Basis for five (5) years is the interest rate at which the sum of the present values of the Standardized Annual Retention—Illustrated Basis for the first five (5) years equals zero. This is computed according to the formula:

$$0 = \sum_{t=1}^{5} \left(\frac{1}{1+i}\right)^t SARI_t$$

where $SARI_t$ is the Standardized Annual Retention—Illustrated Basis for policy year t as defined in Section 4(12). The Life Insurance Yield Comparison Index—Illustrated Basis for ten years is the interest rate at which the sum of the present values of the Standardized Annual Retention—Illustrated Basis for the first ten (10) years equals zero. The Life Insurance Yield Comparison Index —Illustrated Basis for twenty (20) years is the interest rate at which the sum of the present values of the Standardized Annual Retention —Illustrated Basis for the first twenty (20) years equals zero.

(4) Life Insurance Yield Comparison Index—Guaranteed Basis. The Life Insurance Yield Comparison Index—Guaranteed Basis is calculated by applying the following steps:

(a) Determine the guaranteed cash value and guaranteed death benefit for each of the first twenty (20) policy years.

(b) Obtain the standardized value of death protection for each of the first twenty (20) policy years.

(c) The Life Insurance Yield Comparison Index—Guaranteed Basis for five (5) years is the interest rate at which the sum of the present values of the Standardized Annual Retention—Guaranteed Basis for the first five (5) years equals zero. This is computed according to the formula:

$$0 = \sum_{t=1}^{5} \left(\frac{1}{1+i}\right)^t SARG_t$$

where $SARG_t$ is the Standardized Annual Retention—Guaranteed Basis for policy year t as defined in Section 4(13). The Life Insurance Yield Comparison Index—Guaranteed Basis for ten (10) years is the interest rate at which the sum of the present values of the Standardized Annual Retention—Guaranteed Basis for the first ten (10) years equals zero. The Life Insurance Yield Comparison Index—Guaranteed Basis for twenty (20) years is the interest rate at which the sum of the present values of the Standardized Annual Retention—Guaranteed Basis for the first twenty (20) years equals zero.

J. Nonguaranteed Factor. A nonguaranteed factor is any item entering into the calculation of a Comparison Index—Illustrated Basis that can be changed by the company without the consent of the policy owner. Such items include, but are not limited to, premiums, benefits, interest rates, mortality charges, expense charges and dividends.

Drafting Note: It was felt appropriate to list a number of possible nonguaranteed factors, but the language is intended to make it clear that any others not listed but meeting the definition, i.e., can be changed by the company without policyowner consent, are also included.

K. Policy Data. The policy data is a display or schedule of numerical values, both guaranteed and nonguaranteed, for each policy year or a series of designated policy years of the following information: illustrated annual, other periodic, and terminal dividends; premiums; death benefits; cash surrender values and endowment benefits.

L. Policy Summary. The policy summary is a written statement describing the elements of the policy, including, but not limited to:

(1) A prominently placed title as follows: STATEMENT OF POLICY COST AND BENEFIT INFORMATION.

(2) The name and address of the insurance agent or, if no agent is involved, a statement of the procedure to be followed in order to receive responses to inquiries regarding the policy summary.

(3) The full name and home office or administrative office address of the company in which the life insurance policy is to be or has been written.

(4) The generic name of the basic policy and each rider.

(5) The following amounts, where applicable, for the first five (5) policy years and representative policy years thereafter sufficient to clearly illustrate the premium and benefit patterns; including, but not necessarily limited to, the years for which cost comparison indexes are displayed and the earlier of at least one age from sixty (60) through sixty-five (65) and policy maturity:

(a) The annual premium for the basic policy;

(b) The annual premium for each optional rider;

(c) The amount payable upon death at the beginning of the policy year regardless of the cause of death, other than suicide or other specifically enumerated exclusions, which is provided by the basic policy and each optional rider; with benefits provided under the basic policy and each rider shown separately;

(d) The total cash surrender values at the end of the year with values shown separately for the basic policy and each rider;

(e) The cash dividends payable at the end of the year with values shown separately for the basic policy and each rider (dividends need not be displayed beyond the twentieth policy year);

(f) Any endowment amounts payable under the policy which are not included under cash surrender values above;

(g) If the policy has a nonguaranteed factor, the maximum premium, minimum amount payable upon death, minimum cash value, and minimum endowment amounts allowed by the policy. These amounts may be shown in addition on the basis of the company's current rate schedule and current dividend scale.

(6) The effective policy loan annual percentage interest rate, if the policy contains this provision, specifying whether this rate is applied in advance or in arrears. If the policy loan interest rate is adjustable, the policy summary shall also indicate that the annual percentage rate will be determined by the company in accordance with the provisions of the policy and the applicable law.

(7) (a) The Net Payment Comparison Index for five (5), ten (10) and twenty (20) years but in no case beyond the premium-paying period. Indexes shall be shown on the guaranteed basis as defined in Section 4I(2) and, if there are dividends or any nonguaranteed factors, shall also be shown on the illustrated basis as defined in Section 4I(1). Separate indexes shall be displayed for the basic policy and for each optional term life insurance rider. Such indexes need not be included for optional riders which are limited to benefits; such as accidental death benefits, disability waiver of premium, preliminary term life insurance coverage of less than twelve (12) months and guaranteed insurability benefits; nor for any basic policies or optional riders covering more than one life.

(b) The Life Insurance Yield Comparison Index for five (5), ten (10) and twenty (20) years. Indexes shall be shown on the guaranteed basis as defined in Section 4I(4) and, if there are any nonguaranteed factors, shall also be shown on the illustrated basis as defined in Section 4I(3). In any case where the guaranteed or illustrated cash value at the end of five, ten or twenty (20) years (as appropriate) is zero, the corresponding index need not be shown and wording substantially equivalent to "not applicable - zero cash value" should be shown. Such indexes need not be included for (a) basic policies under which the illustrated cash value never exceeds $200 per $1,000 of death benefit during the first twenty (20) policy years, (b) optional riders under which the illustrated cash value never exceeds $200 per $1,000 of death benefit during the first twenty (20) policy years, or (c) any basic policies or optional riders covering more than one life.

In a case involving an optional rider under which the benefit at some point during the first twenty (20) policy years, the yield comparison index shall be calculated for the policy/rider combination.

Drafting Note: The above combination approach will provide better comparisons between (a) traditional policies with riders developing substantial cash values and (b) non-traditional policies with similar overall premium payment patterns.

(8) A policy summary which includes dividends shall also include a statement that dividends are based on the company's current dividend scale and are not guaranteed.

(9) If the policy has a nonguaranteed factor, a statement indicating that the insurer reserves the right to change the nonguaranteed factor at any time and for any reason. However, if the insurer has agreed to limit this right in any wey; such as, for example, if it has agreed to change a nonguaranteed factor only at certain intervals or only if there is a change in the insurer's current or anticipated experience; the statement may indicate any such limitation on the insurer's right.

(10) This statement in close proximity to the comparison indexes:

"An explanation of the intended use of these indexes is provided in the Life Insurance Buyer's Guide."

(11) The date on which the policy summary is prepared.

The policy summary must consist of a separate document. All information required to be disclosed must be set out in such a manner as not to minimize or render any portion thereof obscure. Any amounts which remain level for two (2) or more years of the policy may be represented by a single number if it is clearly indicated what amounts are applicable for each policy year. Amounts in Item (5) of this section shall be listed in total, not on a per thousand nor per unit basis. If more than one insured is covered under one policy or rider, death benefits shall be displayed separately for each insured or for each class of insureds if death benefits do not differ within the class. Zero amounts shall be displayed as a blank space.

M. Portfolio Average Method. The portfolio average method is the method of determining dividends so that, except for the effect of policy loans, dividends reflect investment earnings on funds attributable to all policies whenever issued.

N. Preneed Funeral Contract or Prearrangement. An agreement by or for an individual before that individual's death relating to the purchase or provision of specific funeral or cemetery merchandise or services.

O. Life Insurance Yield Comparison Index Additional Definitions. For the purpose of these amendments, the following definitions shall apply:

(1) Dividend Option. The dividend option for participating policies is that option which applies the policy dividends to purchase paid-up whole life or endowment additions.

(2) Death Benefit Pattern. Where the policy provides several death benefit options, the death benefit is that according to the death benefit option for which the applicant applied.

(3) Premium Paying Pattern. The premium paying pattern is the fixed level(s) of premiums payable for a specified number of years under the contract that is illustrated or for which the applicant applied. If the policy applied for does not specify a fixed level(s) of premiums payable and the duration, the premium paying pattern shall be the level and incidence of premium payments for which the individual applied.

(4) Policy Size. The policy size is the initial face amount of the death benefit for which the individual applied.

(5) Frequency of Premium Payment. The frequency of premium payment is the annual mode under a policy whose death benefit and/or cash values do not vary if the premiums are paid on other than an annual basis. The frequency of premium payment is that mode for which the applicant applied under a policy whose death benefit and/or cash values vary based upon the frequency of premium payment.

Drafting Note: It is not intended that a refund of premium paid beyond the time of death be interpreted as causing death benefit variation because of mode of premium payment.

(6) Illustrated Cash Value. The illustrated cash value for each policy year is the cash surrender value that will be available at the end of that policy year under the current rate schedule and current dividend scale (if applicable), based on the assumed death benefit pattern, premium payment pattern, frequency of premium payment and dividend option (if applicable), and based on the further assumptions that no funds are withdrawn from the policy and no loans are made against the policy.

(7) Guaranteed Cash Value. The guaranteed cash value for each policy year is the minimum cash surrender value at the end of that policy year, as guaranteed in the policy, based on the assumed death benefit pattern, premium payment pattern and frequency of premium payment, and based on further assumption that no funds are withdrawn from the policy and no loans are made against the policy.

(8) Illustrated Death Benefit. The illustrated death benefit for each policy year is the death benefit that would be payable at the end of that policy year under the current rate schedule and current dividend scale (if applicable), based on the assumed death benefit pattern, frequency of premium payment and dividend option (if applicable), and based on further assumptions that no funds are withdrawn from the policy and no loans are made against the policy.

(9) Guaranteed Death Benefit. The guaranteed death benefit for each policy year is the minimum death benefit payable to a policyholder who dies at the end of that policy year, as guaranteed in the policy, based on the assumed death benefit pattern, premium payment pattern and frequency of premium payment, and based on the further assumptions that no funds are withdrawn from the policy and no loans are made against the policy.

(10) Standardized Value of Death Protection. The standardized Value of Death Protection per $1,000 for each policy year is based on the policyholder classification and the policy size. It is calculated as:

$$SVDP_t = .95q_{x,t} + .70 + \frac{35}{S}$$

where $SVDP_t$ = Standardized Value of Death Protection per $1,000

where

$q_{x,t} = \overset{u}{(qx + t - 1)}\ (sel_{x,t})$

where x = issue age

t = policy year

$\overset{u}{qx + t - 1}$ = mortality rate per \$1,000 at age (x + t - 1), according to the 1980 CSO Basic Table that corresponds to the sex and smoking status as defined in the policyholder classification

$sel_{x,t}$ = the 1980 CSO Graded Select Factor corresponding to the sex as defined in the policyholder classification

Drafting Note: This definition of x and t is not appropriate for use with an in-force policy if the purpose of the calculation is to evaluate a potential replacement where it is assumed that the policyowner can qualify for new insurance. In such a case, x should be the attained age instead of the original issue age and t should be the policy year since the calculation date. The above definition may be appropriate in other situations with in-force policies.

S = Policy size in \$1,000's.

(11) Policyholder Classification. The policyholder classification is the policyholder's issue age (on an age nearest birthday basis or an age last birthday basis), sex and smoking status as set forth in the policy. However, unisex status is to be used only if a unisex rate structure is required by applicable law or regulation, and the smoking status is nonsmoker if the premium rate or mortality charge basis under the policy is not available to smokers, otherwise it is smoker.

Drafting Note: This approach automatically produces a smoker status if the rate structure under the policy does not provide for the possibility of a nonsmoker discount. This approach was selected because in some cases, the company may not have information as to the applicant's smoking status.

(12) Standardized Annual Retention—Illustrated Basis. The Standardized Annual Retention—Illustrated Basis for each policy year is calculated as:

$$SARI_t = (P_t + ICV_{t-1})\ (1 + i) - ICV_t \quad - SVDP_t\,(.001)\,(IDB_t - ICV_t)$$

Drafting Note: For a policy under which cash values and/or death benefits may vary according to the frequency of premium payment, the first term in the above formula should be

$$P_t \quad \left(\frac{1}{1+i}\right)^{\frac{m-1}{2m}}$$

where m is the number of premium payments in the year. The interest factor was omitted for the sake of simplifying the calculation; this tends to depress the index. Companies should be allowed to use the theoretically correct approach, or an alternative approach, if they can certify that their method does not produce index values higher than the theoretical approach.

where

$SARI_t$ = Standardized Annual Retention - Illustrated Basis for policy year t

P_t = Total premium for policy year t

ICV_t = Illustrated Cash Value for policy year t

ICV_{t-1} = Illustrated Cash Value for policy year (t-1)

IDB_t = Illustrated Death Benefit for policy year t

100i = Yield Comparison Index

(13) Standardized Annual Retention—Guaranteed Basis. The Standardized Annual Retention—Guaranteed Basis for each policy year is calculated as:

$$SARG_t = (P_t + GCV_{t-1})\ (1 + i) - GCV_t$$

$$-SVDP_t\ (.001)\ (GDB_t - GCV_t)$$

Note: See the drafting note in (12) above.

where

$SARG_t$ = Standardized Annual Retention - Guaranteed Basis for policy year t

P_t = Total premium for policy year t

GCV_t = Guaranteed Cash Value for policy year t

GCV_{t-1} = Guaranteed Cash Value for policy year (t-1)

GDB_t = Guaranteed Death Benefit for policy year t.

Section 5. Duties of Insurers

A. Requirements Applicable Generally

(1) 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; provided, however, that:

(a) If the policy for which application is made or its policy summary contains an unconditional refund provision of at least ten (10) days, the Buyer's Guide and policy summary must be delivered with the policy or prior to delivery of the policy.

(b) If the equivalent level of death benefit of the policy for which application is made does not exceed $5,000, the requirement for providing a policy summary will be satisfied by delivery of a written statement containing the information described in Section 4L Paragraphs (2), (3), (4), (5a), (5b), (5c), (6), (7), (9), (10), and (11).

(2) In the case of universal life and indeterminate premium products, the Statement of Policy Information for Applicant illustrated in Appendix B must be delivered at the time of application or within fifteen (15) working days thereafter, but at least five (5) days before delivery of the policy.

If the policy is delivered sooner than five (5) days after delivery of the disclosure statement, the free-look period shall be extended to fifteen (15) days. In the event the disclosure statement is not delivered at the time of application, the disclosure shall be accompanied by a statement that it is delivered for the express purpose of allowing comparison with other policies.

(3) In the case of a solicitation by direct response methods, the insurer shall provide the Statement of Policy Information for applicant prior to accepting the applicant's application; provided however, that if the policy for which application is made contains an unconditional refund provision of at least ten (10) days, the Statement of Policy Information for Applicant may be delivered with the policy.

(4) If any prospective purchaser requests a Buyer's Guide, a policy summary or policy data, the insurer shall provide the item or material requested. Unless otherwise requested, the Policy Data shall be provided for policy years one through twenty (20), and for indeterminate premium and universal life products shall substantially conform to the illustration in Appendix B.

B. Requirements Applicable to Participating Policies. If a life insurance company illustrates policyholder dividends that are calculated in a manner or on a basis that:

(1) Deviates substantially from the contribution principle, the policy summary and all other sales material showing illustrated policyholder dividends must display prominently the following statement: "The illustrated dividends for this policy have not been determined in accordance with the contribution principle. Contact this company for further information."

(2) Uses the portfolio average method, the policy summary and all other sales material showing illustrated policyholder dividends must include the following statement: "Illustrated dividends reflect current investment earnings on funds applicable to all policies and are based on the current dividend scale. Refer to your Buyer's Guide for further information."

(3) Uses the investment generation method, the policy summary and all other sales material showing illustrated policyholder dividends must include the following statement: "Illustrated dividends reflect current investment earnings on funds attributable to policies issued since 19[ ] and are based on the current dividend scale. Refer to your Buyer's Guide for further information."

Drafting Note: Insert at [ ] the earliest year of the issue-year grouping used to determine the investment earnings on currently issued policies.

(4) Uses any combination of the portfolio average method and the investment generation method, the policy summary and all other sales material showing illustrated policyowner dividends must include an appropriate statement, analogous to the statements required by Sections 5B(2) and 5B(3), indicating how current investment earnings are reflected in illustrated dividends.

C. Requirements Applicable to Existing Policies.

(1) If a policy owner residing in this state requests it, the insurer shall provide policy data for that policy. Unless otherwise requested, the policy data shall be provided for twenty consecutive years beginning with the previous policy anniversary. The statement of policy data shall include cash dividends according to the current dividend scale, the amount of outstanding policy loans, and the current policy loan interest rate. Policy values shown shall be based on the dividend option in effect at the time of the request. The insurer may charge a reasonable fee, not to exceed $[insert amount], for the preparation of the statement.

(2) If a life insurance company:

(a) Deviates substantially from the contribution principle, it shall annually advise each affected policy owner residing in this state that the dividend paid that year was not determined in accordance with the contribution principle and that the policy owner may contact the company for further information.

(b) Is determining dividends, as of the effective date of this regulation, using the investment generation method, it shall, within eighteen (18) months of such date, advise each affected policy owner residing in this state that the dividend for the policy reflects current investment earnings on funds applicable to policies issued from 19 [ ] through 19 [ ]. This requirement shall not apply to policies for which the amount payable upon death under the basic policy as of the date when advice would otherwise be required does not exceed $5,000.

Drafting Note: Insert at [ ] the applicable years of issue.

(c) Changes its method of determining dividend scales on existing policies from or to the investment generation method; it shall, no later than when the first dividend is payable on the new basis, advise each affected policy owner residing in this state of this change and of its implication on dividends payable on affected policies. This requirement shall not apply to policies for which the amount payable upon death under the basic policy as of the date when advice would otherwise be required does not exceed $5,000.

(3) If the insurer makes a material revision in the terms and conditions under which it will limit its right to change any nonguaranteed factor; it shall, no later than the first policy anniversary following the revision, advise accordingly each affected policy owner residing in this state.

Section 6. Special Plans

This section modifies the application of this regulation as indicated for certain special plans of life insurance:

A. Enhanced Ordinary Life Policies.

(1) An enhanced ordinary life policy is a participating policy which has the following characteristics for all issue ages:

(a) The basic policy has a guaranteed death benefit that reduces after an initial period of one or more years to a basic amount; and

(b) A special dividend option that provides

(i) A combination of immediate paid-up additions and one-year term insurance; or

(ii) Deferred paid-up additions;

either of which on the basis of the current dividend scale will provide a combined death benefit (reduced basic amount plus paid-up additions plus one-year term insurance) at least equal to the initial face amount.

(2) The crossover point of an enhanced ordinary life policy is the first policy anniversary at which the sum of the reduced basic amount and paid-up additions equals or exceeds the initial death benefit. For these policies:

(a) The cash value of benefits purchased by dividends payable on or before the crossover point is included in the cash surrender value for the purpose of Section 4J(1)(a);

(b) The death benefit purchased by dividends payable on or before the crossover point is included in the amount payable upon death for the purpose of Section 4G(1);

(c) Dividends payable after the crossover point are assumed to be paid in cash for the purpose of Section 4J(1)(b).

B. Flexible Premium and Benefit Policies. For policies commonly called "universal life insurance policies," which:

(1) Permit the policy owner to vary, independently of each other, the amount or timing of premium payments, or the amount payable on death, and

(2) Provide for a cash value that is based on separately identified interest credits and mortality and expense charges made to the policy.

All indexes and other data shall be displayed assuming specific schedules of anticipated premiums and death benefits at issue.

In addition to all other information required by this regulation, the policy summary shall indicate when the policy will expire based on the interest rates and mortality and other charges guaranteed in the policy and the anticipated or assumed annual premiums shown in the policy summary.

C. Multitrack Policies. For policies which allow a policyowner to change or convert the policy from one plan or amount to another, the policy summary:

(1) Shall display all indexes and other data assuming that the option is not exercised; and

(2) May display all indexes and other data using a stated assumption about the exercise of the option.

D. Policies with Any Rate Subject to Continued Insurability. For policies which allow a policyowner a reduced premium rate if the insured periodically submits evidence of continued insurability, the policy summary:

(1) Shall display cost indexes and other data assuming that the insured always qualifies for the lowest premium;

(2) Shall display cost indexes and other data assuming that the company always charges the highest premiums allowable; and

(3) Shall indicate the conditions that must be fulfilled for an insured to qualify periodically for the reduced rate.

E. Individualized Policy Information

(1) In addition to all other information required by this regulation, in those situations specified in Section 8K, the information illustrated in Appendix C shall be prepared on an individual basis.

(2) If an insurer uses a form other than the Financial Review of This Policy form, that form shall be approved for use by the state insurance department. An insurer may use the appropriate box or boxes from the top of the disclosure form for the specific policy being illustrated without seeking state insurance department approval for this change in the form.

(3) If cost of insurance, nonguaranteed dividends or benefits or potential preferential tax implications are presented in the policy, advertising, marketing materials, or verbally explained to the consumer; the agent, or company if a direct marketer, shall attach all those materials or representations to the Financial Review of This policy form before issuance of the policy if not previously provided.

(4) If any method other than the Financial Review of This policy form is used to explain the death benefit, a copy of the illustration signed by the applicant and the agent must be attached to the form.

(5) The information contained in Appendix C must be furnished to the applicant no later than the point of issue of the policy.

(6) The original of the individual information form shall be delivered simultaneously with the policy at issue and a copy shall be retained by the insurer as long as the policy remains in force, plus two (2) years.

Drafting Note: This language cannot be construed to limit the ability of a regulator or a consumer to hold the insurer responsible for the actions of an agent in any misrepresentations on the disclosure form.

F. For all other special plans of life insurance, an insurer shall provide or deliver both a policy summary substantially similar to that described in Section 4M and a Buyer's Guide. Use of those materials shall be deemed to be substantial compliance with this regulation unless the commissioner makes a finding that such disclosure materials misrepresent a material term or condition of the contract or omit a material fact.

Section 7. Preneed Funeral Contracts or Prearrangements

The following information shall be adequately disclosed at the time an application is made, prior to accepting the applicant's initial premium or deposit, for a preneed funeral contract or prearrangement as defined in Section 4N above which is funded or to be funded by a life insurance policy:

A. The fact that a life insurance policy is involved or being used to fund a prearrangement as defined in Section 4N of this regulation;

B. The nature of the relationship among the soliciting agent or agents, the provider of the funeral or cemetery merchandise or services, the administrator and any other person;

C. The relationship of the life insurance policy to the funding of the prearrangement and the nature and existence of any guarantees relating to the prearrangement;

D. The impact on the prearrangement

(1) Of any changes in the life insurance policy including but not limited to, changes in the assignment, beneficiary designation or use of the proceeds;

(2) Of any penalties to be incurred by the policyholder as a result of failure to make premium payments;

(3) Of any penalties to be incurred or monies to be received as a result of cancellation or surrender of the life insurance policy;

E. A list of the merchandise and services which are applied or contracted for in the prearrangement and all relevant information concerning the price of the funeral services, including an indication that the purchase price is either guaranteed at the time of purchase or to be determined at the time of need;

F. All relevant information concerning what occurs and whether any entitlements or obligations arise if there is a difference between the proceeds of the life insurance policy and the amount actually needed to fund the prearrangement as defined in Section 4N;

G. Any penalties or restrictions, including but not limited to geographic restrictions or the inability of the provider to perform, on the delivery of merchandise, services or the prearrangement guarantee;

H. The fact that a sales commission or other form of compensation is being paid and if so, the identity of such individuals or entities to whom it is paid.

Section 8. General Rules

A. Each insurer shall maintain, at its home office or principal office, a complete file containing one copy of each document authorized and used by the insurer pursuant to this regulation. Such file shall contain one copy of each authorized form for a period of three (3) years following the date of its last authorized use unless otherwise provided by this regulation.

B. An agent shall inform the prospective purchaser, prior to commencing a life insurance sales presentation, that he or she is acting as a life insurance agent and inform the prospective purchaser of the full name of the insurance company which the agent is representing to the buyer. In sales situations in which an agent is not involved, the insurer shall identify its full name.

C. Terms such as financial planner, investment advisor, financial consultant, or financial counseling shall not be used in such a way as to imply that the insurance agent is primarily engaged in an advisory business in which compensation is unrelated to sales unless such is actually the case.

D. Any reference to a dividend or nonguaranteed factor must include a statement that such item is not guaranteed and is based on the company's current dividend scale or current rate schedule. If a dividend or nonguaranteed factor would be reduced by the existence of a policy loan, a statement to this effect must be included in any reference to such dividend or nonguaranteed factor.

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 costs or benefits, other than that required pursuant to this regulation, shall not display guaranteed and nonguaranteed factors as a single sum unless they are shown separately in close proximity thereto.

G. Any statement regarding the use of comparison indexes shall also 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. Any comparison index which reflects a nonguaranteed factor shall be accompanied by a statement that it is based on the company's current dividend scale or current rate schedule and is not guaranteed.

I. Any illustrations of nonguaranteed factors must not be more favorable than those based on the insurer's current scale and must contain a statement to the effect that they are not to be construed as guarantees or estimates of amounts to be paid in the future.

J. Any advertisement which includes any nonguaranteed factor or yield comparison index must also contain the Life Insurance Yield Comparison Index for five (5), ten (10) and twenty (20) years for a specific policy covered by the advertisement. The advertisement must further set forth the policy specifications upon which the yield comparison indexes were calculated. Such policy specifications must include:

(1) The plan of insurance;

(2) The amount of death benefit;

(3) The insured's age at issue, sex and underwriting classification;

(4) The policy premium and frequency of payment.

The advertisement must also call attention to the fact that the Life Insurance Yield Comparison Indexes applicable in a particular case may vary significantly from those shown in the advertisement, and any interested person should be encouraged to contact the insurance company or its agents to obtain Life Insurance Yield Comparison Indexes based on policy specifications appropriate to his or her particular situation.

Drafting Note: It was assumed that the information required above can be expressed in reasonable length. The importance of its inclusion justifies the additional wording required.

K. Whenever a policy is issued for delivery in this state to an applicant at age sixty (60) or over, which limits death benefits during a period following the inception date of the policy or where the accumulated premiums exceed the death benefit at any point during the first ten (10) years, then the form labeled Appendix C to this regulation and guide labeled Appendix D or a form and guide containing substantially similar information and approved by the commissioner shall be completed by the insurer and delivered simultaneously with the policy and the free-look period shall be extended to thirty (30) days.

Drafting Note: States have the option of choosing an earlier time for required delivery, such as at point of solicitation.

L. Prior to taking an application for a policy which is subject to the disclosure requirements of Section 8K, the insurer must provide the applicant with a prominent notice in the following form, or in a form containing substantially similar information approved by the [title of supervisory authority]:

NOTICE TO APPLICANTS AGE SIXTY (60) OR OVER

With your policy, you may receive a "Financial Review of This Policy" form showing premiums and benefits for a ten (10) year period. You should review the form and your policy, and decide if the policy is suitable for you. If you are not entirely satisfied, please review the cancellation provision on the form for directions on obtaining a full refund of any premiums paid.

Section 9. Failure to Comply

Failure of an insurer to provide or deliver a Buyer's Guide, a policy summary or policy data as provided in Sections 5 and 6 shall constitute an omission which misrepresents the benefits, advantages, conditions or terms of an insurance policy.

Section 10. Separability

If any provisions of this rule be held invalid, the remainder shall not be affected.

Section 11. Effective Date

This rule shall become effective [insert a date at least 6 months following adoption by the regulatory authority].

APPENDIX A

LIFE INSURANCE BUYER'S GUIDE

The language in the Buyer's guide is limited to that contained in the following pages of this Appendix, or to language approved by [title of supervisory authority]. However, companies can vary the type style and format and are encouraged to enhance the readability, design, and attractiveness of the Buyer's Guide.

The face page of the Buyer's Guide shall read as follows:

Life Insurance Buyer's Guide

This guide can help you get the most for your money when you shop for life insurance. It can help you answer questions about:

- Buying Life Insurance
- Deciding How Much you Need
- Finding a Low Cost Policy
- Things to Remember

Prepared by the National Association of Insurance Commissioners

The National Association of Insurance Commissioners is an association of state insurance regulatory officials. This association helps the various Insurance Departments to coordinate insurance laws for the benefit of all consumers.

This Guide Does Not Endorse Any Company or Policy

Reprinted by. . .

Buying Life Insurance

When you buy life insurance, you want coverage that fits your needs and doesn't cost too much.

First, decide how much you need - and for how long - and what you can afford to pay.

Next, find out what kinds of policies are available to meet your needs and pick the one that best suits you.

Then, find out what different companies charge for that kind of policy - for the amount of insurance you want. You can find important cost differences between life insurance policies by using cost comparison indexes as described in this guide.

It makes good sense to ask a life insurance agent or company to help you. An agent can be particularly useful in reviewing your insurance needs and in giving you information about the kinds of policies that are available. If one kind doesn't seem to fit your needs, ask about others.

This guide provides only basic information. You can get more facts from a life insurance agent or company or at your public library.

What About Your Present Policy? Think twice before dropping a life insurance policy you already have to buy a new one.

- It can be costly because much of what you paid in the early years of the policy you now have was used for the company's expense of selling and issuing the policy. This expense will be incurred again for a new policy.

- If you are older or your health has changed, premiums for the new policy will often be higher.

- You may have valuable rights and benefits in your present policy that are not in the new one.

- You might be able to change your present policy or even add to it to get the coverage or benefits you now want.

Check with the agent or company that issued your present policy - get both sides of the story. In any case, don't give up your present policy until you are covered by a new one.

How Much Do you Need?

To decide how much life insurance you need, figure out what your dependents would have if you were to die now, and what they would actually need. Your new policy should come as close to making up the difference as you can afford.

In figuring what you have, count your present insurance - including any group insurance where you work, social security or veteran's insurance. Add other assets you have - savings, investments, real estate, and personal property.

In figuring what you need, think of income for your dependents - for family living expenses, educational costs and any other future needs. Think also of cash needs - for the expenses of a final illness and for paying taxes, mortgages or other debts.

What Is the Right Kind?

All life insurance policies agree to pay an amount of money when you die. But all policies are not the same. Some provide permanent coverage and others temporary coverage. Some build up cash values and others do not. Some polices combine different kinds of insurance, and others let you change from one kind of insurance to another. Your choice should be based on your needs and what you can afford.

A wide variety of plans is being offered today. Here is a brief description of two basic kinds - term and whole life - and some combinations and variations. You can get detailed information from a life insurance agent or company.

Term Insurance covers you for a term of one or more years. It pays a death benefit only if you die in that term. Term insurance generally provides the largest immediate death protection for your premium dollar.

Most term insurance policies are renewable for one or more additional terms even if your health has changed. Each time you renew the policy for a new term, premiums will be higher. Check the premiums at older ages and how long the policy can be continued.

Many term insurance policies can be traded before the end of a conversion period for a whole life policy - even if you are not in good health. Premiums for the new policy will be higher than you have been paying for the term insurance.

Whole Life Insurance covers you for as long as you live. The common type is called straight life or ordinary life insurance - you pay the same premiums for as long as you live. These premiums can be several times higher than you would pay at first for the same amount of term insurance. But they are smaller than the premiums you would eventually pay if you were to keep renewing a term policy until your later years.

Some whole life policies let you pay premiums for a shorter period such as 20 years, or until age 65. Premiums for these policies are higher than for ordinary life insurance since the premium payments are squeezed into a shorter period.

Whole life policies develop cash values. If you stop paying premiums, you can take the cash - or you can used the cash value to buy continuing insurance protection for a limited time or a reduced amount. (Some term policies that provide coverage for a long period also have cash values.)

You may borrow against the cash values by taking a policy loan. Any loan and interest on the loan that you do not pay back will be deducted from the benefits if you die, or from the cash value if you stop paying premiums.

Combinations and Variations. You can combine different kinds of insurance. For example, you can buy whole life insurance for lifetime coverage and add term insurance for the period of your greatest insurance need. Usually the term insurance is on your life - but it can also be bought for your spouse or children.

Endowment insurance policies pay a sum or income to you if you live to a certain age. If you die before then, the death benefit is paid to the person you named as beneficiary.

Other policies may have special features which allow flexibility as to premiums and coverage. Some let you choose the death benefit you want and the premium amount you can pay. The kind of insurance and coverage period are determined by these choices.

One kind of flexible premium policy, often called universal life, lets you vary your premium payments every year, and even skip a payment if you wish. The premiums you pay (less expense charges) go into a policy account that earns interest and charges for the insurance are deducted from the account. Here, insurance continues as long as there is enough money in the account to pay the insurance charges.

Variable life is a special kind of insurance where the death benefits and cash values depend upon investment performance of one or more separate accounts. Be sure to get the prospectus provided by the company when buying this kind of policy. The method of cost comparison outlined in this Guide does not apply to policies of this kind.

Finding a Low Cost Policy

After you have decided which kind of life insurance is best for you, compare similar polices from different companies to find which one is likely to give you the best value for your money. A simple comparison of the premiums is not enough. There are other things to consider. For example:

- Do Premiums or benefits vary from year to year?
- How much cash value builds up under the policy?

- What part of the premiums or benefits is not guaranteed?

- What is the effect of interest on money paid and received at different times on the policy?

Comparison Index numbers, which you get from your life insurance agents or companies, take these sorts of items into account and can point the way to better buys.

Comparison Indexes. There are two types of comparison index numbers. Both assume you will live and pay premiums for the period of the index.

1. Yield Comparison Index. The Life Insurance Yield Comparison Index is a measure of cash value growth over the Index period which takes into account the interest credited, the estimated value of the death protection provided, and the expenses charged. A higher yield index number generally indicates a better buy. Since this index reflects items other than interest earnings, it may differ from the credited interest rate advertised or guaranteed in your policy. For the same reason, the yield index will differ substantially from the return on a pure investment like a savings account. Keep this in mind if you attempt to compare Yield Indexes with investment returns.

2. The Net Payment Cost Comparison Index helps you compare costs over a 10 or 20 year period assuming you will continue to pay premiums on your policy and do not take its cash value. It is useful if your main concern is the benefits that are to be paid at your death.

Guaranteed and Illustrated Figures. Many policies provide benefits on a more favorable basis than the minimum guaranteed basis in the policy. They may do this by paying dividends, or by charging less than the maximum premium specified. Or they may do this in other ways, such as by providing higher cash values or death benefits that the minimums guaranteed in the policy. In these cases the index numbers are shown on both a guaranteed and currently illustrated basis. The currently illustrated basis reflects the company's current scale of dividends, premiums or benefits. These scales can be changed after the policy is issued, so that the actual dividends, premiums or benefits over the years can be higher or lower than those assumed in the indexes on the currently illustrated basis.

Some policies are sold only on a guaranteed or fixed cost basis. These polices do not pay dividends; the premiums and benefits are fixed at the time you buy the policy and will not change.

Using Comparison Indexes. The most important thing to remember is that, when using the Net Payment Cost Comparison Index, a policy with smaller index numbers is generally a better buy than a similar policy with larger index numbers. When using the Life Insurance Yield Comparison Index, the opposite is true: a policy with larger Yield Comparison Index numbers is generally a better buy than one with smaller Yield Comparison Index numbers.

Compare index numbers only for similar policies - those which provide essentially the same benefits, with premiums payable for the same length of time. Make sure they are for your age, and for the kind of policy and amount you intend to buy. Remember that no one company offers the lowest cost at all ages for all kinds and amounts of insurance.

Small differences in index number should be disregarded, particularly where there are dividends or nonguaranteed premiums or benefits. Also, small differences could easily be offset by other policy features, or difference in the quality of service from the agent or company. When you find small differences in the indexes, your choice should be based on something other than cost.

Finally, keep in mind that index numbers cannot tell you the whole story. You should also consider:

- The pattern of policy benefits. Some policies have low cash values in the early years that build rapidly later on. Other policies have a more level cash value build-up. A year-by-year display of values and benefits can be very helpful. (The agent or company will give your a Policy Summary that will show benefits and premiums for selected years.)

- Any special policy features may be particularly suited to your needs.

- The methods by which nonguaranteed values are calculated. For example, interest rates are an important factor in determining policy dividends. In some companies dividends reflect the average interest earning on all policies whenever issued. In others, the dividends for policies issued in a recent year, or a group of years, reflect the interest earnings on those policies; in this case, dividends are likely to change more rapidly when interest rates change.

Things to Remember

- Review your particular insurance needs and circumstances. Choose the kind of policy with benefits that most closely fit your needs. Ask an agent or company to help you.

- Be sure that the premiums are within your ability to pay. Don't look only at the initial premium, but take account of any later premium increase.

- Ask about comparison index numbers and check several companies which offer similar policies. Remember, smaller index number generally represent a better buy when using the Net Payment Cost Comparison Indexes. But larger index numbers generally represent a better buy when using the Life Insurance Yield Comparison Indexes.

- Don't buy life insurance unless you intend to stick with it. It can be very costly if you quit during the early years of the policy.

- Read your policy carefully. Ask your agent or company about anything that is not clear to you.

- Review your life insurance program with your agent or company every few years to keep up with changes in your income and your needs.

APPENDIX B

POLICY INFORMATION FOR APPLICANT - UNIVERSAL LIFE POLICY

This information is being provided to help you to understand this policy and to compare it to similar policies, so you can choose the one that is best for you. If you have questions about this form, be sure to ask your agent for an explanation.

[Name of Insurance Company]
[Address of Insurance Company]

Policy Name: [insert name]
Form Number: [insert number]

A policy for [Name of Insured(s)]
Social Security Number(s): [Insert number]
Date of Birth: [Insert DOB]

Applied for on [insert date]

Your Agent is [Name of Agent]
[Agent's Address]
[Agent's Telephone Number]

POLICY APPLIED FOR

Type of Universal Life Insurance Policy: _______________ Flexible Premium _____________________ Fixed Premium

[A flexible premium policy means that you may vary the premiums paid subject to any minimum and maximum payments stated in the policy. If you do not pay enough to cover the cost of insurance, part of your cash value will be used. Some policies can lapse without value if premiums are not paid.]

[A fixed premium policy means that you have agreed to pay a scheduled premium on each due date.]

The first year death benefit applied for is $[insert amount]. The death benefit option applied for is [describe the option].

The first year annual premium is $[insert amount].

You have agreed to pay premiums [insert frequency] and each premium payment is scheduled to be $[insert amount].

This information does not include any riders for which you may apply with this policy. Riders give you extra benefits not included in the basic policy. Riders may affect your premium and cash values. Ask your agent for a full explanation of any riders.

Risk Classification Information (as applied for):
M____ F____ Age____ Smoker____ Non-Smoker____ Other____ (Specify) ____________________

YOUR POLICY CHARGES

The *mortality charge* is the amount used to pay for the basic insurance death benefit. The current mortality charge is $[insert amount] for the first year, so this much of your first year premium pays for the death benefit. This amount may increase as you get older. In addition, the mortality charge can change. The maximum mortality charge for your current age is $[insert amount]. The company reviews mortality charges every [insert frequency].

The company's fee for *administration* of this policy may change from time to time. The current fee is $[insert amount] per [insert period], so this much of your yearly premium pays for the company's administrative costs. The maximum fee that can be charged is $[insert amount] per [insert period].

Expense Deductions (front end loads) These are additional charges that may be deducted from your premium. The amount of the charge may change depending on how long the policy has been in force. The amount currently being charged in the first year is [insert dollar amount or percentage], and the maximum charge permitted in the first year is [insert dollar amount or percentage].

Surrender charges (back end loads) are charges you may pay when your policy is surrendered. The current charge is [insert dollar amount or percentage] and the maximum charge permitted is [insert dollar amount or percentage]. Surrender charges are assessed for [insert number] years [in decreasing amounts].

YOUR POLICY CREDITS

The part of your premium not used for the above charges earns interest for you. It is the cash surrender value which you can take if you should cancel this policy.

The company has the right to change the interest rates credited to amounts paid into this policy to reflect current investment earnings. The company reviews interest rates every [insert time period]. We guarantee our rates will not go below [insert amount] %.

This policy's interest rate [is/is not] interest indexed. Interest indexing means that the interest rate credited to the amounts paid in to the policy follows a formula based on changes in the [insert index].

OTHER IMPORTANT INFORMATION ABOUT THIS POLICY

The company will pay an endowment benefit to the insured if the policy is still in force, and the insured is living and attains the age of [insert number]. This is called the "maturity age." This means the company will pay your [death benefit amount] [cash surrender value] when you have reached the maturity age, instead of waiting until you die.

If interest rates and charges were to be consistent with those illustrated in Chart A, the expenses of the policy could cause it to terminate before the maturity age. This policy would terminate at age [insert number].

Under the Chart A assumptions, the level annual premium required to provide the first year death benefit to maturity age is $[insert amount].

Based on the current assumption used to develop Chart B, the policy [would/would not] terminate before the maturity age. [If it would, indicate the policy year in which it would terminate.]

ILLUSTRATION OF POLICY VALUES

Chart A shows the guaranteed minimum interest rate and how your cash value would grow if the illustrated premium and interest rate were credited every year. Chart B shows how your cash value will grow if the interest rate remains at the level currently being paid. In both cases, the effect of any riders added to the policy is not shown.

CHART A

The following values are based on the interest rates which are guaranteed by the company and based on your timely payment of the premiums in Column 1 as applied for. If you pay a different premium in any year, results will differ.

CHART B

The following values are based on the current interest rates which the company is crediting on this policy form. Interest rates may increase or decrease from this rate. Also this chart assumes you pay the premiums shown in Column 1 as applied for.

	Chart A 1	Chart A 2	Chart A 3	Chart A 4	Chart B 1*	Chart B 2	Chart B 3	Chart B 4	
Policy Year	Annual Premium	Death Benefit	Interest Rate	Cash Surrender Value at Year End	Annual Premium	Death Benefit	Interest Rate	Cash Surrender Value at Year End	Policy Year
[1]									[1]
[2]									[2]
[3]									[3]
[4]									[4]
[5]									[5]
[6]									[6]
[7]									[7]
[8]									[8]
[9]									[9]
[10]									[10]
[11]									[11]
[12]									[12]
[13]									[13]
[14]									[14]
[15]									[15]
[16]									[16]
[17]									[17]
[18]									[18]
[19]									[19]
[20]									[20]

[Fill in other years as needed at five year intervals]

AGE									AGE
[60]									[60]
[65]									[65]
[70]									[70]

[To year of termination or maturity age]

*The first year annual premium includes any additional amounts to be deposited as applied for.

In addition to interest rates, changes in mortality and expense charges may affect the illustrations in Chart B. Current charges are used to determine the values in Chart B. The maximum guaranteed charges are used to determine the values in Chart A.

DISCLAIMER NOTICE REGARDING TAX LAW

The information in this "Policy Information for Applicant" is not intended to be used in tax planning nor is it intended for the purpose of providing tax advice. The possibility of future changes in tax laws must be recognized and taken into consideration.

POLICY INFORMATION FOR APPLICANT - INDETERMINATE PREMIUM LIFE POLICY

This information is being provided to help you understand this policy and to compare it to similar policies, so you can choose the one that is best for you. If you have questions about this form, be sure to ask your agent for an explanation.

[Name of Insurance Company]
[Address of Insurance Company]

Policy Name: [insert name]
Form Number: [insert number]

A policy for [Name of Insured(s)]
Social Security Number(s): [Insert number]
Date of Birth: [Insert DOB]

Applied for on [insert date]

Your Agent is [Name of Agent]
[Agent's Address]
[Agent's Telephone Number]

This information does not include any extra benefit riders which you may apply for with this policy. Riders may affect your premium and cash values. Ask your agent for a full explanation of any riders.

The death benefit applied for is $[insert amount]. The death benefit option applied for is [describe the option]. The first year annual premium is $[insert amount].

You have agreed to pay premiums [insert frequency] and each premium payment is scheduled to be $[insert amount].

Risk Classification Information (as applied for):
M____ F____ Age____ Smoker____ Non-Smoker____ Other____ (Specify) ____________________

OTHER IMPORTANT INFORMATION ABOUT THIS POLICY

The company has the right to change the amounts of premiums required under this policy. The company reviews amounts of premiums every [insert frequency]. Amounts of premium required will not exceed the amounts shown in Column 2 of the "Illustration of Policy Values." [If there are any other limitations on the company's right to change premiums explain here.]

[If policy is a participating policy include this statement: There may be dividends paid to the policy owner. The "Illustration of Policy Values" does not include any dividends.]

ILLUSTRATION OF POLICY VALUES

The following values are based on your timely payment of the premiums required.

(1) Age	(2) Maximum Annual Premium (Guaranteed Assumptions)	(3) Possible Annual Premium (Current Assumptions)	(4) Death Benefit	(5) Cash Surrender Value at Year End
[1]	______	______	______	______
[2]	______	______	______	______
[3]	______	______	______	______
[4]	______	______	______	______
[5]	______	______	______	______
[6]	______	______	______	______
[7]	______	______	______	______
[8]	______	______	______	______
[9]	______	______	______	______
[10]	______	______	______	______
[11]	______	______	______	______
[12]	______	______	______	______
[13]	______	______	______	______
[14]	______	______	______	______
[15]	______	______	______	______
[16]	______	______	______	______
[17]	______	______	______	______
[18]	______	______	______	______
[19]	______	______	______	______
[20]	______	______	______	______

[Fill in other years as needed at five year intervals]

DISCLAIMER NOTICE REGARDING TAX LAW

The information in this "Policy Information for Applicant" is not intended to be used in tax planning nor is it intended for the purpose of providing tax advice. The possibility of future changes in tax laws must be recognized and taken into consideration.

INSTRUCTIONS FOR FILLING IN "POLICY INFORMATION FOR APPLICANT - UNIVERSAL LIFE POLICY"

The completed policy information statement may be delivered at, or before, the time an application is made. If the completed policy information statement is not delivered at the time of application, it must be delivered within fifteen working days after application is made, but at least five days before delivery of the policy except as provided in the next sentence. If the policy is delivered sooner than five days after the completed policy information statement is delivered, then the free-look period shall be extended to fifteen days. This policy information statement is required in connection with all applications for universal life policies, except where the policy is solicited by direct mail.

If any of the information on this policy information statement changes between the date when it is delivered and the date the policy is delivered, then a revised policy information statement based on the changed information must be delivered at the same time as the policy. In any such case, a written notice shall be furnished which outlines the major reason for the change. For example, the notice might state that the " Interest Rate" shown in Chart B has changed. As another example, the applicant could have applied as a standard risk and after underwriting been found to be a substandard risk requiring higher mortality charges.

"Joint Life Policy": If the policy applied for is a joint policy, fill in the name, social security number, and date of birth of both persons under "Name of Insured." Also, fill in the blanks under "Risk Classification Information" on that sheet in duplicate with appropriate information on the sex, smoking status and age for each person, and indicating identity for each classification.

POLICY APPLIED FOR

"Risk Classification Information (as applied for)" - If the insurance company does not distinguish between smokers and non-smokers for the policy applied for, check neither "smoker" or "non-smoker." Instead, fill in "composite" following the word "other" in the line below.

If the insured applies for a policy on a substandard basis, this should be disclosed following the word "other."

YOUR POLICY CHARGES

All of the information in this section continues to assume that the policy does not contain any extra benefit riders that require an additional premium or additional periodic change.

Mortality Charge - Fill in the blank with the current mortality charge for Year 1. The paragraph also includes wording where it can be indicated whether the maximum mortality charge increases each year. All blanks in this paragraph must be filled in on the basis of an annual mortality charge, even if the insurance company actually makes calculations monthly. (In such cases, the annual mortality charge would be twelve times the applicable monthly charge.)

The paragraph also provides for information on the maximum mortality change. Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" for Year 1 must be calculated consistently with the amount filled in for this blank - subject to the two notes in the paragraph which follows.

Note, that if a negative Year 1 cash surrender value is generated by the calculation, the illustrated "Cash Surrender Value at Year End" for Year 1 in Chart A must be shown as zero. Note also that some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. In such cases, the illustrated "Cash Surrender Value at Year End" for Year 1 in Chart A must be filled in consistently with the provisions in policy language.

Since Chart B illustrates current values, the "Cash Surrender Value at Year End" for Year 1 must be calculated consistently with the amount filled in as the current mortality change, - subject to the two notes in the paragraph above which refers to Chart A, and are also true of Chart B.

Fee for Administration - The policy information statement contains blanks for both the current and the maximum fee for administration. For the purpose of filling in these blanks, a "fee for administration" refers to any type of charge made by the insurance company, other than a mortality charge, which is applied whether or not a premium is paid and which is required to maintain the policy in force. If the policy language makes no provision for a fee for administration, these blanks must be filled in with appropriate wording such as "none."

If there are such fees, the fill-in must describe those fees on a current basis and indicate the frequency with which the fee is charged. If the fee is only charged for a limited period, indicate that here. Thus, in the case of a universal life policy on which the current fee was $5 each month for the first five years only, the paragraph could say: $5 each month for the first five years, no fee thereafter."

In some cases, the policy language may provide for such a fee, but it is not currently being charged by the insurance company. In the case of such a policy, this paragraph could state: "No fee is currently being charged; however, policy language permits such a fee during the first five years."

Since Chart B illustrates current values, the "Surrender Value at Year End" amounts must be calculated consistently with the current fee for administration, if there is such a fee. However, this is subject to the two notes in the paragraph which follows.

Note that if any negative cash surrender values are generated by the calculations, the illustrated "Cash Surrender Value at Year End" in Chart B must be shown as zero for such years. Note also that some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. In such cases, the illustrated "Cash Surrender Value at Year End" in Chart B must be filled in consistently with the provisions in the policy language.

Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" amounts must be calculated consistently with the maximum fee for administration, if there is such a fee. However, this is subject to the two notes in the paragraph above which described Chart B, and are also true of Chart A.

"Expense Deductions (Front End Loads)" - The policy information statement contains blanks for both the current and the maximum expense deductions. For the purpose of filling in these blanks, an "expense deduction" refers to a charge which is deducted by the insurance company when premiums are paid - but not otherwise.

These expense deductions are sometimes called "front end loads" because they are deducted immediately after premiums are paid. Therefore, they affect the amount earning interest under the policy while that policy is maintained in force.

If the policy language makes no provision for an expense deduction, these blanks must be filled in with appropriate wording such as "none."

Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" amounts for year one must be calculated consistently with the maximum expense deductions, if there are such deductions. However, this is subject to the two notes in the paragraph which follows.

Note that if any negative cash surrender values are generated by the calculations, the illustrated "Cash Surrender Values at Year End" in Chart A must be shown as zero for such years. Note also that some fixed premium universal life policies define cash surrender values as the larger of two separate quantities. In such cases, the illustrated Surrender Values at Year End in Chart A must be filled in consistently with the provisions in the policy language.

Since Chart B illustrates current values, the "Cash Surrender Value at Year End" amounts for year one must be calculated consistently with the current expense deductions, if there are such deductions. However, this is subject to the two notes in the paragraph above which referred to Chart A, and are also true of Chart B.

"Surrender Charges (Back End Loads)" - The policy information statement contains blanks for both the current and the maximum surrender charge. For the purpose of filling in these blanks, a "surrender charge" refers to a charge which is deducted by the insurance company if the policy is surrendered for its cash surrender value - but not otherwise.

The surrender charges are sometimes called "back end loads" because they do not affect the amount earning interest under the policy, while that policy is maintained in force.

If the policy language makes no provision for a surrender charge, this blank must be filled in with appropriate wording such as "none." If the charges decrease as the years pass, indicate how at the end of the paragraph. For example the paragraph could say: "Year 1 - $400, Year 2 - $375, reducing by $25 each year until it reaches 0 at Year 13."

A surrender charge must be disclosed if the policy contains a provision that this surrender charge can be charged under certain conditions, even if it is waived by the insurance company under other conditions. (Such provisions are commonly called "bail-out" provisions.)

Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" amounts must be calculated consistently with the maximum surrender charges, if there are such charges. However, please see the two notes in the paragraph which follows.

Note that if any negative cash surrender values are generated by the calculations, the illustrated "Cash Surrender Values at Year End" in Chart A must be shown as zero for such years. Note also that some fixed premium universal life policies define cash surrender values as the larger of two separate quantities. In such cases, the illustrated Surrender Values at Year End in Chart A must be filled in consistently with the provisions in the policy language.

Since Chart B illustrates current values, the "Cash Surrender Value at Year End" amounts must be calculated consistently with the current surrender charges, if there are such charges. However, please see the two notes in the paragraph above which referred to Chart A, and are also true of Chart B.

YOUR POLICY CREDITS

The fill-ins should be consistent with Charts A and B to the extent applicable.

OTHER IMPORTANT INFORMATION ABOUT THIS POLICY

Maturity Age - This must be filled in consistently with the policy language.

If, under the assumptions of Chart A, termination would occur during one of the years illustrated in that chart, indicate year.

If, under the Assumptions of Chart B, termination would occur during one of the years illustrated in that chart, indicate year. Since Chart B is based on current assumptions, the policy year of termination under chart B may be a later year than the policy year of termination under Chart A.

ILLUSTRATION OF POLICY VALUES

If "flexible premium policy" is checked, Charts A and B are based on a policy with level annual premiums and level death benefits, except that there may be an additional amount assumed to be deposited in year one as illustrated in Charts A and B. This policy is assumed not to contain any extra benefit riders that require an additional premium or additional periodic charge. This policy is also assumed not to have any policy loans against it at any time.

If "fixed premium policy" is checked, Charts A and B are based on a policy with annual premiums and death benefits consistent with automatic options in the language of the policy applied for. This policy is assumed not to contain any extra benefit riders that require an additional premium or periodic charge. This policy is also assumed not to have any policy loans against it at any time.

"Age 60" - Both Chart A and Chart B contains lines for "Age 60" in the "Year" columns. "Age 60" refers to the year that the insured would have attained age 60 by the end of that year. For example, if the issue age of the insured is filled in as 34, "Age 60" refers to the year that the insured would have attained age 60 at the end of that year. If the issue age is 34, "Age 65" would refer to the 31st year. The same rule will hold true for the other ages required to be listed.

"Chart A" - Chart A is an illustration on a "Guaranteed Basis," assuming that the insurance company consistently credits interest at the minimum rate permitted by the language in the policy, and that all charges and deductions are the maximums permitted by the policy language. However, as stated above, it is assumed that the policy contains no extra benefit riders requiring an additional premium or periodic charge.

The following instructions apply to Chart A if "flexible premium policy" is checked.

(1) The "Annual Premium" must be a level amount equal to the "First Year Annual Premium" shown, except that the "Annual Premium" must be shown as zero if there is no death benefit provided by the policy during that year, provided, however, that there may be an additional amount assumed to be deposited in year one as illustrated in Charts A and B.

(2) The "Death Benefit" shall be an amount equal to the "First Year Death Benefit" (but increased if the amount earning interest under the policy is so large that an increase in death benefit is generated by the policy language). However, if a death benefit equal to the "First Year Death Benefit" cannot be provided for the entire year, the death benefit for that year shall be filled in as the "First Year Death Benefit" followed by a slash mark and a zero. The "Policy Information for Applicant" form may provide, but is not required to provide, an explanatory footnote to indicate how long into that particular year the "First Year Death Benefit" could be provided. The "Death Benefit" shall be shown as zero for any subsequent years.

(3) The "Interest Rate" column must disclose the applicable guaranteed interest rate, used in calculating the amounts in the "Cash Surrender Value at Year End" column. These guaranteed interest rates must be consistent with the guaranteed interest rates described in

the policy. However, these guaranteed interest rates must be filled in on an annual interest rate basis. An equivalent annual interest rate must be filled in, if the "Cash Surrender Value at Year End" is determined by making monthly calculations for each twelve months.

(4) The "Cash Surrender Value at Year End" must be filled in as the amount which would actually be paid as a cash surrender value. If the cash surrender value would be negative at the end of any year which is illustrated, the "Cash Surrender Value at Year End" must be shown as zero for that year. Some universal life policies contain provisions for surrender charges which are deducted under certain conditions, but not under others. (Such provisions are commonly called "bail-out" provisions.) The surrender values for policies containing such provisions must be illustrated assuming that the insurance company can and will deduct the maximum surrender charge.

(5) The lines for "Age 60," "Age 65" and "Age 70" and on must be filled in unless the following sentence applies. This is not required if either (a) the "Death Benefit" is filled in as zero in Chart A for the twentieth year or (b) the "Death Benefit" would go down to zero before the year in which insured would attain age 60 at the end of the year. Guaranteed assumptions are used in testing for this possibility. Please see the note above in these instructions describing "Age 60," for additional information concerning these lines.

To fill in Chart A if "fixed premium policy" is checked, use the same principles described above for a flexible premium policy with the following three exceptions. First, the "Annual Premium" column must be filled in using annual premiums actually described in the universal life fixed premium policy, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of premiums. Second, the "Death Benefits" column must be filled in using the appropriate actual death benefits provided under the policy in each year, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of death benefits and also assuming that the premiums are paid consistently with the amounts of premiums shown in the "Annual Premiums" column. Third, some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. The "Cash Surrender Value at Year End" column must be filled-in consistently with any such provision in the policy language.

"Chart B" - Chart B is an illustration on a "Current Basis," assuming that the company consistently credits interest at current interest rates, and all charges and deductions are also on a current basis. These current interest rates, current charges and deductions are not guaranteed. The insurance company has the right to change these current interest rates, charges and deductions to the extent described in the contract. However, as stated above, it is assumed that the policy contains no extra benefit riders requiring an additional premium or periodic charge.

The following instructions apply to Chart B if "flexible premium policy" is checked.

(1) The "Annual Premium" must be a level amount equal to the "First Year Annual Premium" shown, except that the "Annual Premium" must be shown as zero if there is no death benefit provided by the policy during that year, provided, however, that there may be an additional amount assumed to be deposited in year one as illustrated in Charts A and B. Since Chart B is based on current assumptions, the "Annual Premium" will in some cases become zero in a later year under Chart B than under Chart A.

(2) The "Death Benefit" shall be an amount equal to the "First Year Death Benefit" (but increased if the amount earning interest under the policy is so large that an increase in death benefit is generated by the policy language). However, if a death benefit equal to the "First Year Death Benefit" cannot be provided for the entire year, the death benefit for that year

shall be filled in as the "First Year Death Benefit" followed by a slash mark and a zero. The "Policy Information for Applicant" form may provide, but is not required to provide, an explanatory footnote to indicate how long into that particular year the "First Year Death Benefit" could be provided. The "Death Benefit" shall be shown as zero for any subsequent years. Since Chart B is based on current assumptions, the "Death Benefit" may become zero in a later year under Chart B than Chart A.

(3) The "Interest Rate" column must disclose the applicable interest rate, used in calculating the amounts in the "Cash Surrender Value at Year End" column. No increase in this interest rate can be illustrated for future years, unless such an increase is specifically described and guaranteed in the policy language. However, the current interest rates must be filled in on an annual interest rate basis. An equivalent annual interest rate must be filled in, if the "Cash Surrender Value at Year End" is determined by making monthly calculations for each twelve months.

(4) The "Cash Surrender Value at Year End" is the amount which would actually be paid as a cash surrender value. Chart B is intended to illustrate cash surrender values on a current basis, and not on the basis of non-guaranteed future improvements that may be anticipated or hoped for. No enhancement or increment can be illustrated in Chart B unless such enhancement or increment is specifically described and guaranteed in the policy language. If the cash surrender value would be negative at the end of any year which is illustrated, the "Cash Surrender Value at Year End" must be shown as zero for that year. Some universal life policies contain provisions for surrender charges which are deducted under certain conditions, but not under others. (Such provisions are commonly called "bail-out" provisions.) The surrender values for policies containing such provisions must be illustrated assuming that the insurance company can and will deduct the current surrender charge.

(5) The lines for "Age 60," "Age 65" and "Age 70" and on must be filled in unless the following sentence applies. This is not required either if (a) the "Death Benefit" is filled in as zero in Chart B for the twentieth year, or (b) the "Death Benefit" would go down to zero before the year in which the insured would attain age 60 at the end of the year. Current assumptions are used in testing for this possibility. Please see the note above in these instructions, describing "Age 60" for additional information concerning these three lines.

To fill in Chart B if "fixed premium policy" is checked, use the same principles described above for a "flexible premium policy" with the following three exceptions. First, the "Annual Premium" column must be filled in using annual premiums actually described in the universal life fixed premium policy, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of premiums. Second, the "Death Benefits" column must be filled in using the appropriate actual death benefit provided under the policy in each year, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of death benefits and also assuming that the premiums are paid consistently with the amounts of premiums shown in the "Annual Premiums" column. Third, some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. The "Cash Surrender Value at Year End" column must be filled in consistently with any such provision in the policy language.

INSTRUCTIONS FOR FILLING IN "POLICY INFORMATION FOR APPLICANT - INDETERMINATE PREMIUM LIFE PLANS"

The completed policy information statement may be delivered at, or before, the time an application is made. If the completed policy information statement is not delivered at the time of application, it must be delivered within fifteen working days after application is made, but at least five days before delivery of the policy except as provided in the next sentence. If the policy is delivered sooner than five days after the completed policy information statement is delivered, then the free-look period shall be extended to fifteen days. This policy information statement is required in connection with all applications for indeterminate premium life policies, except where the policy is solicited by direct mail.

If any of the information filled in on this policy information statement changes between the date when it is delivered and the date the policy is delivered, then a new revised policy information statement based on the changed information must be delivered at the same time as the policy. In any such case, a written notice shall be furnished which outlines the major reason for the change. For example, the applicant could have applied as a standard risk and after underwriting been found to be a substandard risk requiring higher premium rates.

"Joint Life Policy": If the policy applied for is a joint policy, fill in the name, social security number and date of birth of both persons under "Name of Insured." Also, fill in the blanks under "Risk Classification Information" on that sheet in duplicate with appropriate information on the sex, smoking status and age for each person and indicating identity for each classification.

"Risk Classification Information (as applied for)" - If the insurance company does not distinguish between smokers and non-smokers for the policy applied for, check neither "smoker" or "non-smoker." Instead, fill in "composite" following the word "other" in the line below.

If the insured applies for a policy on a substandard basis, this should be disclosed following the word "other."

OTHER IMPORTANT INFORMATION ABOUT THIS POLICY

"The company reviews amounts of premiums every _____." - This blank must be filled in with a period of time, such as "month," "quarter" or "year." Of course, the fill-in must be appropriate for the manner in which the insurance company makes calculations under the policy applied for.

If there are any limitations on the company's right to change premiums, describe any such limitations which may apply. This would include calling attention to any provision in the policy language which could prevent the insurance company from charging the maximum premiums shown in the illustration on Page 2 of the policy information sheet.

ILLUSTRATION OF POLICY VALUES

The values in this illustration are based on a policy with annual premiums and death benefits consistent with automatic options in the language of the policy applied for. This policy is assumed not to contain any extra benefit riders that require an additional premium or periodic charge. This policy is also assumed not to have any policy loans against it at any time.

Maximum Annual Premiums (Guaranteed Assumptions) - The blanks in this column must be filled in with the maximum annual premium which is allowed under the policy language for the basic policy, but not including the additional premium for any extra benefit riders. For Year 1, this must be equal to the "First Year Annual Premium" shown elsewhere on Page 1 of the policy information statement.

Possible Annual Premium (Current Assumptions) - the blanks in this column must be filled in with the amount of annual premium which would be charged under the insurance company's current non-guaranteed premium rate schedule, but not including the additional premium for any extra benefit riders. For Year 1, this must be equal to the "First Year Annual Premium" shown elsewhere on Page 1 of the policy information statement.

The "Death Benefit" column must be filled in with the amount of death benefit provided at the beginning of the year under the basic policy, but not including the death benefit for any riders that require an additional premium. For Year 1, this must be identical to the "Death Benefit," shown elsewhere on Page 1 of the policy information statement.

The "Cash Surrender Value at Year End" column must be filled in with the amount which would actually be paid as a cash surrender value, under the basic policy. The cash value of any extra benefit riders, requiring an extra premium, is not included. If the cash surrender value would be negative at the end of any year which is illustrated, the "Cash Surrender Value at Year End" must be shown as zero for that year.

APPENDIX C

FINANCIAL REVIEW OF THIS POLICY

NOTICE: You have thirty (30) days to review your policy and, if not entirely satisfied, to return it for a full refund of any premium paid.

[THIS IS A GUARANTEED ISSUE POLICY OFFERED WITHOUT AN ATTEMPT TO CLASSIFY RISKS BY DETERMINING YOUR STATE OF HEALTH. PREMIUMS MAY HAVE BEEN LOWER IF HEALTH INFORMATION HAD BEEN OBTAINED.]

THIS IS A POLICY ISSUED ON THE BASIS OF THE ANSWERS TO THE HEALTH QUESTIONS SET FORTH IN THE APPLICATION. PREMIUMS MAY HAVE BEEN LOWER IF FURTHER HEALTH INFORMATION HAD BEEN OBTAINED.]

THIS IS A POLICY WHERE THE ACCUMULATED PREMIUM EXCEEDS THE DEATH BENEFIT IN TEN YEARS OR LESS.]

Applicant Information:

NAME: ______________________________ AGE: ____

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

____

____

End of Policy Year	1 Premiums	2 Premiums Accumulating Interest at 5%*	3 Death Benefits**	4 Cash Surrender Value	5 Column 3 Minus Column 2 Net Gain (Net Loss)
1					
2					
3					
4					
5					
6					
7					
8					
9					
10					

Definitions: The following terms used in the above chart are defined as:

1. **Premiums** - Amount you must pay each year to keep this policy in force.
2. **Premiums Accumulating Interest at 5%** - The amount which could be earned if, instead of purchasing insurance, the dollars were left to accumulate at 5% interest.
3. **Death Benefits** - The amount that will be paid upon your death exclusive of any supplementary benefits.
4. **Cash Surrender Value** - The amount the insurance company will pay you if you surrender your policy to the company for cash.
5. **Net Gain or Loss** - This column shows whether your money would have earned more or less at 5% interest than your life insurance benefit.

*Note: This figure does not take into account the cost of insurance, any dividends or additional benefits which are not guaranteed under the policy, nor potential preferential tax implications.

[**Agent/Company: If death benefits have been explained in any manner other than shown on the above chart (through use of CPI index, dividends, or other non-guaranteed increase or a reduction in premium), a copy of the illustration signed by the applicant and agent must be attached.]

APPENDIX D

GUIDE TO BUYING LIFE INSURANCE AFTER AGE 60

This guide is designed to help you review your life insurance policy. Like many financial products, life insurance is regulated to protect buyers. It's not possible to discuss all of the consumer protections in this guide. Also, they vary from state to state. This guide discusses two items of particular importance to older buyers, the "free look" period and the Financial Review of This Policy form.

You will also receive a Life Insurance Buyer's Guide. It has additional information you may wish to review. Both guides were prepared by the National Association of Insurance Commissioners, an association of state insurance officials. Neither guide endorses any company or policy.

"Free Look" Period

With every new policy, your state requires insurance companies to provide policyholders with a "free look" period. During that period you can reconsider your decision to purchase the policy. Your policy has a 30-day "free look" period. If you choose to cancel during the "free look" period, the company must refund the premium paid (premiums are the amount you pay for coverage). The clock starts ticking when you receive the policy.

The "free look" period is the time for you to decide if the life insurance policy meets your needs.

Financial Review

To help you make a financial evaluation of your policy, before you make your final decision to keep it, insurance regulations in your state require life insurance companies to furnish some buyers over age 60 with a financial review of their policy. This review displays your policy's premiums, death benefits (the amount your beneficiary, the person you designate, receives after death) and cash values (the amount available if you cancel). Not every buyer over 60 will receive this form. Persons receiving the form purchased a policy where:

- Premiums for the policy, plus 5 percent interest, compounded annually, exceed death benefits at some time during the first 10 years; or

- Death benefits are limited for some period after the policy is issued (for example, a policy that limits death benefits for the first two years).

Drafting note: State law may require full death benefits for accidental death.

The review form is an individual analysis of your policy. It's displayed on a form called a "Financial Review of This Policy." The review is designed to help you decide if this policy makes financial sense for you and your family.

This guide uses two examples to let you see how the review form works with two different policies. These are real policies purchased by people over age 60. The policy you buy will almost surely be different from these two. Nevertheless, these illustrations should help you evaluate your policy.

Marvin Policyholder

Marvin Policyholder is 77 years old and bought an increasing benefit life policy. Even though he pays premiums over a 10-year period, his death benefits begin on day one. The policy returns an increasing death benefit as long as Marvin pays his annual premium of $507.38 ($5,073.80 over 10 years). The death benefit starts at $1,500.00 and increases by $75.00 each year. Marvin received a copy of his policy and the review form at the same time.

Forms may vary from state to state, but Marvin's looked like this:

FINANCIAL REVIEW OF THIS POLICY

Notice: You have thirty (30) days to review your policy and, if not entirely satisfied, to return it for a full refund of any premiums paid.

[ ] This is a guaranteed issue policy offered without an attempt to classify risks by determining your state of health. Premiums may have been lower if health information had been obtained.

[x] This is a policy issued on the basis of the answers to the health questions set forth in the application. Premiums may have been lower if further health information had been obtained.

[x] This is a policy where the accumulated premium exceeds the death benefit in 10 years or less.

Applicant information:

Name: Marvin Policyholder Age: 77 Sex: M
List other personal information used in determining the premium for this policy:

End of Policy Year	1 Premiums	2 Premiums Accumulating Interest at 5%*	3 Death Benefits	4 Cash Surrender Value	5 Column 3 minus Column 2 Net Gain (Net Loss)
1	$507.38	$532.74	$1500.00	$45.66	$967.26
2	$507.38	$1092.12	$1575.00	$206.79	$482.88
3	$507.38	$1679.47	$1650.00	$374.59	$(29.47)
4	$507.38	$2296.19	$1725.00	$550.79	$(571.19)
5	$507.38	$2943.75	$1800.00	$737.55	$(1143.75)
6	$507.38	$3623.68	$1875.00	$938.06	$(1748.68)
7	$507.38	$4337.60	$1950.00	$1157.15	$(2387.60)
8	$507.38	$5087.23	$2025.00	$1402.34	$(3062.23)
9	$507.38	$5874.33	$2100.00	$1684.77	$(3774.33)
10	$507.38	$6700.79	$2175.00	$2020.76	$(4525.79)

Definitions: The following terms used in the above chart are defined as:

1. **Premiums** - Amount you must pay each year to keep this policy in force.
2. **Premiums Accumulating Interest at 5%** - The amount which could be earned if, instead of purchasing insurance, the dollars were left to accumulate at 5% interest.
3. **Death Benefits** - The amount that will be paid upon your death exclusive of any supplementary benefits.
4. **Cash Surrender Value** - The amount the insurance company will pay you if you surrender your policy to the company for cash.
5. **Net Gain or Loss** - This column shows whether your money would have earned more or less at 5% interest than your life insurance benefit.

*Note: This figure does not take into account the cost of insurance, any dividends or additional benefits which are not guaranteed under the policy, nor potential preferential tax implications.

If death benefits have been explained in any manner other than shown on the above chart (through use of CPI index, dividends, or other non-guaranteed increase or a reduction in premium), a copy of the illustration signed by the applicant and agent must be attached.

At the top of the form (below the line discussing the 30-day "free look" period) are three boxes. The insurance company checked the second box because Marvin's policy was underwritten. He was required to answer several health questions on his application.

The third box was checked because Marvin's premiums at 5 percent compound interest, exceed death benefits before the end of 10 years. This occurs in the third year. Whenever premiums accumulated at 5 percent interest exceed benefits within the first 10 years of a policy, the insurance company is required to check this box.

Next comes Marvin's name, age, and so on. Below that are six columns of information about his policy. Columns 1, 2, 3, and 5 explain in more detail the relationship between the actual premiums Marvin paid, and what would have been the result if he had put money in a 5 percent compound interest account instead. It also displays how the death benefits increase.

Life insurance really isn't a savings investment. For example, Marvin's eligible for $1500 in death benefits on day one even though he paid only $507.38. In addition, these benefits aren't taxed. Both of these could be to his advantage. On the other hand he also needs to look at how much it costs for these death benefits over time.

Death Benefits--Column Number 3 indicates the amount of the death benefits his policy provides as long as Marvin pays his premiums. Benefits with Marvin's policy increase every year during the first 10 years by an amount of $75. This amount increases over the life of the policy.

Cash Surrender Value--This column (Number 4) tells Marvin how much he would receive if he cancels his policy. This amount increases over the life of the policy. Not all policies, however, provide a cash surrender value*.

*** Term insurance, for example, does not. See Life Insurance Buyer's Guide for more information.**

Net Gain, Net Loss--The last column (Number 5) provides Marvin with cost-benefit information. It is a comparison of columns 2 and 3. Notice the column changes every year. Column 5 tells Marvin:

- For the first two years, his policy has a net gain ($967.26 in year one, and $482.88 in year two);

- In the third year, however, there is a net loss. His policy reports a net loss every year after that. Whenever there is a loss, it is reported inside parenthesis such as ($29.47).

This is important information. Marvin needs to weigh this comparison with his reasons for buying life insurance and then decide if this policy best meets his needs.

Marla Policyholder

Now let's look at a policy purchased by Marla Policyholder. She is a 65 year old woman who purchased a guaranteed issue policy. This means no health questions are asked. Her policy's death benefits are reduced for the first two years. Death benefits are $470 at the end of the first year, and $940 at the end of the second. After the third year, however, they rise to $3880.

Her financial review looked like this:

FINANCIAL REVIEW OF THIS POLICY

Notice: You have thirty (30) days to review your policy and, if not entirely satisfied, to return it for a full refund of any premiums paid.

[x] This is a guaranteed issue policy offered without an attempt to classify risks by determining your state of health. Premiums may have been lower if health information had been obtained.

[ ] This is a policy issued on the basis of the answers to the health questions set forth in the application. Premiums may have been lower if further health information had been obtained.

[ ] This is a policy where the accumulated premium exceeds the death benefit in 10 years or less.

Application Information:

Name: **Marla Policyholder** Age: 65 Sex: F
List other personal information used in determining the premium for this policy: ______________________________

End of Policy Year	1 Premiums	2 Premiums Accumulating Interest at 5%*	3 Death Benefits	4 Cash Surrender Value	5 Column 3 minus Column 2 Net Gain (Net Loss)
1	$235.20	$241.52	$470.40	$0.00	$228.88
2	$235.20	$495.12	$940.80	$72.00	$445.68
3	$235.20	$761.40	$3880.00	$96.00	$3118.60
4	$235.20	$1041.00	$3880.00	$120.00	$2839.00
5	$235.20	$1334.56	$3880.00	$140.00	$2545.44
6	$235.20	$1642.80	$3880.00	$160.00	$2237.20
7	$235.20	$1966.48	$3880.00	$176.00	$1913.52
8	$235.20	$2066.32	$3880.00	$184.00	$1813.68
9	$235.20	$2663.16	$3880.00	$188.00	$1216.84
10	$235.20	$3037.84	$3880.00	$184.00	$842.16

Definitions: The following terms used in the above chart are defined as:

1. **Premiums** - Amount you must pay each year to keep this policy in force.
2. **Premiums Accumulating Interest at 5%** - The amount which could be earned if, instead of purchasing insurance, the dollars were left to accumulate at 5% interest.
3. **Death Benefits** - The amount that will be paid upon your death exclusive of any supplementary benefits.
4. **Cash Surrender Value** - The amount the insurance company will pay you if you surrender your policy to the company for cash.
5. **Net Gain or Loss** - This column shows whether your money would have earned more or less at 5% interest than your life insurance benefit.

*Note: This figure does not take into account the cost of insurance, any dividends or additional benefits which are not guaranteed under the policy, nor potential preferential tax implications.

If death benefits have been explained in any manner other than shown on the above chart (through use of CPI index, dividends, or other non-guaranteed increase or a reduction in premium), a copy of the illustration signed by the applicant and agent must be attached.

As you can see, Marla's policy is very different. The major differences are: (1) death benefits exceed premiums accumulating at 5 percent for all 10 years, and (2) death benefits are limited for the first 2 years.

Box number one is checked because this is a guaranteed issue policy. No health questions were asked of Marla. Therefore, the second box wasn't checked. This third box wasn't checked because benefits exceed premiums accumulating at 5 percent for all 10 years. Let's now look at how the policy compares in the five columns of information.

Premiums–Marla pays $235.20 a year for 10 years for a total of $2352.00.

Premiums Accumulating at 5%–The amount in this column is less than the amount if death benefits are payable in each of the first ten policy years.

Death Benefits–Marla's death benefits are reduced for the first two years and then are $3,880.00 for the next eight years.

Cash Surrender Value–Cash surrender values are low with Marla's policy.

Net Gain, Net Loss–Marla's policy consistently reports a net gain for the first 10 years. This means her life insurance death benefits are greater than premiums accumulating at 5 percent interest for the first 10 years.

Part of the difference between Marvin and Marla's policies is tied to the fact that Marla is younger and she's a woman. Life insurance premiums are usually based on age and sex.

The difference between these policies is also related to the fact that different companies offer different policies. It's up to you to choose what's best for you. You should review your reasons for buying life insurance, your age, and health. In addition, a careful financial review of your policy is needed. This guide is designed to help you review your life insurance policy.

You should also read your policy carefully before deciding to keep it. If you have any questions or if anything is unclear, contact your agent, the insurance company, or your state insurance commissioner.

Legislative History (all references are to the Proceedings of the NAIC).

1976 Proc. I 7, 10-11, 381, 521, 523-527 (adopted).
1976 Proc. II 15, 17, 397, 542, 545-552 (reprinted with technical amendments and Buyer's Guide).
1978 Proc. I 13, 15, 348, 472 (corrected).
1984 Proc. I 6, 31, 375, 496, 497-510 (amended and named changed from Life Insurance Solicitation to Life Insurance Disclosure Model Regulation).
1988 Proc. I 9, 19-20, 599-600, 625-626 (amended).
1988 Proc. II 5, 12, 478, 490, 503-510 (amended, regulation reprinted).
1989 Proc. II 13, 23, 414-415, 419-422, 428-429, 430-442, 841-859 (amended to create optional version with yield index).
1990 Proc. I 6, 27, 438-439, 450-451, 453-463 (amended).
1991 Proc. II 25, 57, 683, 702, 703-714 (amended).
1992 Proc. I 86, 94, 860, 868, 869-878 (amended by virtue of previous decision to add all amendments to Life Insurance Disclosure Regulation to this optional version also).
1993 Proc. I (amended, added Appendix D).

The following have been superseded by the model regulation above.

a. Deceptive Practices in Life Insurance Model Regulation:
1973 Proc. II 18, 21, 471, 532-533, 541-543 (adopted).
1974 Proc. I 12, 14, 405, 440, 442-443 (amended).

b. Life Insurance Cost Comparison (Interest Adjusted Index) Model Regulation:
1973 Proc. II 18, 21, 471, 532-533, 538-540 (adopted).
1974 Proc. 12, 14, 405, 440, 442 (corrected).

OPTIONAL FORM OF LIFE INSURANCE DISCLOSURE MODEL REGULATION WITH YIELD INDEX

See the listing for the Life Insurance Disclosure Model Regulation at page 580-45 for a comprehensive list of states.

ATTACHMENT C

UNIVERSAL LIFE INSURANCE MODEL REGULATION

Table of Contents

Section 1. Authority.

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

Section 2. Purpose.

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

(Note: It is the position of the drafters of this regulation that universal life insurance is simply another, competing type of life insurance which should be treated, to the extent possible, in the same regulatory manner as other life insurance products. This regulation is designed to address those areas where universal life insurance does not "fit" into the existing regulatory framework. This regulation does not supersede existing requirements relating to filing, solicitation, advertising, etc., but is supplementary to them.)

Section 3. Definitions.

As used in this regulation:

A. Universal Life Insurance Policy.

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

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

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

B. Flexible Premium Universal Life Insurance Policy.

"Flexible premium universal life insurance policy" means a universal life insurance policy which permits the policyowner to vary, independently of each other, the amount or timing of one or more premium payments or the amount of insurance.

C. Fixed Premium Universal Life Insurance Policy.

"Fixed premium universal life insurance policy" means a universal life insurance policy other than a flexible premium universal life insurance policy.

D. Interest-Indexed Universal Life Insurance Policy.

"Interest-indexed universal life insurance policy" means any universal life insurance policy where the interest credits are linked to an external referent.

(Note: This definition is not intended to include those policies which only have a variable policy loan interest rate provision, but have no other link to an external referent.

This regulation presently addresses only the indexing of interest credits. The regulation does not preclude the indexing of other factors, e.g., mortality or expenses. Should other products be developed which involve the indexing of factors other than interest credits, this regulation may require modification. The regulation does not preclude insurance departments from adding requirements regarding the indexing of such other factors.)

E. Net Cash Surrender Value.

"Net Cash Surrender Value" means the maximum amount payable to the policyowner upon surrender.

F. Cash Surrender Value.

"Cash Surrender Value" means the Net Cash Surrender Value plus any amounts outstanding as policy loans.

G. Policy Value.

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

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

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

H. May.

"May" is permissive.

I. Shall.

"Shall" is mandatory.

J. Commissioner.

"Commissioner" (Director, Superintendent) means the Insurance Commissioner (Director, Superintendent) of this state.

Section 4. Scope.

This regulation encompasses all individual universal life insurance policies except those policies defined under Article II, Section 19 of the NAIC Model Variable Life Insurance Regulation.

Section 5. Valuation.

A. Requirements.

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

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

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

(B) is the quanitity $\frac{PVFB}{\ddot{a}_x}\ddot{a}_{x+t}$ where PVFB is the present value of all benefits guaranteed at issue assuming future Guaranteed Maturity Premiums are paid by the policyowner and taking into account all guarantees contained in the policy or declared by the insurer.

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

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

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

The Guaranteed Maturity Fund at any duration is that amount which, together with future Guaranteed Maturity Premiums, will mature the policy based on all policy guarantees at issue.

(C) is the quantity ((a) − (b)) $\frac{\ddot{a}_{x+t}}{\ddot{a}_x}$ r where (a) − (b) is as described in [Section Four of the Standard Valuation Law, as amended in 1980] for the plan of insurance defined at issue by the Guaranteed Maturity Premiums and all guarantees contained in the policy or declared by the insurer.

$\ddot{a}_{x-t}$ and $\ddot{a}_x$ are defined in (B) above.

(D) is the sum of any additional quantities analogous to (C) which arise because of structural changes[3] in the policy, with each such quantity being determined on a basis consistent with that of (C) using the maturity date in effect at the time of the change.

The Guaranteed Maturity Premium, the Guaranteed Maturity Fund and (B) above shall be recalculated to reflect any structural changes in the policy. This recalculation shall be done in a manner consistent with the descriptions above.

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

All present values shall be determined using (i) an interest rate (or rates) specified by the [Standard Valuation Law, as amended in 1980] for policies issued in the same year; (ii) the mortality rates specified by the [Standard Valuation Law, as amended in 1980] for policies issued in the same year or contained in such other table as may be approved by the Commissioner for this purpose; and (iii) any other tables needed to value supplementary benefits provided by a rider which is being valued together with the policy.

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

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

Ever since the adoption of the original Standard Valuation Law (SVL) in 1942, provision has been made for valuation calculations on the basis of substandard mortality. (See Section 3(g) of SVL.) While this provision has been used infrequently in the past, it is anticipated that substandard mortality will be more frequently utilized in universal life insurance, given its flexible nature, to reflect the mortality classification assigned to the policy by the insurer.

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

B. Alternative Minimum Reserves.

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

(1) The reserve calculated according to the method, the mortality table, and the rate of interest actually used.

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

For universal life insurance reserves on a net level premium basis, the valuation net premium is $\frac{PVFB}{\ddot{a}_x}$ and for reserves on a Commissioners Reserve Valuation Method, the valuation net premium is $\frac{PVFB}{\ddot{a}_x} + \frac{(a) - (b)}{\ddot{a}_x}$.

Section 6. Nonforfeiture.

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

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

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

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

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

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

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

The initial acquisition expense charges shall be the excess of the expense charges, other than service charges, actually made in the first policy year over the averaged administrative expense charges for that year. Additional acquisition expense charges shall be the excess of the expense charges, other than service charges, actually made in an insurance-increase year over the averaged administrative expense charges for that year. An insurance-increase year shall be the year beginning on the date of increase in the amount of insurance by policyowner request (or by the terms of the policy).

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

The initial expense allowance shall be the allowance provided by [items (ii), (iii) and (iv) of section five] or by [items (ii) and (iii) of section five – c(l)], as applicable, of the [Standard Nonforfeiture Law for Life Insurance, as amended in 1980] for a fixed premium, fixed benefit endowment policy with a face amount equal to the initial face amount of the flexible premium universal life insurance policy, with level premiums paid annually until the highest attained age at which a premium may be paid under the flexible premium universal life insurance policy, and maturing on the latest maturity date permitted under the policy, if any, otherwise at the highest age in the valuation mortality table. The unused initial expense allowance shall be the excess, if any, of the initial expense allowance over the initial acquisition expense charges as defined above.

If the amount of insurance is subsequently increased upon request of the policyowner (or by the terms of the policy), an additional expense allowance and an unused additional expense allowance shall be determined on a basis consistent with the above and with [section five – c(5) of the Standard Nonforfeiture Law for Life Insurance, as amended in 1980], using the face amount and the latest maturity date permitted at that time under the policy.

The unamortized unused initial expense allowance during the policy year beginning on the policy anniversary at age x + t (where "x" is the same issue age) shall be the unused initial expense allowance multiplied by $\frac{\ddot{a}_{x+t}}{\ddot{a}_x}$ where $\ddot{a}_{x+t}$ and $\ddot{a}_x$ are present values of an annuity of one per year payable on policy anniversaries beginning at ages x + t and x, respectively, and continuing until the highest attained age at which a premium may be paid under the policy, both on the mortality and interest bases guaranteed in the policy. An unamortized unused additional expense allowance shall be the unused additional expense allowance multiplied by a similar ratio of annuities, with $\ddot{a}_x$ replaced by an annuity beginning on the date as of which the additional expense allowance was determined.

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

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

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

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

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

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

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

(B) is the present value of future adjusted premiums. The adjusted premiums are calculated as described in [sections 5 and 5 − a or in paragraph (1) of section 5 − c], as applicable, of [the Standard Nonforfeiture Law for Life Insurance, as amended in 1980]. If section 5 − c, paragraph (l) is applicable, the nonforfeiture net level premium is equal to the quantity $\frac{PVFB}{\ddot{a}_x}$, where PVFB is the present value of all benefits guaranteed at issue assuming future premiums are paid by the policyowner and all guarantees contained in the policy or declared by the insurer.

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

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

(D) is the sum of any quantities analogous to (B) which arise because of structural changes[5] in the policy.

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

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

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

C. Minimum Paid-Up Nonforfeiture Benefits.

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

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

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

Ever since the adoption of the original Standard Nonforfeiture Law (SNFL) in 1942, provision has been made for nonforfeiture calculations on the basis of substandard mortality. (See sections 5, 5-a, and 5-c of paragraph 8(c) of SNFL.) While this provision has been used infrequently in the past, it is anticipated that substandard mortality will be more frequently utilized in universal life insurance, given its flexible nature, to reflect the mortality classification assigned to the policy by the insurer.

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

Section 7. Mandatory Policy Provisions.

The policy shall provide the following:

A. Periodic Disclosure to Policyowner.

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

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

B. Illustrative Reports.

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

C. Policy Guarantees.

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

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

D. Calculation of Cash Surrender Values.

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

1. The guaranteed maximum expense charges and loads.

2. Any limitation on the crediting of additional interest. Interest credits shall not remain conditional for a period longer than twenty-four months.

3. The guaranteed minimum rate or rates of interest.

4. The guaranteed maximum mortality charges.

5. Any other guaranteed charges.

6. Any surrender or partial withdrawal charges.

E. Changes in Basic Coverage.

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

F. Grace Period and Lapse.

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

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

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

G. Misstatement of Age or Sex.

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

H. Maturity Date.

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

Section 8. Disclosure Requirements.

A. Initial Disclosure.

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

1. Any statement of policy cost factors or benefits shall contain:

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

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

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

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

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

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

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

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

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

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

(Note: It is not intended that this section conflict with or supersede the Model Act on Unfair Trade Practices or Model Regulations on Advertising and Solicitation. This Section supplements those models to the extent that they do not contemplate universal life insurance policy forms and covers those areas which appear to be most subject to misunderstandings by the public.)

B. Disclosure at Time of Sale.

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

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

If the policy is delivered sooner than five days after the Policy Information for Applicant, the free-look period shall be extended to fifteen days. In the event the Statement of Policy Information for Applicant is not delivered at the time of application, the disclosure shall be accompanied by a statement that it is delivered for the express purpose of allowing comparison with other policies.

C. Direct Response Solicitation

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

Section 9. Periodic Disclosure to Policyowner.

A. Requirements.

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

Such report shall include the following:

1. The beginning and end of the current report period.

2. The policy value at the end of the previous report period and at the end of the current report period.

3. The total amounts which have been credited or debited to the policy value during the current report period, identifying each by type (e.g., interest, mortality, expense and riders).

4. The current death benefit at the end of the current report period on each life covered by the policy.

5. The net cash surrender value of the policy as of the end of the current report period.

6. The amount of outstanding loans, if any, as of the end of the current report period.

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

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

Section 10. Interest-Indexed Universal Life Insurance Policies.

A. Initial Filing Requirements.

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

1. A description of how the interest credits are determined, including:

    a. a description of the index;

    b. the relationship between the value of the index and the actual interest rate to be credited;

    c. the frequency and timing of determining the interest rate;

    d. the allocation of interest credits, if more than one rate of interest applies to different portions of the policy value;

2. The insurer's investment policy, which includes a description of the following:

    a. how the insurer addressed the reinvestment risks;

    b. how the insurer plans to address the risk of capital loss on cash outflows;

    c. how the insurer plans to address the risk that appropriate investments may not be available or not available in sufficient quantities;

    d. how the insurer plans to address the risk that the indexed interest rate may fall below the minimum contractual interest rate guaranteed in the policy;

    e. the amount and type of assets currently held for interest indexed policies;

    f. the amount and type of assets expected to be acquired in the future;

3. If policies are linked to an index for a specified period less than to the maturity date of the policy, a description of the method used (or currently contemplated) to determine interest credits upon the expiration of such period.

4. A description of any interest guarantee in addition to or in lieu of the index.

5. A description of any maximum premium limitations and the conditions under which they apply.

B. Additional Filing Requirements.

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

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

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

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

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

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

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

I, ______________________ am ______________________________________
(Name) (position or relationship to Insurer)
for the XYZ Life Insurance Company (The Insurer) in the state of ______________
(State of Domicile of Insurer)

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

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

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

I relied on the investment policy of the Insurer and on projected investment cash flows as provided by ______________________, Chief Investment Officer of the Insurer.[5]

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

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

Signature of Actuary

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

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

Footnotes:

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

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

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

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

5. See footnote 3.

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

APPENDIX A

POLICY INFORMATION FOR APPLICANT - UNIVERSAL LIFE POLICY

This information is being provided to help you to understand this policy and to compare it to similar policies, so you can choose the one that is best for you. If you have questions about this form, be sure to ask your agent for an explanation.

[Name of Insurance Company]
[Address of Insurance Company]

Policy Name: [insert name]
Form Number: [insert number]

A policy for [Name of Insured(s)]
Social Security Number(s): [Insert number]
Date of Birth: [Insert DOB]

Applied for on [insert date]

Your Agent is [Name of Agent]
[Agent's Address]
[Agent's Telephone Number]

POLICY APPLIED FOR

Type of Universal Life Insurance Policy: ____ Flexible Premium ____ Fixed Premium

[A flexible premium policy means that you may vary the premiums paid subject to any minimum and maximum payments stated in the policy. If you do not pay enough to cover the cost of insurance, part of your cash value will be used. Some policies can lapse without value if premiums are not paid.]

[A fixed premium policy means that you have agreed to pay a scheduled premium on each due date.]

The first year death benefit applied for is $[insert amount]. The death benefit option applied for is [describe the option].

The first year annual premium is $[insert amount].

You have agreed to pay premiums [insert frequency] and each premium payment is scheduled to be $[insert amount].

This information does not include any riders for which you may apply with this policy. Riders give you extra benefits not included in the basic policy. Riders may affect your premium and cash values. Ask your agent for a full explanation of any riders.

Risk Classification Information (as applied for):

M____ F____ Age____ Smoker____ Non-Smoker____ Other____ (Specify) ________

YOUR POLICY CHARGES

The mortality charge is the amount used to pay for the basic insurance death benefit. The current mortality charge is $[insert amount] for the first year, so this much of your first year premium pays for the death benefit. This amount may increase as you get older. In addition, the mortality charge can change. The maximum mortality charge for your current age is $[insert amount]. The company reviews mortality charges every [insert frequency].

The company's fee for administration of this policy may change from time to time. The current fee is $[insert amount] per [insert period], so this much of your yearly premium pays for the company's administrative costs. The maximum fee that can be charged is $[insert amount] per [insert period].

Expense Deductions (front end loads) These are additional charges that may be deducted from your premium. The amount of the charge may change depending on how long the policy has been in force. The amount currently being charged in the first year is [insert dollar amount or percentage], and the maximum charge permitted in the first year is [insert dollar amount or percentage].

Surrender charges (back end loads) are charges you may pay when your policy is surrendered. The current charge is [insert dollar amount or percentage] and the maximum charge permitted is [insert dollar amount or percentage]. Surrender charges are assessed for [insert number] years [in decreasing amounts].

YOUR POLICY CREDITS

The part of your premium not used for the above charges earns interest for you. It is the cash surrender value which you can take if you should cancel this policy.

The company has the right to change the interest rates credited to amounts paid into this policy to reflect current investment earnings. The company reviews interest rates every [insert time period]. We guarantee our rates will not go below [insert amount] %.

This policy's interest rate [is/is not] interest indexed. Interest indexing means that the interest rate credited to the amounts paid in to the policy follows a formula based on changes in the [insert index].

OTHER IMPORTANT INFORMATION ABOUT THIS POLICY

The company will pay an endowment benefit to the insured if the policy is still in force, and the insured is living and attains the age of [insert number]. This is called the "maturity age." This means the company will pay your [death benefit amount] [cash surrender value] when you have reached the maturity age, instead of waiting until you die.

If interest rates and charges were to be consistent with those illustrated in Chart A, the expenses of the policy could cause it to terminate before the maturity age. This policy would terminate at age [insert number].

Under the Chart A assumptions, the level annual premium required to provide the first year death benefit to maturity age is $[insert amount].

Based on the current assumption used to develop Chart B, the policy [would/would not] terminate before the maturity age. [If it would, indicate the policy year in which it would terminate.]

ILLUSTRATION OF POLICY VALUES

Chart A shows the guaranteed minimum interest rate and how your cash value would grow if the illustrated premium and interest rate were credited every year. Chart B shows how your cash value will grow if the interest rate remains at the level currently being paid. In both cases, the effect of any riders added to the policy is not shown.

Chart A

The following values are based on the interest rates which are guaranteed by the company and based on your timely payment of the premiums in Column 1 as applied for. If you pay a different premium in any year, results will differ.

POLICY YEAR	1* ANNUAL PREMIUM	2 DEATH BENEFIT	3 INTEREST RATE	4 CASH SURRENDER VALUE AT YEAR END
[1]				
[2]				
[3]				
[4]				
[5]				
[6]				
[7]				
[8]				
[9]				
[10]				
[11]				
[12]				
[13]				
[14]				
[15]				
[16]				
[17]				
[18]				
[19]				
[20]				
AGE				
[60]				
[65]				
[70]				

Chart B

The following values are based on the interest rates which the company is currently crediting on this policy form. Interest rates may increase or decrease from this rate. Also this chart assumes you pay the premiums shown in Column 1 as applied for.

1* ANNUAL PREMIUM	2 DEATH BENEFIT	3 INTEREST RATE	4 CASH SURRENDER VALUE AT YEAR END	POLICY YEAR
				[1]
				[2]
				[3]
				[4]
				[5]
				[6]
				[7]
				[8]
				[9]
				[10]
				[11]
				[12]
				[13]
				[14]
				[15]
				[16]
				[17]
				[18]
				[19]
				[20]
				AGE
				[60]
				[65]
				[70]

[Fill in other years as needed at five year intervals]

[To year of termination or maturity age]

*The first year annual premium includes any additional amounts to be deposited as applied for

In addition to interest rates, changes in mortality and expense charges may affect the illustrations in Chart B. Current charges are used to determine the values in Chart B. The maximum guaranteed charges are used to determine the values in Chart A.

DISCLAIMER NOTICE REGARDING TAX LAW

The information in this "Policy Information for Applicant" is not intended to be used in tax planning nor is it intended for the purpose of providing tax advice. The possibility of future changes in tax laws must be recognized and taken into consideration.

INSTRUCTIONS FOR FILLING IN "POLICY INFORMATION FOR APPLICANT - UNIVERSAL LIFE POLICY"

The completed policy information statement may be delivered at, or before, the time an application is made. If the completed policy information statement is not delivered at the time of application, it must be delivered within fifteen working days after application is made, but at least five days before delivery of the policy except as provided in the next sentence. If the policy is delivered sooner than five days after the completed policy information statement is delivered, then the free-look period shall be extended to fifteen days. This policy information statement is required in connection with all applications for universal life policies, except where the policy is solicited by direct mail.

If any of the information on this policy information statement changes between the date when it is delivered and the date the policy is delivered, then a revised policy information statement based on the changed information must be delivered at the same time as the policy. In any such case, a written notice shall be furnished which outlines the major reason for the change. For example, the notice might state that the " Interest Rate" shown in Chart B has changed. As another example, the applicant could have applied as a standard risk and after underwriting been found to be a substandard risk requiring higher mortality charges.

"Joint Life Policy": If the policy applied for is a joint policy, fill in the name, social security number, and date of birth of both persons under "Name of Insured." Also, fill in the blanks under "Risk Classification Information" on that sheet in duplicate with appropriate information on the sex, smoking status and age for each person, and indicating identity for each classification.

POLICY APPLIED FOR

"Risk Classification Information (as applied for)" — If the insurance company does not distinguish between smokers and non-smokers for the policy applied for, check neither "smoker" or "non-smoker." Instead, fill in "composite" following the word "other" in the line below.

If the insured applies for a policy on a substandard basis, this should be disclosed following the word "other."

YOUR POLICY CHARGES

All of the information in this section continues to assume that the policy does not contain any extra benefit riders that require an additional premium or additional periodic change.

Mortality Charge — Fill in the blank with the current mortality charge for Year 1. The paragraph also includes wording where it can be indicated whether the maximum mortality charge increases each year. All blanks in this paragraph must be filled in on the basis of an annual mortality charge. even if the insurance company actually makes calculations monthly. (In such cases, the annual mortality charge would be twelve times the applicable monthly charge.)

The paragraph also provides for information on the maximum mortality change.
Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" for Year 1 must be calculated consistently with the amount filled in for this blank — subject to the two notes in the paragraph which follows.

Note, that if a negative Year 1 cash surrender value is generated by the calculation, the illustrated "Cash Surrender Value at Year End" for Year 1 in Chart A must be shown as zero. Note also that some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. In such cases, the illustrated "Cash Surrender Value at Year End" for Year 1 in Chart A must be filled in consistently with the provisions in policy language.

Since Chart B illustrates current values, the "Cash Surrender Value at Year End" for Year 1 must be calculated consistently with the amount filled in as the current mortality change, — subject to the two notes in the paragraph above which refers to Chart A, and are also true of Chart B.

Fee for Administration — The policy information statement contains blanks for both the current and the maximum fee for administration. For the purpose of filling in these blanks, a "fee for administration" refers to any type of charge made by the insurance company, other than a mortality charge, which is applied whether or not a premium is paid and which is required to maintain the policy in force. If the policy language makes no provision for a fee for administration, these blanks must be filled in with appropriate wording such as "none."

If there are such fees, the fill-in must describe those fees on a current basis and indicate the frequency with which the fee is charged. If the fee is only charged for a limited period, indicate that here. Thus, in the case of a universal life policy on which the current fee was $5 each month for the first five years only, the paragraph could say: $5 each month for the first five years, no fee thereafter."

In some cases, the policy language may provide for such a fee, but it is not currently being charged by the insurance company. In the case of such a policy, this paragraph could state: "No fee is currently being charged; however, policy language permits such a fee during the first five years."

Since Chart B illustrates current values, the "Surrender Value at Year End" amounts must be calculated consistently with the current fee for administration, if there is such a fee. However, this is subject to the two notes in the paragraph which follows.

Note that if any negative cash surrender values are generated by the calculations, the illustrated "Cash Surrender Value at Year End" in Chart B must be shown as zero for such years. Note also that some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. In such cases, the illustrated "Cash Surrender Value at Year End" in Chart B must be filled in consistently with the provisions in the policy language.

Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" amounts must be calculated consistently with the maximum fee for administration, if there is such a fee. However, this is subject to the two notes in the paragraph above which described Chart B, and are also true of Chart A.

"Expense Deductions (Front End Loads)" — The policy information statement contains blanks for both the current and the maximum expense deductions. For the purpose of filling in these blanks, an "expense deduction" refers to a charge which is deducted by the insurance company when premiums are paid — but not otherwise.

These expense deductions are sometimes called "front end loads" because they are deducted immediately after premiums are paid. Therefore, they affect the amount earning interest under the policy while that policy is maintained in force.

If the policy language makes no provision for an expense deduction, these blanks must be filled in with appropriate wording such as "none."

Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" amounts for year one must be calculated consistently with the maximum expense deductions, if there are such deductions. However, this is subject to the two notes in the paragraph which follows.

Note that if any negative cash surrender values are generated by the calculations, the illustrated "Cash Surrender Values at Year End" in Chart A must be shown as zero for such years. Note also that some fixed premium universal life policies define cash surrender values as the larger of two separate quantities. In such cases, the illustrated Surrender Values at Year End in Chart A must be filled in consistently with the provisions in the policy language.

Since Chart B illustrates current values, the "Cash Surrender Value at Year End" amounts for year one must be calculated consistently with the current expense deductions, if there are such deductions. However, this is subject to the two notes in the paragraph above which referred to Chart A, and are also true of Chart B.

"Surrender Charges (Back End Loads)"—The policy information statement contains blanks for both the current and the maximum surrender charge. For the purpose of filling in these blanks, a "surrender charge" refers to a charge which is deducted by the insurance company if the policy is surrendered for its cash surrender value—but not otherwise.

The surrender charges are sometimes called "back end loads" because they do not affect the amount earning interest under the policy, while that policy is maintained in force.

If the policy language makes no provision for a surrender charge, this blank must be filled in with appropriate wording such as "none." If the charges decrease as the years pass, indicate how at the end of the paragraph. For example the paragraph could say: "Year 1—$400, Year 2—$375, reducing by $25 each year until it reaches 0 at Year 13."

A surrender charge must be disclosed if the policy contains a provision that this surrender charge can be charged under certain conditions, even if it is waived by the insurance company under other conditions. (Such provisions are commonly called "bail-out" provisions.)

Since Chart A illustrates guaranteed values, the "Cash Surrender Value at Year End" amounts must be calculated consistently with the maximum surrender charges, if there are such charges. However, please see the two notes in the paragraph which follows.

Note that if any negative cash surrender values are generated by the calculations, the illustrated "Cash Surrender Values at Year End" in Chart A must be shown as zero for such years. Note also that some fixed premium universal life policies define cash surrender values as the larger of two separate quantities. In such cases, the illustrated Surrender Values at Year End in Chart A must be filled in consistently with the provisions in the policy language.

Since Chart B illustrates current values, the "Cash Surrender Value at Year End" amounts must be calculated consistently with the current surrender charges, if there are such charges. However, please see the two notes in the paragraph above which referred to Chart A, and are also true of Chart B.

YOUR POLICY CREDITS

The fill-ins should be consistent with Charts A and B to the extent applicable.

OTHER IMPORTANT INFORMATION ABOUT THIS POLICY

Maturity Age—This must be filled in consistently with the policy language.

If, under the assumptions of Chart A, termination would occur during one of the years illustrated in that chart, indicate year.

If, under the Assumptions of Chart B, termination would occur during one of the years illustrated in that chart, indicate year. Since Chart B is based on current assumptions, the policy year of termination under chart B may be a later year than the policy year of termination under Chart A.

ILLUSTRATION OF POLICY VALUES

If "flexible premium policy" is checked, Charts A and B are based on a policy with level annual premiums and level death benefits, except that there may be an additional amount assumed to be deposited in year one as illustrated in Charts A and B. This policy is assumed not to contain any extra benefit riders that require an additional premium or additional periodic charge. This policy is also assumed not to have any policy loans against it at any time.

If "fixed premium policy" is checked, Charts A and B are based on a policy with annual premiums and death benefits consistent with automatic options in the language of the policy applied for. This policy is assumed not to contain any extra benefit riders that require an additional premium or periodic charge. This policy is also assumed not to have any policy loans against it at any time.

"Age 60"—Both Chart A and Chart B contains lines for "Age 60" in the "Year" columns. "Age 60" refers to the year that the insured would have attained age 60 by the end of that year. For example, if the issue age of the insured is filled in as 34, "Age 60" refers to the year that the insured would have attained age 60 at the end of that year. If the issue age is 34, "Age 65" would refer to the 31st year. The same rule will hold true for the other ages required to be listed.

"Chart A"—Chart A is an illustration on a "Guaranteed Basis, " assuming that the insurance company consistently credits interest at the minimum rate permitted by the language in the policy, and that all charges and deductions are the maximums permitted by the policy language. However, as stated above, it is assumed that the policy contains no extra benefit riders requiring an additional premium or periodic charge.

The following instructions apply to Chart A if "flexible premium policy" is checked.

(1) The "Annual Premium" must be a level amount equal to the "First Year Annual Premium" shown, except that the "Annual Premium" must be shown as zero if there is no death benefit provided by the policy during that year, provided, however, that there may be an additional amount assumed to be deposited in year one as illustrated in Charts A and B.

(2) The "Death Benefit" shall be an amount equal to the "First Year Death Benefit" (but increased if the amount earning interest under the policy is so large that an increase in death benefit is generated by the policy language). However, if a death benefit equal to the "First Year Death Benefit" cannot be provided for the entire year, the death benefit for that year shall be filled in as the "First Year Death Benefit" followed by a slash mark and a zero. The "Policy Information for Applicant" form may provide, but is not required to provide, an explanatory footnote to indicate how long into that particular year the "First Year Death Benefit" could be provided. The "Death Benefit" shall be shown as zero for any subsequent years.

(3) The "Interest Rate" column must disclose the applicable guaranteed interest rate, used in calculating the amounts in the "Cash Surrender Value at Year End" column. These guaranteed interest rates must be consistent with the guaranteed interest rates described in the policy. However, these guaranteed interest rates must be filled in on an annual interest rate basis. An equivalent annual interest rate must be filled in, if the "Cash Surrender Value at Year End" is determined by making monthly calculations for each twelve months.

(4) The "Cash Surrender Value at Year End" must be filled in as the amount which would actually be paid as a cash surrender value. If the cash surrender value would be negative at the end of any year which is illustrated, the "Cash Surrender Value at Year End" must be shown as zero for that year. Some universal life policies contain provisions for surrender charges which are deducted under certain conditions, but not under others. (Such provisions are commonly called "bail-out" provisions.) The surrender values for policies containing such

provisions must be illustrated assuming that the insurance company can and will deduct the maximum surrender charge.

(5) The lines for "Age 60," "Age 65" and "Age 70" and on must be filled in unless the following sentence applies. This is not required if either (a) the "Death Benefit" is filled in as zero in Chart A for the twentieth year or (b) the "Death Benefit" would go down to zero before the year in which insured would attain age 60 at the end of the year. Guaranteed assumptions are used in testing for this possibility. Please see the note above in these instructions describing "Age 60," for additional information concerning these lines.

To fill in Chart A if "fixed premium policy" is checked, use the same principles described above for a flexible premium policy with the following three exceptions. First, the "Annual Premium" column must be filled in using annual premiums actually described in the universal life fixed premium policy, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of premiums. Second, the "Death Benefits" column must be filled in using the appropriate actual death benefits provided under the policy in each year, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of death benefits and also assuming that the premiums are paid consistently with the amounts of premiums shown in the "Annual Premiums" column. Third, some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. The "Cash Surrender Value at Year End" column must be filled-in consistently with any such provision in the policy language.

"Chart B" — Chart B is an illustration on a "Current Basis," assuming that the company consistently credits interest at current interest rates, and all charges and deductions are also on a current basis. These current interest rates, current charges and deductions are not guaranteed. The insurance company has the right to change these current interest rates, charges and deductions to the extent described in the contract. However, as stated above, it is assumed that the policy contains no extra benefit riders requiring an additional premium or periodic charge.

The following instructions apply to Chart B if "flexible premium policy" is checked.

(1) The "Annual Premium" must be a level amount equal to the "First Year Annual Premium" shown, except that the "Annual Premium" must be shown as zero if there is no death benefit provided by the policy during that year, provided, however, that there may be an additional amount assumed to be deposited in year one as illustrated in Charts A and B. Since Chart B is based on current assumptions, the "Annual Premium" will in some cases become zero in a later year under Chart B than under Chart A.

(2) The "Death Benefit" shall be an amount equal to the "First Year Death Benefit" (but increased if the amount earning interest under the policy is so large that an increase in death benefit is generated by the policy language). However, if a death benefit equal to the "First Year Death Benefit" cannot be provided for the entire year, the death benefit for that year shall be filled in as the "First Year Death Benefit" followed by a slash mark and a zero. The "Policy Information for Applicant" form may provide, but is not required to provide, an explanatory footnote to indicate how long into that particular year the "First Year Death Benefit" could be provided. The "Death Benefit" shall be shown as zero for any subsequent years. Since Chart B is based on current assumptions, the "Death Benefit" may become zero in a later year under Chart B than Chart A.

(3) The "Interest Rate" column must disclose the applicable interest rate, used in calculating the amounts in the "Cash Surrender Value" at Year End" column. No increase in this interest rate can be illustrated for future years, unless such an increase is specifically described and guaranteed in the policy language. However, the current interest rates must be filled in on an

annual interest rate basis. An equivalent annual interest rate must be filled in, if the "Cash Surrender Value at Year End" is determined by making monthly calculations for each twelve months.

(4) The "Cash Surrender Value at Year End" is the amount which would actually be paid as a cash surrender value. Chart B is intended to illustrate cash surrender values on a current basis, and not on the basis of non-guaranteed future improvements that may be anticipated or hoped for. No enhancement or increment can be illustrated in Chart B unless such enhancement or increment is specifically described and guaranteed in the policy language. If the cash surrender value would be negative at the end of any year which is illustrated, the "Cash Surrender Value at Year End" must be shown as zero for that year. Some universal life policies contain provisions for surrender charges which are deducted under certain conditions, but not under others. (Such provisions are commonly called "bail-out" provisions.) The surrender values for policies containing such provisions must be illustrated assuming that the insurance company can and will deduct the current surrender charge.

(5) The lines for "Age 60," "Age 65" and "Age 70" and on must be filled in unless the following sentence applies. This is not required either if (a) the "Death Benefit" is filled in as zero in Chart B for the twentieth year, or (b) the "Death Benefit" would go down to zero before the year in which the insured would attain age 60 at the end of the year. Current assumptions are used in testing for this possibility. Please see the note above in these instructions, describing "Age 60" for additional information concerning these three lines.

To fill in Chart B if "fixed premium policy" is checked, use the same principles described above for a "flexible premium policy" with the following three exceptions. First, the "Annual Premium" column must be filled in using annual premiums actually described in the universal life fixed premium policy, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of premiums. Second, the "Death Benefits" column must be filled in using the appropriate actual death benefit provided under the policy in each year, without any extra benefit riders, and assuming that the policy owner does not exercise any option to change the amounts of death benefits and also assuming that the premiums are paid consistently with the amounts of premiums shown in the "Annual Premiums" column. Third, some fixed premium universal life policies define the cash surrender value as the larger of two separate quantities. The "Cash Surrender Value at Year End" column must be filled in consistently with any such provision in the policy language.

Legislative History (all references are to the Proceedings of the NAIC).

1984 Proc. I 6, 31, 376, 514, 515-526 (adopted).
1988 Proc. I 9, 19-20, 494, 599-600, 627 (adopted change to footnote 3).
1989 Proc. II 13, 23, 414-415, 428-429, 431-442 (amended to include consumer disclosure requirement).
1990 Proc. I 6, 27, 438-439, 450-451, 453-463 (amended).

UNIVERSAL LIFE INSURANCE MODEL REGULATION

The date in parentheses is the effective date of the legislation or regulation, with latest amendments.

NAIC MEMBER	MODEL/SIMILAR LEGIS.	RELATED LEGIS./REGS.
Alabama	NO ACTION TO DATE	
Alaska	NO ACTION TO DATE	
Arizona	NO ACTION TO DATE	
Arkansas	ARK. INS. RULE & REG. 34 (1985).	
California	NO ACTION TO DATE	
Colorado	NO ACTION TO DATE	
Connecticut	NO ACTION TO DATE	
Delaware	NO ACTION TO DATE	
D.C.	NO ACTION TO DATE	
Florida	NO ACTION TO DATE	
Georgia	NO ACTION TO DATE	
Guam	NO ACTION TO DATE	
Hawaii	NO ACTION TO DATE	
Idaho	NO ACTION TO DATE	
Illinois	NO ACTION TO DATE	
Indiana	NO ACTION TO DATE	
Iowa	NO ACTION TO DATE	
Kansas	KAN. ADMIN. REGS. § 40-15b-1 (1985/1986) (Adopted by reference).	
Kentucky	NO ACTION TO DATE	
Louisiana	LA. INS. REG. 36 (1985).	

UNIVERSAL LIFE INSURANCE MODEL REGULATION

NAIC MEMBER	MODEL/SIMILAR LEGIS.	RELATED LEGIS./REGS.
Maine	NO ACTION TO DATE	
Maryland	NO ACTION TO DATE	
Massachusetts	NO ACTION TO DATE	
Michigan	NO ACTION TO DATE	
Minnesota	NO ACTION TO DATE	
Mississippi	MISS. INS. REG. L A & H 84-106 (1984).	
Missouri	MO. ADMIN. CODE tit. 20 § 400-1.100 (1985).	
Montana	NO ACTION TO DATE	
Nebraska	NEB. ADMIN. R. tit. 210 ch. 40 (1984).	
Nevada	NO ACTION TO DATE	
New Hampshire	NO ACTION TO DATE	
New Jersey	NO ACTION TO DATE	
New Mexico	N.M. INS. REGS. Art. 20 Rule 2 (1985) [SCC-85-13].	
New York	NO ACTION TO DATE	
North Carolina	NO ACTION TO DATE	
North Dakota	N.D. ADMIN. CODE §§ 45-04-05-01 to 45-04-05-09 (1985/1986).	
Ohio	NO ACTION TO DATE	
Oklahoma	OKLA. INS. REGS. § 365:10-5-80 (1985).	
Oregon	NO ACTION TO DATE	

UNIVERSAL LIFE INSURANCE MODEL REGULATION

NAIC MEMBER	MODEL/SIMILAR LEGIS.	RELATED LEGIS./REGS.
Pennsylvania	Adopted the NAIC model as filing guidelines.	
Puerto Rico		Circular Letter No. AV-III-8-886-82 (1982).
Rhode Island	NO ACTION TO DATE	
South Carolina	NO ACTION TO DATE	
South Dakota	NO ACTION TO DATE	
Tennessee	NO ACTION TO DATE	
Texas	NO ACTION TO DATE	
Utah	NO ACTION TO DATE	
Vermont	NO ACTION TO DATE	
Virgin Islands	NO ACTION TO DATE	
Virginia		VA. CODE § 38.2-3117 (Gives commissioner authority to establish universal life standards) (1986).
Washington	WASH. ADMIN. CODE R. §§ 284-84-010 to 284-84-110 (1985).	
West Virginia	NO ACTION TO DATE	
Wisconsin	NO ACTION TO DATE	
Wyoming	WYO. INS. REGS. ch. XL (1984).	

RULES GOVERNING THE ADVERTISING OF LIFE INSURANCE

Table of Contents

Section I. Purpose

The purpose of these rules is to set forth minimum standards and guidelines to assure a full and truthful disclosure to the public of all material and relevant information in the advertising of life insurance policies and annuity contracts.

Section II. Definitions

For the purpose of these rules:

1. "Advertisement" shall be material designed to create public interest in life insurance or annuities or in an insurer, or in an insurance producer; or to induce the public to purchase, increase, modify, reinstate, borrow on, surrender, replace, or retain a policy including:

Comment: See drafting note caveat immediately following the definition of "Insurance Producer" in this section.

(a) printed and published material, audiovisual material, and descriptive literature of an insurer or insurance producer used in direct mail, newspapers, magazines, radio and television scripts, billboards and similar displays;

(b) descriptive literature and sales aids of all kinds, authored by the insurer, its insurance producers, or third parties, issued, distributed or used by such insurer or insurance producer; including but not limited to circulars, leaflets, booklets, depictions, illustrations and form letters;

(c) material used for the recruitment, training, and education of an insurer's insurance producers which is designed to be used or is used to induce the public to purchase, increase, modify, reinstate, borrow on, surrender, replace or retain a policy;

(d) prepared sales talks, presentations and material for use by insurance producers.

2. "Advertisement" for the purpose of these rules shall not include:

(a) communications or materials used within an insurer's own organization and not intended for dissemination to the public;

(b) communications with policyholders other than material urging policyholders to purchase, increase, modify, reinstate or retain a policy;

(c) a general announcement from a group or blanket policyholder to eligible individuals on an employment or membership list that a policy or program has been written or arranged; provided the announcement clearly indicates that it is preliminary to the issuance of a booklet explaining the proposed coverage.

3. "Insurance Producer" shall mean an individual who solicits, negotiates, effects, procures, renews, continues or binds policies of insurance covering risks located in this State.

Note: This term and words related thereto should not be included in life advertising rules or regulations unless "insurance producer" also is statutorily defined and the definitions are identical.

4. "Insurer" shall include any individual, corporation, association, partnership, reciprocal exchange, inter-insurer, Lloyd's, fraternal benefit society, and any other legal entity which is defined as an "insurer" in the insurance code of this State or issues life insurance or annuities in this State and is engaged in the advertisement of a policy.

5. "Policy" shall include any policy, plan, certificate, including a fraternal benefit certificate, contract, agreement, statement of coverage, rider or endorsement which provides for life insurance or annuity benefits.

6. "Nonguaranteed Policy Element" shall mean any premium, cash value, death benefit, endowment value, dividend or other policy benefit or pricing element or portion thereof whose amount is not guaranteed by the terms of the contract. Any policy element that contractually follows a separate account result or a defined index is not considered a nonguaranteed policy element.

7. "Preneed Funeral Contract or Prearrangement" shall mean an agreement by or for an individual before the individual's death relating to the purchase or provision of specific funeral or cemetary merchandise or services.

Section III. Applicability

1. These rules shall apply to any life insurance or annuity advertisement intended for dissemination in this State.

2. Every insurer shall establish and at all times maintain a system of control over the content, form and method of dissemination of all advertisements of its policies. All such advertisements, regardless of by whom written, created, designed or presented, shall be the responsibility of the insurer.

Section IV. Form and Content of Advertisements

1. Advertisements shall be truthful and not misleading in fact or by implication. The form and content of an advertisement of a policy shall be sufficiently complete and clear so as to avoid deception. It shall not have the capacity or tendency to mislead or deceive.

Whether an advertisement has the capacity or tendency to mislead or deceive shall be determined by the Commissioner of Insurance from the overall impression that the advertisement may be reasonably expected to create upon a person of average education or intelligence within the segment of the public to which it is directed.

2. No advertisement shall use the terms "investment," "investment plan," "founder's plan," "charter plan," "deposit," "expansion plan," "profit," "profits," "profit sharing," "interest plan," "savings," "savings plan," or other similar terms in connection with a policy in a context or under such circumstances or conditions as to have the capacity or tendency to mislead a purchaser or prospective purchaser of such policy to believe that he will receive, or that it is possible that he will receive, something other than a policy or some benefit not available to other persons of the same class and equal expectation of life.

Section V. Disclosure Requirements

1. The information required to be disclosed by these rules shall not be minimized, rendered obscure, or presented in an ambiguous fashion or intermingled with the text of the advertisement so as to be confusing or misleading.

2. No advertisement shall omit material information or use words, phrases, statements, references or illustrations if such omission or such use has the capacity, tendency or effect of misleading or deceiving purchasers or prospective purchasers as to the nature or extent of any policy benefit payable, loss covered, premium payable, or state or federal tax consequences. The fact that the policy offered is made available to a prospective insured for inspection prior to consummation of the sale, or an offer is made to refund the premium if the purchaser is not satisfied, does not remedy misleading statements.

3. In the event an advertisement uses "Non-Medical," "No Medical Examination Required," or similar terms where issue is not guaranteed, such terms shall be accompanied by a further disclosure of equal prominence and in juxtaposition thereto to the effect that issuance of the policy may depend upon the answers to the health questions set forth in the application.

4. An advertisement shall not use as the name or title of a life insurance policy any phrase which does not include the words "life insurance" unless accompanied by other language clearly indicating it is life insurance.

5. An advertisement shall prominently describe the type of policy advertised.

6. An advertisement of an insurance policy marketed by direct response techniques shall not state or imply that because there is no insurance producer or commission involved there will be a cost saving to prospective purchasers unless such is the fact. No such cost savings may be stated or implied without justification satisfactory to the Insurance Commissioner prior to use.

7. An advertisement for a policy containing graded or modified benefits shall prominently display any limitation of benefits. If the premium is level and coverage decreases or increases with age or duration, such fact shall be prominently disclosed. An advertisement of or for a life insurance policy under which the death benefit varies with the length of time the policy has been in force shall accurately describe and clearly call attention to the amount of minimum death benefit under the policy.

8. An advertisement for the types of policies described in 6 and 7 of this Section shall not use the words "inexpensive," "low cost," or other phrase or words of similar import when such policies are being marketed to persons who are fifty years of age or older, where the policy is guaranteed issue.

9. Premiums

(a) An advertisement for a policy with non-level premiums shall prominently describe the premium changes.

(b) An advertisement in which the insurer describes a policy where it reserves the right to change the amount of the premium during the policy term, but which does not prominently describe this feature, is deemed to be deceptive and misleading and is prohibited.

(c) An advertisement shall not contain a statement or representation that premiums paid for a life insurance policy can be withdrawn under the terms of the policy. Reference may be made to amounts paid into an advance premium fund, which are intended to pay premiums at a future time, to the effect that they may be withdrawn under the conditions of the prepayment agreement. Reference may also be made to withdrawal rights under any unconditional premium refund offer.

(d) An advertisement which represents a pure endowment benefit as a "profit" or "return" on the premium paid rather than as a policy benefit for which a specified premium is paid is deemed to be deceptive and misleading and is prohibited.

10. Analogies between a life insurance policy's cash values and savings accounts or other investments and between premium payments and contributions to savings accounts or other investments must be complete and accurate.

11. An advertisement shall not state or imply in any way that interest charged on a policy loan or the reduction of death benefits by the amount of outstanding policy loans is unfair, inequitable, or in any manner an incorrect or improper practice.

12. If nonforfeiture values are shown in any advertisement, the values must be shown either for the entire amount of the basic life policy death benefit or for each $1,000 of initial death benefit.

13. The words "free," "no cost," "without cost," "no additional cost," "at no extra cost," or words of similar import shall not be used with respect to any benefit or service being made available with a policy unless true. If there is no charge to the insured, then the identity of the payor must be prominently disclosed. An advertisement may specify the charge for a benefit or a service or may state that a charge is included in the premium or use other appropriate language.

14. No insurance producer may use terms such as "financial planner," "investment advisor," "financial consultant," or "financial counseling" in such a way as to imply that he or she is generally engaged in an advisory business in which compensation is unrelated to sales unless such actually is the case.

15. Nonguaranteed Policy Elements

(a) An advertisement shall not utilize or describe nonguaranteed policy elements in a manner which is misleading or has the capacity or tendency to mislead.

(b) An advertisement shall not state or imply that the payment or amount of nonguaranteed policy elements is guaranteed. If nonguaranteed policy elements are illustrated, they must be based on the insurer's current scale and the illustration must contain a statement to the effect that they are not to be construed as guarantees or estimates of amounts to be paid in the future.

(c) An advertisement that includes any illustrations or statements containing or based upon nonguaranteed elements shall set forth with equal prominence comparable illustrations or statements containing or based upon the guaranteed elements.

(d) If an advertisement refers to any nonguaranteed policy element, it shall indicate that the insurer reserves the right to change any such element at any time and for any reason. However, if an insurer has agreed to limit this right in any way; such as, for example, if it has agreed to change these elements only at certain intervals or only if there is a change in the insurer's current or anticipated experience, the advertisement may indicate any such limitation on the insurer's right.

(e) An advertisement shall not refer to dividends as "tax free" or use words of similar import, unless the tax treatment of dividends is fully explained and the nature of the dividend as a return of premium is indicated clearly.

16. An advertisement shall not state that a purchaser of a policy will share in or receive a stated percentage or portion of the earnings on the general account assets of the company.

17. Testimonials, Appraisals, Analysis, or Endorsements by Third Parties

(a) Testimonials, appraisals or analysis used in advertisements must be genuine; represent the current opinion of the author; be applicable to the policy advertised, if any; and be accurately reproduced with sufficient completeness to avoid misleading or deceiving prospective insureds as to the nature or scope of the testimonial, appraisal, analysis or endorsement. In using testimonials, appraisals or analysis; the insurer or insurance producer makes as its own all of the statements contained therein, and such statements are subject to all the provisions of these rules.

(b) If the individual making a testimonial, appraisal, analysis or an endorsement has a financial interest in the insurer or a related entity as a stockholder, director, officer, employee or otherwise, or receives any benefit directly or indirectly other than required union scale wages, such fact shall be prominently disclosed in the advertisement.

(c) An advertisement shall not state or imply that an insurer or a policy has been approved or endorsed by a group of individuals, society, association or other organization unless such is the fact and unless any proprietary relationship between an organization and the insurer is disclosed. If the entity making the endorsement or testimonial is owned, controlled or managed by the insurer, or receives any payment or other consideration from the insurer for making such endorsement or testimonial, such fact shall be disclosed in the advertisement.

18. An advertisement shall not contain statistical information relating to any insurer or policy unless it accurately reflects recent and relevant facts. The source of any such statistics used in an advertisement shall be identified therein.

19. Policies Sold to Students

(a) The envelope in which insurance solicitation material is contained may be addressed to the parents of students. The address may not include any combination of words which imply that the correspondence is from a school, college, university or other education or training institution nor may it imply that the institution has endorsed the material or supplied the insurer with information about the student unless such is a correct and truthful statement.

(b) All advertisements including but not limited to informational flyers used in the solicitation of insurance must be identified clearly as coming from an insurer or insurance producer, if such is the case, and these entities must be clearly identified as such.

(c) The return address on the envelope may not imply that the soliciting insurer or insurance producer is affiliated with a university, college, school or other educational or training institution, unless true.

20. Introductory, Initial or Special Offers and Enrollment Periods

(a) An advertisement of an individual policy or combination of such policies shall not state or imply that such policy or combination of such policies is an introductory, initial or special offer, or that applicants will receive substantial advantages not available at a later date, or that the offer is available only to a specified group of individuals, unless such is the fact. An advertisement shall not describe an enrollment period as "special" or "limited" or use similar words or phrases in describing it when the insurer uses successive enrollment periods as its usual method of marketing its policies.

(b) An advertisement shall not state or imply that only a specific number of policies will be sold, or that a time is fixed for the discontinuance of the sale of the particular policy advertised because of special advantages available in the policy.

(c) An advertisement shall not offer a policy which utilizes a reduced initial premium rate in a manner which overemphasizes the availability and the amount of the reduced initial premium. When an insurer charges an initial premium that differs in amount from the amount of the renewal premium payable on the same mode, all references to the reduced initial premium shall be followed by an asterisk or other appropriate symbol which refers the reader to that specific portion of the advertisement which contains the full rate schedule for the policy being advertised.

Note: Some states prohibit a reduced initial premium. This section does not imply that the states which prohibit such initial premium are not in conformity with the NAIC rules.

(d) An enrollment period during which a particular insurance policy may be purchased on an individual basis shall not be offered within this State unless there has been a lapse of not less than [insert number] months between the close of the immediately preceding enrollment period for the same policy and the opening of the new enrollment period. The advertisement shall specify the date by which the applicant must mail the application, which shall be not less than ten days and not more than forty days from the date on which such enrollment period is advertised for the first time. This rule applies to all advertising media - i.e., mail, newspapers, radio, television, magazines and periodicals - by any one insurer or insurance producer. The phrase "any one insurer" includes all the affiliated companies of a group of insurance companies under common management or control. This rule does not apply to the use of a termination or cutoff date beyond which an individual application for a guaranteed issue policy will not be accepted by an insurer in those instances where the application has been sent to the applicant in response to his request. It is also inapplicable to solicitations of employees or members of a particular group or association which otherwise would be eligible under specified provisions of the Insurance Code for group, blanket or franchise insurance. In cases where an insurance product is marketed on a direct mail basis to prospective insureds by reason of some common relationship with a sponsoring organization, this rule shall be applied separately to each sponsoring organization.

21. An advertisement of a particular policy shall not state or imply that prospective insureds shall be or become members of a special class, group, or quasi-group and as such enjoy special rates, dividends or underwriting privileges, unless such is the fact.

22. An advertisement shall not make unfair or incomplete comparisons of policies, benefits, dividends or rates of other insurers. An advertisement shall not disparage other insurers, insurance producers, policies, services or methods of marketing.

23. For individual deferred annuity products or deposit funds, the following shall apply:

    (a) Any illustrations or statements containing or based upon interest rates higher than the guaranteed accumulation interest rates shall likewise set forth with equal prominence comparable illustrations or statements containing or based upon the guaranteed accumulation interest rates. Such higher interest rates shall not be greater than those currently being credited by the company unless such higher rates have been publicly declared by the company with an effective date for new issues not more than three months subsequent to the date of declaration.

    (b) If an advertisement states the net premium accumulation interest rate, whether guaranteed or not, it shall also disclose in close proximity thereto and with equal prominence, the actual relationship between the gross and the net premiums.

    (c) If any contract does not provide a cash surrender benefit prior to commencement of payment of any annuity benefits, any illustrations or statements concerning such contract shall prominently state that cash surrender benefits are not provided.

24. An advertisement of a life insurance product and an annuity as a single policy or life insurance policy with an annuity rider shall include the following disclosure or substantially similar statement at the point of sale before the application is

taken; provided, however, if the policy contains an unconditional refund provision of at least ten days, then the disclosure statement shall be delivered with or prior to the delivery of the policy, or upon the applicant's request, whichever occurs sooner. The disclosure shall include the first five policy years, the tenth and twentieth policy years, at least one age from sixty to seventy and the scheduled commencement of annuity payments:

Year	Gross Annual Life %	Premium Annuity %	Guaranteed Cash Value of Annuity
1	%	%	$
2	%	%	$
3	%	%	$
4	%	%	$
5	%	%	$
10	%	%	$
20	%	%	$
etc.	%	%	$

Information in the disclosure statement shall be based on gross premium. The life and annuity percentages of the total gross premium shall equal 100% for each required duration. The guaranteed cash value of the annuity shall be the value at the end of the contract year. A copy of the disclosure statement shall be provided to the applicant.

25. An advertisement for the solicitation or sale of a preneed funeral contract or prearrangement as defined in Section II 7 above which is funded or to be funded by a life insurance policy or annuity contract shall adequately disclose the following:

(a) the fact that a life insurance policy or annuity contract is involved or being used to fund a prearrangement as defined in Section II 7 of these rules, and

(b) the nature of the relationship among the soliciting agent or agents, the provider of the funeral or cemetery merchandise or services, the administrator and any other person.

Section VI. Identity of Insurer

1. The name of the insurer shall be clearly identified in all advertisements. and if any specific individual policy is advertised it shall be identified either by form number or other appropriate description. If an application is a part of the advertisement, the name of the insurer shall be shown on the application. An advertisement shall not use a trade name, an insurance group designation, name of the parent company of the insurer, name of a particular division of the insurer, service mark, slogan, symbol or other device or reference without disclosing the name of the insurer, if the advertisement would have the capacity or tendency to mislead or deceive as to the true identity of the insurer or create the impression that a company other than the insurer would have any responsibility for the financial obligation under a policy.

2. No advertisement shall use any combination of words, symbols or physical materials which by their content, phraseology, shape, color or other characteristics are so similar to a combination of words, symbols or physical materials used by a governmental program or agency or otherwise appear to be of such a nature that they tend to mislead prospective insureds into believing that the solicitation is in some manner connected with such governmental program or agency.

Section VII. Jurisdictional Licensing and Status of Insurer

1. An advertisement which is intended to be seen or heard beyond the limits of the jurisdiction in which the insurer is licensed shall not imply licensing beyond such limits.

2. An advertisement may state that an insurer or insurance producer is licensed in the state where the advertisement appears, provided it does not exaggerate such fact or suggest or imply that competing insurers or insurance producers may not be so licensed.

3. An advertisement shall not create the impression that the insurer, its financial condition or status, the payment of its claims or the merits, desirability, or advisability of its policy forms or kinds of plans of insurance are recommended or endorsed by any governmental entity. However, where a governmental entity has recommended or endorsed a policy form or plan, such fact may be stated if the entity authorizes its recommendation or endorsement to be used in an advertisement.

Section VIII. Statements About the Insurer

An advertisement shall not contain statements, pictures or illustrations which are false or misleading, in fact or by implication, with respect to the assets, liabilities, insurance in force, corporate structure, financial condition, age or relative position of the insurer in the insurance business. An advertisement shall not contain a recommendation by any commercial rating system unless it clearly defines the scope and extent of the recommendation.

Section IX. Enforcement Procedures

1. Each insurer shall maintain at its home or principal office a complete file containing a specimen copy of every printed, published or prepared advertisement of its individual policies and specimen copies of typical printed, published or prepared advertisements of its blanket, franchise and group policies, hereafter disseminated in this State, with a notation indicating the manner and extent of distribution and the form number of any policy advertised. Such file shall be subject to inspection by this Department. All such advertisements shall be maintained in said file for a period of either four years or until the filing of the next regular report on the examination of the insurer, whichever is the longer period of time.

2. If the Commissioner determines that an advertisement has the capacity or tendency to mislead or deceive the public, the Commissioner may require an insurer or insurance producer to submit all or any part of the advertising material for review or approval prior to use.

3. Each insurer subject to the provisions of these rules shall file with this Department with its Annual Statement a certificate of compliance executed by an authorized officer of the insurer wherein it is stated that to the best of his knowledge, information and belief the advertisements which were disseminated by or on behalf of the insurer in this State during the preceding statement year, or during the portion of such year when these rules were in effect, complied or were made to comply in all respects with the provisions of these rules and the Insurance Laws of this State as implemented and interpreted by these rules.

Section X. Penalties

Any insurer or any of its officer, directors, agents (producers) or employees thereof which, or who, violate any of the provisions of this regulation, or knowingly participate in or abet such violation, shall be subject to a fine up to $1000 for each violation and/or subject to suspension or revocation of their certificate of authority or license.

Section XI. Conflict With Other Rules

It is not intended that these rules conflict with or supersede any rules currently in force or subsequently adopted in this State governing specific aspects of the sale or replacement of life insurance including, but not limited to, rules dealing with life insurance cost comparison indices, deceptive practices in the sale of life insurance, and replacement of life insurance policies. Consequently, no disclosure required under any such rules shall be deemed to be an advertisement within the meaning of these rules.

Section XII. Severability

If any section, term or provision of this rule shall be adjudged invalid for any reason, such judgment shall not affect, impair or invalidate any other Section, term or provision of this rule, and the remaining Sections, terms and provisions shall be and remain in full force and effect.

Legislative History (all references are to the Proceedings of the NAIC).

1975 Proc. II 6, 9, 244, 325, 326-330 (adopted).
1976 Proc. II 15, 17, 342, 366, 373-374 (amended).
1988 Proc. I 9, 18, 88-91, 130-131, 138-144 (amended and reprinted).
1988 Proc. II 5, 12, 478, 490, 497-503 (amended).

RULES GOVERNING THE ADVERTISING OF LIFE INSURANCE

The date in parentheses is the effective date of the legislation or regulation, with latest mendments.

NAIC MEMBER	MODEL/SIMILAR LEGIS.	RELATED LEGIS./REGS.
Alabama	ALA. INS. DEPT. REG. 69 (1981/1989) (Many additional provisions).	
Alaska	NO ACTION TO DATE	
Arizona		ARIZ. ADMIN. COMP. R4-14-202 (1969).
Arkansas		ARK. INS. RULE & REG. 17 §§ 1, 7-9 (1974).
California	CAL. ADMIN. CODE tit. 10 R. 2547 to 2547.11 (1975).	
Colorado		COLO. ADMIN. INS. REG. 4-1-2 (1974).
Connecticut	CONN. ADMIN. CODE tit. 38a §§ 819-22 to 819-31 (1976/1987).	
Delaware	NO ACTION TO DATE	
D.C.	NO ACTION TO DATE	
Florida	FLA. ADMIN. CODE §§ 4-35.001 to 4-35.020 (1973/1989).	
Georgia	GA. ADMIN. COMP. ch. 120-2-11 (1980) (Some extra provisions).	
Guam	NO ACTION TO DATE	
Hawaii	NO ACTION TO DATE	
Idaho	NO ACTION TO DATE	
Illinois	ILL. ADMIN. REG. tit. 50 §§ 909.10 to 909.110 (1976/1991).	
Indiana	NO ACTION TO DATE	
Iowa	IOWA ADMIN. CODE § 191-15.40 to 191-15.49 (1976/1989).	

RULES GOVERNING THE ADVERTISING
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NAIC MEMBER	MODEL/SIMILAR LEGIS.	RELATED LEGIS./REGS.
Kansas	KAN. ADMIN. REGS. §§ 40–9-118 (1977/1988) (1976 model adopted by reference with exceptions).	
Kentucky		806 KY. ADMIN. REGS. 12:010 to 12:020 (1975).
Louisiana	NO ACTION TO DATE	
Maine	NO ACTION TO DATE	
Maryland		MD. ADMIN. CODE tit. 9 subtit. 30 ch. 25 § 01 to 10 (1970).
Massachusetts	NO ACTION TO DATE	
Michigan	MICH. ADMIN. CODE R. 500.1371 to 500.1387 (1984).	
Minnesota		MINN. INS. REGS. §§ 2790.0100 to 2790.2200 (1971/1989).
Mississippi	NO ACTION TO DATE	
Missouri	MO. ADMIN. CODE tit. 20 § 400-5.100 (1976/1977).	
Montana	NO ACTION TO DATE	
Nebraska	NEB. ADMIN. R. tit. 210 ch. 50 (1990).	
Nevada	NO ACTION TO DATE	
New Hampshire	NO ACTION TO DATE	
New Jersey	N.J. ADMIN. CODE §§ 11:2-23.1 to 11:2-23.10 (1985/1989).	
New Mexico	NO ACTION TO DATE	
New York	N.Y. ADMIN. CODE tit. 11 §§ 219.1 to 219.7 (1980) (Regulation 34-A).	

RULES GOVERNING THE ADVERTISING OF LIFE INSURANCE

NAIC MEMBER	MODEL/SIMILAR LEGIS.	RELATED LEGIS./REGS.
North Carolina	N.C. ADMIN. CODE tit. 11 ch. 12 §§ 0424 to 0433 (1978/1992).	
North Dakota	NO ACTION TO DATE	
Ohio		OHIO INS. REGS. RULE 3901-1-06 (1972).
Oklahoma	OKLA. INS. REGS. §§ 365:10-3-30 to 365:10-3-38 (1990).	
Oregon	NO ACTION TO DATE	
Pennsylvania	NO ACTION TO DATE	
Puerto Rico		P.R.R. RULE XVI (1957).
Rhode Island	NO ACTION TO DATE	
South Carolina	NO ACTION TO DATE	
South Dakota		S.D. ADMIN. R. 20:06:10 (1973/1989) (Regulation based on model at page 40-1).
Tennessee	TENN. INS. RULES §§ 0780-1-33-.01 to 0780-1-33-.13 (1976).	
Texas		TEX. ADMIN. CODE §§ 21.101 to 21.112, 21.114 (1981).
Utah		UTAH INS. R540-130 (1989/1990) (Based on accident and health insurance advertising model at 40-1).
Vermont	NO ACTION TO DATE	
Virgin Islands	NO ACTION TO DATE	
Virginia	VA. INS. REG. 23 (Case No. INS810107) (1982) (More comprehensive than model).	

RULES GOVERNING THE ADVERTISING
OF LIFE INSURANCE

NAIC MEMBER	MODEL/SIMILAR LEGIS.	RELATED LEGIS./REGS.
Washington	WASH. ADMIN. CODE R. §§ 284-23-010 to 284-23-550 (1975/1989).	
West Virginia	NO ACTION TO DATE	
Wisconsin		WIS. ADMIN. CODE § INS. 2.16 (1984/1989).
Wyoming	NO ACTION TO DATE	

ATTACHMENT E

Model Regulation Service January 1987

Illustrations Guideline for Variable Life Insurance Model Regulation

Any sales illustration shown or furnished in connection with the sale of variable life insurance must conform with the following requirements except that these requirements only apply to the variable portion of contracts with fixed and variable funding options. Item 9 specifically pertains to variable life insurance contracts offering both fixed and variable funding options.

1. The hypothetical interest rates used to illustrate accumulated policy values must be an annual effective gross rate after brokerage expenses and prior to any deduction for taxes, expenses and contract charges.

2. If illustrations of accumulated policy values are shown, then for the highest interest rate used, one illustration must be based solely upon guarantees contained in the policy contract being illustrated. (For example, if the illustration includes the effect of mortality charges and administrative charges which are below the guaranteed maximums for such charges, an illustration must be prepared which involves the effect of the maximum charges.)

3. Except for illustrations contained in the prospectus, the pattern of premium payments used in an illustration should be the initial pattern requested by the proposed policyholder at inception or upon changes in face amount requested by the policyholder.

4. If the illustrated policy contract provides for a variety of investment options, the illustration may either use an asset charge which is reasonably representative or use the asset charge of a particular option. The illustration should clearly identify the asset charge and either label it "hypothetical" or identify the fund.

5. The illustration must disclose the transaction charges which will be levied against the contract because of transactions requested in accordance with rights and privileges specified in the policy contract. Any charge for the exercise of a right or privilege upon which the illustration is based must be reflected in the illustrated values. The nature of any other such charges must be disclosed in a clear statement accompanying such illustrations. (For example, a charge to switch from one investment option or death benefit option to another.)

6. A clear statement must be made following the table of illustrated accumulated policy values that use of hypothetical investment results does not in any way represent actual results or suggest that such results will be achieved and must indicate that the policy values which actually arise will differ from those shown whenever the actual investment results differ from the hypothetical rates illustrated. Assumptions upon which illustrations are based must be clearly disclosed.

7. Any sales illustration to a prospective policyholder must reflect the policy being presented accurately. Misleading statements or captions or other misrepresentations are prohibited.

8. The requested sales illustration must be printed clearly and legibly on hard paper copy. An illustration displayed on a computer screen may be used in addition to, but not as a substitute for, hard paper copy.
9. In connection with variable life insurance contracts offering both fixed and variable funding options:

   (a) An illustration of the variable funding option must comply with these guidelines.

(b) If an illustration of the fixed funding option is shown, accumulated policy values must be shown on the basis of guaranteed rates. One or more additional rates may also be shown but such rates may not exceed current rates.

(c) A summary illustration may be given in which results from comparable illustrated and hypothetical interest rates are combined. Such summary must cross-reference to the accompanying separate illustrations of the fixed and variable funding options.

10. Nothing herein shall prohibit the distribution to the prospective policyholder of illustrations in addition to those required by Article VII of the NAIC Model Variable Life Insurance Regulation provided that, except for Item 3 which shall only apply to required illustrations under Article VII, such additional illustrations comply with the standards set forth herein.

Legislative History (all references are to the Proceedings of the NAIC).

1986 Proc. II 12, 18, 599, 601-602, 645, 648 (adopted).

Senator METZENBAUM. Thank you very much, Mr. Lyons, for a very concise and direct statements. We will have some questions for you.

We would like to hear from Mr. Rakich first.

STATEMENT OF MARK RAKICH

Mr. RAKICH. Good morning, Mr. Chairman, Senator Grassley.

My name is Mark Rakich. I am a senior counsel with the California Department of Insurance, and I want to thank the subcommittee for inviting us to participate in these proceedings this morning.

We believe that the focus which this subcommittee has already placed on the issue has benefited consumers already by placing these issues on a much more public agenda. I noted the chairman's comments about the lack of media coverage of last summer's hearings; however, in California, The New York Times coverage of that was really the event which caused both some members of our department, as well as some members of our legislature, to begin to realize that everything was not just fine in the insurance industry.

I noted that in some of the discussion earlier, there was some tension between the complexities of life insurance and the need for straightforward simple language, and in Commissioner Lyons' comments, he made reference to a guide to the disclosure forms, and I think that just points out how complicated the problem is. We have a disclosure form to simplify the policy and a guide to explain the disclosure form. We have a daunting task before us.

I want to discuss some of the misuses of policy illustrations. I have brought a couple of examples with me today. I apologize; I was not able to get them earlier, but I do note last summer's hearings have ample examples.

It was interesting to me when Mr. Bohrer testified, because I happen to have a Prudential illustration with me that was issued to another customer just a few months prior to the illustration that Mr. Bohrer apparently received. And the reason I find it interesting is because it has two different portions in it. It has the illustration if the person keeps paying the premium and the illustration that would occur if the person decided to allow the accumulated cash value to then finance the ongoing death benefit portion of the policy, and in the bottom column, the accumulated cash value turns out to be the same.

Now intuitively I know that is not correct. Something is wrong here.

Senator METZENBAUM. Let me get this straight. The accumulated cash value and what else is the same?

Mr. RAKICH. The accumulated cash value on the portion of the illustration which presumes that the customer is going to continue to pay the premium, and then there is an alternate page of the illustration which outlines the performance of the policy on the assumption that they allow their accumulate cash value after year 8 to begin financing the death benefit portion. But at the bottom of the column, after year 20, the accumulated value is reflected as the same.

Now I am sure that Prudential, when you call the CEO, can have one of their actuaries explain why that is correct. But for the life of me, I have no idea how you can stop paying your $1,200 a year and use your 8-year accumulation to fund other benefits and end up at year 20 with the same amount of money as if you kept on paying. Something is not right.

And if there is a mathematical explanation for how that works, it certainly would be lost on me, and I do not know how a customer looking at that would not have the precise impression that Mr. Bohrer had, which is: I thought I did not have to pay after 8 years, and then they started telling me I had a notice for future payment. You just cannot use these documents to try to figure out what to expect for your retirement plan.

You have to think about for a minute what the insurance companies are doing when they are putting out an illustration. We have heard about the pressure of cutthroat competition and why they are forced to do so.

When we circulated some draft regulations for potential legislation, one insurer responded by telling us that: "The only purpose a new business illustration can serve is to help explain how a policy may operate under a set of options under the scenarios illustrated," which I think is actuarial gobbledygook for saying: If you believe all of our assumptions and you look at these various options, these little twists might turn out differently, depending on what you do.

And I do not believe the customers—I do not believe that the agents—treat illustrations that way. They treat them as predictions.

We heard what Mr. Keating had to say. The company said: Trust us; market, market, market. Look at these numbers. We can do 15 percent standing on our head. And there is no further inquiry, and that is precisely the way that these things are presented when the salesperson appears at your door and sits down at your kitchen table and tries to present it to you.

We talked about the way agents have looked at the history that a particular insurer may have performed. I think Mr. Todd spoke in some detail about that. As the 1970's and the 1980's rolled on and we saw increasing interest rates, companies historically outperforming even the puffed-up projections that they started with, we had the mentality that it will always be that way. It will always go on; it will always improve.

The agent feels confident walking into somebody's living room and telling them: My company is a good company. Here are some values, but do not worry; we have always done better than that.

Well, the reality is, the company did not do a darn thing to outperform the projection. The economy may have. Inflation may have. A number of factors independent of the actual quality of the insurer's management, the quality of their investment portfolio, may have given that mathematical answer, but it has nothing to do with the ability of the company to continue to outperform a particular economic scenario.

I want to briefly outline some of the things we are attempting to do in California. We have prepared and circulated to the industry a draft of a bill which is designed to regulate how an illustration is put together in the first place. Mr. Todd, in one of his suggestions, included that particular item.

We have a situation where, as described, the cutthroat competition is forcing companies to make assumptions in the first instance about what they can do and how to calculate what assumptions to make in putting together these schedules. The reality is, there is misuse of actuarial science in doing that for marketing purposes.

This is a draft that we had hoped to introduce this legislative session, but given that it is a complex problem, we expect to have to wait until the 1994 California legislative session.

We have introduced the disclosure bill, which would require right up front on the top of an illustration a notice indicating to the consumer that these, in fact, are not guarantees; they are projections.

In the examples that you have in last summer's report and in what I have brought, some companies do provide some sort of a disclosure. Prudential, for instance, puts an asterisk on page 1, page 2, and page 3, and on page 4 of their illustration has some sort of an explanation about the fact that this is not guaranteed. However, page 4 follows all the real hard dollar numbers. It is not our view that burying the disclaimer at the end is very effective, once the effect, the marketing effect, of the numbers has already occurred.

There are other approaches which we are continuing to look at. It is fine to ensure that the initial illustration has sound bases for its projections. It is a fine thing to warn policyholders that they are not guarantees. However, it is inevitable in the kind of marketing that we see in the life insurance industry that purchasers are going to rely on these documents as predicted performance, whether the agent has misrepresented something or not, whether they are, you know, hard-sell, puffing or not, or whether they just do not explain it.

Maybe we have a situation like Mr. Keating where he came here today and said: I never explained the downside risks. Of course, John Hancock told him not to, did not explain what those might be to him, but the fact his, he, his family, and his customers were left with a policy that had a lot of downside risk.

We believe that the only way to address that is to require there to be followup documents any time a customer has received an illustration, and the company's performance has fallen below the illustrated or projected performance, the person is entitled to notice now that their expectations may not be realistic. It is not fair to wait until retirement age for somebody to learn that the expectation they had for their retirement income is grossly out of whack with what the policy is actually providing.

Illustrations are not the only issue facing the life industry. We have a yield index which our actuaries tried to explain to me, and I, for the life of me, could not understand, so I am not going to try to explain it here. It is designed to provide more accurate information for somebody who has the capacity to understand the math of it all.

We are pursuing legislation to require insurers to provide written advance notice before they invoke a discretionary provision of the policy allowing them to change the pricing. We have situations where people sign up with bank account deductions for their premium, and the first time they learn of an increased premium is when they bounce a check because the amount of automatic deduction was automatically increased.

There are a whole range of issues which need to be addressed. We are going to continue to work on those. We do not care whether they are at the national or the State level. We are working at the State level, and we are interested in cooperating with this committee and this chairman on those matters.

I did want to briefly comment on a couple of issues. We talked about churning earlier. Well, the NAIC has a model law on replacement coverage. But the interesting thing about that law is that it does not apply when there is a rollover within the same company. It applies to situations where Company No. 1 is having its business replaced by Company No. 2, and so that Company No. 1 has a fair chance to retain the customer, these rules require the new agent to send some sort of a notice to the original agent, so that that person can maybe come and talk to the customer and convince them that, no, your existing policy may well be the correct one.

When we enacted the model replacement law in California, we added provisions to apply most of those rules to same-company transactions, so that we still see churning, but the risks to the consumer are lessened, and the sanctions to the agent doing it are easier to apply, because we have some fairly straight forward bright-line rules that they cannot help but violate if they go through that process.

I also wanted to point out that California does not have policy approval authority over life policies, nor do we even require, with the exception of universal and a couple of the other specialized, highly complex type products—even had any requirement for filing the policies. When we have attempted to walk down that road, the industry's extraordinary jealousy over the fact that they managed to prevent California law from requiring filing of life policies really comes out.

We have had a very difficulty time trying to enact and have failed to enact a requirement for approval of life policies comparable to what we have for health insurance policies, and that is one of the areas that is a hole in our law that I do not know how we can fill, because the industry is very resistant to anything which they perceive as making it more difficult to do business in California.

When we try to do our disclosure law, we hear complaints about California specific requirements that are difficult to comply with. We hear a lot, particularly as members of this committee are aware, California's economy has not rebounded the way most of the rest of the Nation has, and one of the reasons is the allegation that California has an overly regulated economic environment. So every time we begin to talk about the kind of things that people sitting in this room know are important, that they know are not going to stop the industry from selling their product, we hear the argument: Too much regulation, adverse business climate. And when your economy is in the state that the California economy is, that is a powerful argument to the members of the legislature, and it is a strong impediment to enacting the types of things that we have been talking about here today.

But as I indicated, we are prepared to roll up our sleeves, work with this subcommittee, and work in our home state to resolve these problems.

Thank you.

[Mr. Rakich submitted the following:]

PREPARED STATEMENT OF MARK RAKICH ON BEHALF OF THE CALIFORNIA DEPARTMENT OF INSURANCE

Mr. Chairman, Subcommittee members: Good morning. I am Mark Rakich, Senior Counsel of the California Department of Insurance. On behalf of California Insurance Commissioner John Garamendi, I want to thank the Subcommittee for inviting us to participate in these hearings. We believe that the focus this Subcommittee has placed on certain practices of the life insurance industry has benefited consumers across the country by bringing attention to an agenda of reform.

Today I want to discuss the use—or rather, the *misuse*—by the life insurance industry of "policy illustrations." For your reference, I have brought some examples of illustrations which some insurers have used in California. These do not necessarily reflect inaccurate information—I have not had a detailed analysis conducted on these examples. However, in the hands of a sales agent, you can imagine the assertions these documents might suggest.

The misuse of illustrations is a problem which has concerned this Subcommittee, and it is of grave concern to Commissioner Garamendi. The media has reported on this Subcommittee's work, and that reporting has generated serious discussion in California about addressing this problem. Both within the Department, and in the offices of several members of the legislature, we have been attempting to identify the best way to approach this problem. The California Department of Insurance believes that substantial reform is warranted—reforms which will fundamentally change the misleading manner in which illustrations are currently employed in the marketing process. The time for debate has long passed. The consensus among regulators and responsible insurers already exists: there has been, there continues to be, serious misuse of policy illustrations. The only issue is what to do about the problem.

Let's look for a moment at what these illustrations are purportedly representing. As one insurer[1] responded to the Department's draft legislation: "the only purpose a new business illustration can serve is to help explain how a policy *may* operate under a set of options under the scenarios illustrated." (emphasis added.) From this explanation, we can see that the purpose of the illustration for the insurer is simply to explain how the features of the policy work—it has nothing to do with predicting actual performance! Of course, neither the agents who are marketing the policies nor the purchasers of the policies are actuaries or financial analysts. And the reality is that in the hands of the industry's sales force, these illustrations are used to convince prospective customers that the results illustrated should be expected. And I think I am on safe ground when I say that virtually no one in this room denies that "improper" use of illustrations is widespread. The Consumer Services Division of the Department of Insurance has documented complaints from policyholders, and industry representatives consistently agree that problems exist, even if they might question our proposed solutions.

For example, not only will an agent use a current illustration to suggest that it is a prediction of performance, they will point out that historically their company *outperformed* previously illustrated amounts. The implication is that this level of performance should be expected in the future—despite the fact that market conditions completely independent of the quality of the insurers' management and its investment portfolio lead to the historical results. In an era of low and falling interest rates, historical performance based on 1970's and 1980's rising interest rates is more than irrelevant—it is downright misleading.

I want to briefly outline what we are attempting to do in California. First, we have prepared and circulated to the industry a draft bill which is designed to regulate how an illustration is put together in the first place. The draft is designed to require the industry to cease to use illustrations which are no longer actuarially justified; to require reasonably accurate information to be used at all times; and to require some plain language disclosure.

This proposal, based as it is on fairly technical actuarial principles, is still in a rough form. Industry comments have lead to re-thinking some of the features, and

[1] The Guardian Life Insurance Company of America, correspondence dated November 17, 1992.

we are continuing to work on the project with an eye to introduction in the 1994 legislative session. Although we have discussed the possibility of seeking to put the proposal into place by regulation, which might enable us to act sooner, we believe that enacting a statute will be the better approach. We have some doubts that our existing statute authorizes the type of extensive regulatory approach contained in the draft.

We have, however, undertaken to enact legislation this year to require a prominent disclosure on the front of any illustration. I have attached a copy of the bill (SB 1065, by Senator Henry Mello). The disclosure is simple, easy to understand, and does not contain anything which the industry can reasonably object to. We expect enactment of this bill by the end of this summer's session.

There are other approaches which we have under consideration. It is good to control the use of illustrations to ensure that they are not inaccurate at the inception; it is good to warn potential policyholders that the illustration does not guarantee anything. However, it is inevitable that with the one-on-one marketing which is characteristic of the life insurance industry, purchasers will nonetheless rely on the "predicted" performance shown by the illustration. Whether agents will misrepresent, employ an overly "hard-sell" approach, or simply fail to explain adequately, consumers will be left holding a document which will appear to set forth what to expect from the policy.

We believe that life insurers which have used illustrations containing specific values should annually notify policyholders whenever the actual performance of the policy falls below the performance illustrated. Whether this notification should be within an annual statement which most policyholders already receive, or whether it should be an independent notice, is open to debate. Whatever minor burdens this may place on life insurers is vastly outweighed by the benefits to policyholders who will no longer go years down the road operating on false assumptions of financial security.

In addition to regulation of policy illustrations, the California Department of Insurance is currently seeking adopting of a "yield index" regulation. We are pursuing other legislation to require life insurers to provide specific notice to policyholders whenever they invoke policy provisions which provide the insurer with discretionary power to alter the premium owed. We believe that prohibiting the use of misleading illustrations is but one of the issues relating to full and accurate disclosure of critical information. For an industry so inherently intertwined with the public interest, the consumer's "right to know" has long been pushed far into the back seat.

Commissioner Garamendi is interested in assisting this Subcommittee in any way he can, and in pursuing at both the State and national level establishment of the kinds of protections for policyholders to which the citizens of California and this nation are entitled. I am available to answer any questions the Subcommittee may have. If I do not have the information you need, I will be happy upon my return to California to utilize the resources of the Department to adequately respond.

Thank you.

FOR ILLUSTRATIONS, SEE PAGE 3

Amended

AMENDED IN SENATE APRIL 28, 1993

SENATE BILL No. 1065

Introduced by Senator Mello

March 5, 1993

An act to [D> add Sections 10127.81 and 10127.82 to <D] [A> amend Section 10127.9 of, and to add Sections 10127.10, 10127.11, and 10127.12 to, <A] the Insurance Code, relating to insurance.

LEGISLATIVE COUNSEL'S DIGEST

SB 1065, as amended, Mello. Life insurance.

Existing law authorizes every individual life insurance policy [D> with a face value of less than $10,000 <D] to be returned by the owner for cancellation. The period of time set for return of the policy by the insurer shall not be less than 10 days nor more than 30 days. All premiums and policy fees paid are required to be returned to the owner if the policy is cancelled.

This bill would [A> instead <A] authorize [D> a person age 65 years or older to cancel <D] [A> the cancellation of <A] any [A> such <A] policy or certificate of life insurance within 30 days following delivery, as specified. It would require those policies to contain a notice of that provision.

[A> Those provisions of existing law are expressly inapplicable to individual life insurance policies issued in connection with a credit transaction or issued under a contractual policy change on conversion privilege provisions contained in a policy. <A]

[A> This bill would additionally make those provisions inapplicable to noncontributory employer group life insurance contracts. <A]

[A> The bill would also require offerings of life insurance policies that contain illustrations of nonguaranteed values to contain certain disclosures. It would require annual statements to policyowners and certificate holders to disclose the current accumulation value and current cash surrender value and would require life insurance policies and certificates which contain a surrender charge period to disclose the surrender period and penalties associated therewith. <A]

Vote: majority. Appropriation: no. Fiscal committee: no. State-mandated local program: no.

The people of the State of California do enact as follows:

[D> SECTION 1. Section 10127.81 is added to the <D]

[A> SECTION 1. Section 10127.9 of the Insurance Code is amended to read: <A]

10127.9. (a) Every policy of individual life insurance which is initially delivered or issued for delivery in this state on and after January 1, [D> 1990 <D] [A> 1994 <A] , shall have printed thereon or attached thereto a notice stating that, after receipt of the policy by the owner, the policy may be returned by the owner for cancellation by delivering it or mailing it to the insurer or to the agent through whom it was purchased. The period of time set forth by the insurer for return of the policy by the insured shall be clearly stated on the notice and this period shall be not less than [D> 10 <D] [A> 30 <A] days [D> nor more than 30 days <D] . The insured may return the policy to the insurer by mail or otherwise at any time during the period specified in the notice. By delivering or mailing the policy pursuant to this section during the cancellation period, the owner shall void the policy from the beginning, and the parties shall be in the same position as if no policy had been issued. All premiums paid and any policy fee paid for the policy shall be refunded by the insurer to the owner within 30 days from the date that the insurer is notified that the insured has canceled the policy.

(b) This section applies to all policies issued or delivered in this state on or after January 1, [D> 1990 <D] [A> 1994 <A] , but does not apply to any policy subject to Section 10127.7. All policies subject to this section which are in effect on January 1, [D> 1990 <D] [A> 1994 <A] , shall be construed to be in compliance with this section, and any provision in any policy which is in conflict with this section shall be of no force or effect.

(c) [A> Every life insurance policy or certificate subject to this chapter which is delivered or issued for delivery in this state shall have the following notice printed on the cover page or policy jacket in 12-point bold print with one inch of space on all sides: <A]

"IMPORTANT

YOU HAVE PURCHASED A LIFE INSURANCE POLICY. CAREFULLY REVIEW IT FOR LIMITATIONS.

THIS POLICY MAY BE RETURNED WITHIN 30 DAYS FROM THE DATE YOU RECEIVED IT FOR A FULL REFUND EITHER BY RETURNING IT TO THE AGENT OR THE INSURANCE COMPANY. AFTER 30 DAYS CANCELLATION MAY RESULT IN A SUBSTANTIAL PENALTY, KNOWN AS A SURRENDER CHARGE."

[A> (d) <A] This section does not apply to individual life insurance policies issued in connection with a credit transaction or issued under a contractual policy-change or conversion privilege provision contained in a policy. [A> Additionally, this section shall not apply to noncontributory employer group life insurance contracts. <A]

[A> SEC. 2. Section 10127.10 is added to the Insurance Code, to read: <A]

[A> 10127.10. Every insurer and life agent offering for sale life insurance policies with the use of illustrations of nonguaranteed values shall disclose on those illustrations in bold 12-point print with one-half inch space on all four sides the following statement:

"THIS IS AN ILLUSTRATION ONLY. AN ILLUSTRATION IS NOT INTENDED TO PREDICT ACTUAL PERFORMANCE. INTEREST RATES, DIVIDENDS, AND VALUES SET FORTH IN THE ILLUSTRATION ARE NOT GUARANTEED." <A]

[A> All illustrations containing nonguaranteed values shall show the guaranteed minimum interest rate column in bold print. All other columns used in the illustration shall be in standard print. <A]

[A> SEC. 3. Section 10127.11 is added to the Insurance Code, to read: <A]

[A> 10127.11. Whenever an insurer provides an annual statement to a policyowner or certificate holder, the insurer shall also provide the current accumulation value and the current cash surrender value. <A]

[A> SEC. 4. Section 10127.12 is added to the Insurance Code, to read: <A]

[A> 10127.12. All life insurance policies and certificates which contain a surrender charge period shall disclose the surrender period and all penalties associated therewith in bold 12-point print on the cover sheet of the policy or certificate. <A]
[D> Insurance Code, to read: <D]

[D> 10127.81. (a) A policyowner or certificate holder age 65 years or older of any life insurance policy may cancel a policy or certificate by returning it to the issuing insurer or its agent, by mail or otherwise, or by submitting a cancellation request to the insurer or its agent, within the first 30 days following the delivery of the policy or certificate to the senior. By canceling the policy pursuant to this section, the senior shall void the policy or certificate from its inception. All premiums, policy fees, or other consideration paid by the senior shall be refunded by the insurer to the senior within 30 days from the date the insurer receives actual or constructive notice that the senior has canceled the policy or certificate. <D]

[D> (b) For purposes of this section, delivery of the policy or certificate to the senior shall be deemed to have occurred only if the insurer has a signed and dated receipt of delivery from the policyowner or certificate holder, or the policy or certificate is delivered by certified mail through the United States Postal Service and the insurer has a dated receipt signed by the policyowner or certificate holder. A sworn statement by the agent to attest to delivery of the policy or certificate shall not constitute delivery. <D]

[D> (c) This section shall not apply to life insurance policies issued in connection with a credit transaction or issued under a contractual policy change or conversion privilege provision contained in a policy. Additionally, this section shall not apply to noncontributory employer group life insurance contracts. <D]

[D> SEC. 2. Section 10127.82 is added to the Insurance Code, to read: <D]

[D> 10127.82. Every life insurance policy which is delivered or issued for delivery to a person age 65 years or older shall have the following notice printed on the cover page or policy jacket in 12-point bold print with one inch of space on all sides: <D]

"IMPORTANT!

[D>

YOU HAVE PURCHASED A LIFE INSURANCE POLICY. CAREFULLY REVIEW IT FOR LIMITATIONS.

THIS POLICY MAY BE RETURNED WITHIN 30 DAYS FROM THE DATE YOU RECEIVED IT FOR A FULL REFUND EITHER BY RETURNING IT TO THE AGENT OR THE INSURANCE COMPANY. AFTER 30 DAYS CANCELLATION MAY RESULT IN A SUBSTANTIAL PENALTY, KNOWN AS A SURRENDER CHARGE."

<D]

END OF REPORT

Senator METZENBAUM. Thank you very much, Mr. Rakich, and I might say to you that I have a little difficulty in getting over that bridge between California's economy not being in great shape and the reason and that being a basis for not seeing to it that people who buy insurance policies get everything that they are entitled to and more regulation of the insurance industry.

It is not the insurance industry selling insurance policies that helps the economy, except the insurance companies' economy, but it is whether or not what they are selling makes it possible for Californians to use their dollars most efficiently, most effectively, and to have other dollars available to make the other purchases that do make the economy move.

So I would say to you, I hope you do not slow down by reason of concern about the economy. I cannot see that as overregulation.

Mr. RAKICH. Senator, we do not agree with the argument, but it is made, and it is powerful, particularly among members who are reeling from so many economic setbacks and the political repercussions that they sense from the failure of the California economy to rebound. But it definitely is not causing us to pull back; it just makes the road that much tougher.

Senator METZENBAUM. Mr. Lyons, my first question relates to Mr. Rakich's comments, and that is that the model legislation with respect to churning does not include churning within the company.

Do you think that that is a subject that ought to get the attention of the NAIC and perhaps suggest a modification?

Mr. LYONS. Yes, and it is on two fronts. Many of the models, which are general models as a new problem arises, are modified by the States, very similar to what California has done. When you find out that the rating by one company on another company's policies are, in fact, to the detriment of the consumer, we pass a law on the requirement of information and notification. When it then becomes an issue that you have an internal churning, when a company's premium volume has gone down and they are attempting to have more sales, then you make a small modification to the model to apply it also to internal churning as well.

So you are seeing both the States acting individually, and you are seeing a reconsideration of the model and the issues at the NAIC itself.

Senator METZENBAUM. Do you think the model legislation in this area needs some modification?

Mr. LYONS. That is not particularly in the Life Disclosure Working Group; however, it is an issue which I will take back, based upon this hearing, to ensure that it is something being looked at.

Senator METZENBAUM. I think that Mr. Rakich would appreciate it, and I know that this committee would.

I want to thank you, Commissioner Lyons, for being here today. Although I am anxious to see the NAIC do more to address the difficulties encountered by buyers of life insurance described by the witnesses in our first panel, I do not fault you personally for the lack of disclosure. I understand you only became chairman of the Life Disclosure Working Group in the last few weeks, and I do not know why you could not save the world within that period of time, but we appreciate your giving your attention to it.

You do have a fine reputation, and I know you will do everything within your power to see the proposals you suggest in your testimony are enacted.

However, I am concerned that that will not be enough to protect people like Mr. and Mrs. Bohrer or Mrs. Newberry. For example, you testified that the NAIC has already been quite active in improving the access consumers have to the information they need to make informed choices. You cited a buyer's guide available in three-fifths of the States. You spoke of disclosure forms added to a model regulation. You mentioned a bulletin on illustrated projections directed to companies, and you described an illustrations guideline.

Yet the people we have heard from, the witnesses this morning, as you heard, believe they have been misled, and I would guess that they are right on the target on that.

Are the steps that the NAIC has taken inadequate, or are the insurers not adhering to the rules?

Mr. LYONS. It is very difficult to pass a model regulation to prohibit bad acts. You are simply going to have people out there who may intentionally or unintentionally mislead.

In the case of Mr. Keating, for example, and his review—and I understand that there is a lot of litigation—but I am fairly familiar because there were some Iowa policyholders, and those are my responsibility—in that circumstance, the general response is that what, according to the models, will happen—and Iowa has adopted a majority of these models—if the agent sells the project in an intentionally misleading manner, there are civil, administrative, and criminal penalties which can apply, and they are applied.

The second is, if a person unintentionally misleads the consumer, that unintentional misleading, if we have the data to show that it has occurred, still results in administrative actions which puts the consumer in the position which the consumer could rightfully expect to have been in, given the information they were given.

Third, if a consumer receives information and misunderstands that information, we still have what we call consumer remorse. Consumer remorse is not exactly misleading, but it is where the consumer is not satisfied with either the product or the value that the product represents to them, and in those circumstances, the State has the obligation to see if they can work with the insurer to present alternatives to the consumer. So all of those are occurring.

As far as the models themselves, I know that you referred to the fact that many States have not adopted models. There are several things going on, but two of the most important: The response on whether or not States have all adopted models is the fact that when the majority of States or a significant number of States have adopted a model, it becomes a national practice. The companies that do business in more than one State, they adhere to that model even in a State that does not have the model, and you have a level playing field, and a lot of the States then do not go forward in adopting the model.

On the second, however, and more poignant to your concern, Senator, is the fact that some of these models are so complex that even after they have been passed by the NAIC, it is difficult to implement them in the State because they are hard for the consumers to understand when tested in that State. That is one of the reasons, based again upon the letters you have sent to the NAIC and the testimony which we have read from here, we are returning to the life disclosure area to do two things: develop new models, but additionally to go back to those old models which are too complex to take care of the people you heard testify earlier and to make sure those models are made more consumer-friendly.

Senator METZENBAUM. At the best, when do you think the modifications could be made available to States and implemented?

As you know, some model proposals that the NAIC has distributed to the various commissioners, some of them have taken over 20 years in order to implement. And I think one of the worst things that is occurring and seems to be pretty much generally stated here, and that is, the company makes a projection; the salesman sells it. Somewhere in the policy, it says these are not guaranteed figures. But the salesman hypes it. The buyer does not know anything about it and learns too late.

Now that is something that is happening every day of the week right as we sit here now. The policies are being sold.

What can the NAIC do in the short term in order to bring that issue to a head promptly? Could you call in the representatives of the major companies as a group and say to them: Look, this does not make sense; we are going to get a new regulation together. But we are asking you now to stop this perfidious practice that is misleading millions of Americans. There is no justification for it?

What do you see could be done on a more urgent basis than the normal procedure of getting a draft together?

My guess is that through the normal procedures of the NAIC, even with your able leadership, you would not find many States that have changed the law 5 years from now. My guess is, the laws would pretty much all be about the same as they are now, and maybe some had changed, but until you get around to getting something new, getting it approved, sending it out to the States, waiting for the legislatures to act, if they are going to act—what can you do on a more immediate basis?

Mr. LYONS. There are a couple of items within that question, and I will try to respond to them in a couple of examples.

What can you do on an urgent or an immediate basis outside the passage of laws and the passage of regulations? Frankly, Mr. Chairman, much of what you have done over the last year and much of what the NAIC has done over the last year is accomplishing just that. I have never seen so much activity in the professional organizations, be they the Certified Life Underwriters, the National Association of Life Underwriters, the Society of Actuaries. They have all convened working groups to increase their responsibilities and understanding of the agents and the producers that sell for them. So you are immediately having an effect on the producer community.

As you probably noted, as soon as these problems started in the late 1980's—and I think you referenced it earlier—Iowa insurance companies, based upon meetings with the Commissioner's Department, voluntarily moved away, because they understand that buyer's remorse, even if they are not technically liable under administrative law or they are not technically liable under civil or criminal law, they still have a financial problem, and that is buyer's remorse.

The States need to increase the requirements they put on the companies to avoid having consumer problems relating to value. That is also occurring.

Additionally, on a formal basis, what can be done? I am sorry I wrote on it; I brought my only copy. This was kind of a pilot project in this area, and it took a little under a year to develop. And our attempt was to find a segment in the life insurance area, not the whole ball of wax, but one segment that was a very strident concern of ours, and attempt to do something relating to disclosure. And if disclosure does not work in this situation, then the NAIC has to consider beginning to ban products, which is a fairly serious issue.

What we have done is, we got the disclosure form for the sale of low-value life insurance to senior citizens down to one page, which was no small feat in and of itself. And it starts out by having three boxes you must check. Is this a guaranteed issue policy? If it is not a guaranteed issue policy, what was considered, and is there——

Senator METZENBAUM. A guaranteed issue policy?

Mr. LYONS. For example, does your health come into consideration? For example, you see many of these issues late at night on TV where you have a celebrity hawking a product that basically says: No health questions asked.

Well, the concept is, we want the consumers to know that if there are no health questions asked, is that this kind of policy, and if so, they have to be read this sentence: Your premiums may be lower if health information had been obtained, telling them that there are other options for them.

And basically how the financial works is, there is a policy year set out, premiums paid. Then it is matched against premiums accumulating at 5 percent normal interest; it is not an outrageous interest amount. It is a little hard to earn these days on CD's, but it is fairly close. Death benefits, cash surrender value. And then there is a final column. At the end of each year, is that a positive or a negative cash value effect for you? And in many circumstances when the consumer sees this and understands at high ages, low-value life insurance, that they can see clearly on the 1-page disclosure form, that it is negative for them after the second year or after the third year, very early in the policy period, and they choose not to buy it. And additionally disclosed in large print at the top is: Please notice. You have 30 days to review your policy, and if you are not entirely satisfied, you can return it for a full refund of your premium within these 30 days.

Senator METZENBAUM. Now where is that being used?

Mr. LYONS. It has been adopted in Iowa. I am not familiar with how many other States have done it. That was a followup we adopted in late 1992. And again, what we are attempting to do is find that segment of the life insurance industry that really needs a lot of disclosure assistance.

Senator METZENBAUM. Since you only have one copy, while we are speaking, I think I am going to ask a member of my staff to come down and take that out and make a Xerox copy of it.

Mr. LYONS. I have a packet here, if you could just ignore my handwriting. I am sorry. And we will provide clean copies as well, Mr. Chairman.

Senator METZENBAUM. Fine.

You heard Mrs. Newberry tell us this morning about how she was persuaded by her agent to replace a policy she already had with another policy from the same company.

Does the NAIC have a model regulation which would require companies to compare the relative benefits of the new policy to the existing one?

Mr. LYONS. The NAIC has a number of requirements. I am unsure the extent to which we have one that specifically addresses the concept you are looking at, and we will respond and review the models we have and respond to your staff.

I can tell you that in Iowa—for example, the Medicare supplement issue was raised earlier about how the Federal Government and the NAIC together had started to solve an issue—what we have attempted to do in Iowa is to put the burden on the agents and the companies. Before they replace a policy, they have to say the relative value of that policy versus the previous one, and they have to make a determination that there is no duplication whatsoever in any of these policies. If they fail to do that, they are administratively liable, and that has really cut down on the duplicate policies and the policies having no value to the consumer.

But again on your specific question relating to how many of the models which NAIC has may address the issue you noted, I will do a complete review and have that sent to your staff immediately.

Mr. RAKICH. Senator, if I might just interrupt——

Senator METZENBAUM. Sure.

Mr. RAKICH [continuing]. And just point out that if you need any encouragement for going forward, the State' rules on Medicare supplements are predominantly based on Federal mandates. So to the extent that that is an example, you can see the value of maintaining focus here in Washington.

Senator METZENBAUM. Thank you.

Many consumers have contacted us about losing cash value when a policy is replaced. As a matter of fact, I wrote the NAIC about the practice of persuading policyholders to rollover existing cash value policies into new ones, a practice that often incurs new front-end charges and wipes out the equity.

Does the NAIC plan to have a regulation that would require companies or selling agents to demonstrate to policyholders how many years a replacing policy must be kept before lost assets can be restored?

Mr. LYONS. The simple answer is yes. That specific issue is under consideration within the task force, and we will be reporting back to you. As Chairman Weaver had noted earlier, all changes made by the task force will be reported to you and your staff.

The issue is—we are trying to find a balance, however, right now—the issue is, how much information relating to administrative cost, expenses, and overhead to the consumer is necessary for them to judge the value of the policy. We are trying to only provide that information which is absolutely necessary for them to judge how that policy will work for them and meet the protection needs they want, rather than providing them with more and more information that eventually becomes so thick that few consumers will, even if they are attentive and responsible consumers, will attempt to wade through it.

So the answer to your question, though, is yes.

Senator METZENBAUM. I have some additional questions, but I think I will first turn to Senator Thurmond and Senator Grassley.

Senator THURMOND. Thank you very much, Mr. Chairman.

Mr. Lyons, I commend the work of the NAIC and your efforts to increase the number of States that adopt model legislation drafted by the NAIC.

Although you may have mentioned this already, is it true that even when the NAIC's model legislation is not adopted by every State, it still provides substantial benefits all across our Nation? Is it true that this occurs because most insurance companies prefer to conduct their business with as much uniformity as possible throughout the country?

Mr. LYONS. Yes, that is true. In most circumstances, the companies, when they face a particular disclosure issue or a guideline or a model in a significant number of States, simply develop their products and their sales practices to reflect the national trend, rather than the individual State's. So you have many States where even though the disclosure of the delivery of a consumer outline is not required, they still do it because it is done naturally with the policy in the other States.

Additionally, I do not think it is a shortfalling in all circumstances that you see that there are some models that are adopted in a lot of States, some in few States. Putting the models out there creates some flexibility for the States to either adopt a model when they need one very quickly, if they want to create uniformity, a model that they can modify and do something else with in their State to more particularly meet their consumers' needs, or they can say: I looked at that model; I do not have that consumer problem in my State, so I am going to, you know—I am going to center on other models, and I am going to adopt other models on other issues.

As you have probably seen recently, there are vast differences between the insurance companies and the problems for consumers faced in the Southeast and the Northeast, much more so than in the Midwest, so you have States using the models somewhat differently.

Senator THURMOND. As you know, I have long supported State regulation of insurance, rather than establishing a new Federal bureaucracy to supervise insurance.

Mr. LYONS AND MR. Rakich, do you support the continuation of State regulation of insurance?

Mr. LYONS. Go ahead, Mark.

Mr. RAKICH. Senator Thurmond, Commissioner Garamendi is a believer in the State regulatory system.

Senator THURMOND. Speak louder, please. I cannot hear you.

Mr. RAKICH. I am sorry. Mr. Garamendi is a believer in the State regulatory system. He is often aware that the insurance business is a national and in many senses an international business, particularly with alien, outside-the-United-States reinsurers providing a tremendous level of the insurance capacity that the domestic insurance industry provides. There is an important role to be played at the Federal level.

Whether that is a primary hands-on Federal bureaucracy or not is not clear to us, that that is the appropriate way to go, but there are clear limitations on what State-based regulators can do, given the national and international nature of the insurance business, and we believe that a State/Federal partnership in some respects is both beneficial and inevitable. We see it in consumer protection areas with the extent to which the Federal Government has stepped into Medicare supplement insurance, and we feel that those efforts have been very beneficial and supportive of the State-based system.

So, to answer your question directly, we believe the State-based system can be made to work, but it also has limitations that at times will require national Federal level intervention.

Senator THURMOND. Apart from oversight hearings of this sort, do you believe that it is desirable for there to be a Federal role or Federal regulation of the business of insurance, Mr. Lyons?

Mr. LYONS. No; I really do not believe that there is a role to actually regulate and implement, although I will certainly admit that there is a role for oversight and investigation, as is the duty of this subcommittee.

Your comment relating to the role of the Federal Government in actual regulation, I let Mark go first, because I, in my own State, get this question sometimes, and I like to use an analogy as to why I believe in State regulation.

And that is, it is like the difference between having one super-computer or a local area network of smaller computers. I think 25 years ago, everybody rushed out—50 years ago, everybody rushed out when computers first came out to buy the biggest computer you possibly can. Well, most of the major corporations and most of the analysts for computers now understand that a local area network of linked computers is actually more powerful and efficient than a major super-computer because they can work on many different things at the same time. It does not have to be focused just on one issue. The interactive network increases all of the powers because of the different capabilities. And the third is, it survives a crash much better, because even though one piece of the network may go down, many other pieces can step in and fill the gap.

And I believe that is how State regulation of insurance operates. It operates like a local area network of intersupportive 54 pieces of strong regulatory capability that can be brought to bear.

I believe that in investigation and oversight certainly. I think the spotlight that is shown on problems by organizations and by subcommittees such as this is very important, and it is necessary for, then, us as regulators to follow through and implement reforms.

Senator THURMOND. Mr. Rakich, do you have any further comment?

Mr. RAKICH. No, not on that issue. Thank you.

Senator THURMOND. Mr. Rakich, would you give us your perspective on the role of NAIC in developing model legislation for enactment and enforcement by the States?

Mr. RAKICH. Senator, we believe that the NAIC has the resources and national perspective to play a role as a recommendation sort of body. Our concern with the NAIC process is, with any entity made up of so many constituent parts, there is a tendency to move toward the lowest common denominator, and our problem in California is, if we attempt to get out in front, the first thing we hear is: But we do business on a national level; how can you have a rule that is California-specific? Let us look to the NAIC.

We look to the NAIC. The industry brings in resources from across the country, pointing out State-specific kinds of problems, and we end up with something that is overly generic, which does not really provide for the kind of State-unique issues that Mr. Lyons referred to.

The problem comes with when we come back to California and attempt to implement our version or our view of a problem, and we hear from the industry that we just did that battle at NAIC. This is the model. We are happy with the model. We like the model. But the model may not have been tailored to the California problems or the problems of any particular State, and it does have a tendency to prevent the kind of tailoring that I think is necessary if we are going to stick with a State-based system.

Senator THURMOND. Mr. Rakich, do you have any concern that including a yield index in insurance disclosures, as you suggest in your testimony, might confuse consumers by causing them to view their policies as investments rather than principally as insurance?

Mr. RAKICH. Well, I guess there are two questions there. The first question is whether there is a potential for this to be confusing, and I have to say that I am really concerned about that, because it is a very complicated issue.

The benefit of having the yield index is not in getting to where the bottom line is, but in comparing the bottom lines with other products. If there is some level of standardization among different companies as to how they are getting there, there is a point of comparison. The agent can obviously explain why a particular company's product that does not appear to be as comparable might be just as good of a deal, but if every company is doing something differently, there is no basis for comparison.

The second question relates to allowing people or encouraging people to treat the product as an investment rather than primarily an insurance vehicle. And it is difficult to answer that question, because the fact is, these policies are primarily marketed as investment devices. They are pension savings plans. They are retirement plans.

The fact of the matter is, they are a very strong hybrid between traditional term death benefit type life insurance and investment opportunities, and the sales presentation oftentimes is that the consumer is getting two packages all wrapped up into one, and as a result, it is a much simpler way to go.

So I do not think we want to take out the fact that these are investment packages, because that is, in fact, what they are. It is the only reason that the life insurance industry is selling them, and to pretend that they are simple, traditional term life policies as their primary focus, I think, would be more misleading than going down the road of making sure that the investment aspects are adequately explained.

Senator THURMOND [presiding]. I want to thank all you gentlemen and ladies for your appearance here today. We appreciate your testimony.

Senator Grassley, would you care to go ahead?

Senator GRASSLEY. Thank you, Senator Thurmond.

In regard to the first panel, I just thought I would say that we get letters from Iowans who have expressed similar experiences that they have had, and I am sure Mr. Lyons is even more aware of that than I am.

And I also thought I would say, before I ask questions, in regard to something Mr. Keating was concerned about, that I want to concur with Senator Metzenbaum and Senator Thurmond in reassuring Mr. Keating that we will do everything in our power that he is not improperly retaliated against for blowing the whistle on what he considers improper practices by an employer.

Senator Metzenbaum and I have worked together on trying to protect whistleblowers for a long period of time, and we will continue to do so.

Senator METZENBAUM [presiding]. I thank the Senator from Iowa.

Senator GRASSLEY. Thank you.

Commissioner Lyons, do the practices of Iowa life insurers described by Mr. Keating raise concerns with you as Iowa's chief insurance regulator?

Mr. LYONS. Absolutely. The companies outlined by Mr. Keating are not Iowa domestic companies, but they are authorized to sell. There are 1,500 of them, and we are responsible to make sure that all of them live up to their responsibilities. So it does create great concern.

Senator GRASSLEY. Generally speaking, what has been the experience in the State of Iowa with regard to the problems of consumer disclosure of life insurance?

Mr. LYONS. If I can be generic, we have had two major problems. The first is a very specific problem, and that is the changing in the interest rates. We have seen a large upsweep in the number of complaints exactly on point to the testimony that we have heard here today relating to the change in dividends and interest structures. So we have had a lot of work to do in the area of determining whether there were intentional misstatements. In that case, there are civil and administrative actions taken by us and criminal prosecutions referred on. If there is an unintentional, yet identifiable, misleading statement made to consumers, then there is administrative action taken to put the consumer into the position they should have been under the information that was disclosed to them.

Another item I may not have mentioned before, but if an insurance agent in the State of Iowa fails to be able to adequately explain a product they sell, they can lose their insurance license because they do not meet the minimum qualifications. So that is another oversight technique that we use.

And when consumers get a product that does not operate the way they want it, even though it may have been fully disclosed to them, we still work with the company to work out a transfer to a policy that more accurately reflects the consumer's new wishes.

Senator GRASSLEY. Am I correct in understanding that the NAIC has been involved in overseeing consumer disclosure in connection with life insurance policy illustrations for about 20 years?

Mr. LYONS. Yes, since 1975.

Senator GRASSLEY. What is the most recent action you have taken in this area, and has it helped?

Mr. LYONS. I think it has. One of the most recent actions we have taken, just finished up in late 1992, and that was relating to the senior financial disclosure information that I had made reference to earlier and will be providing a copy of to the committee staff.

I think it has been positive because we are attempting to take the life insurance product, which is very problematic, the sale of low-benefit life insurance products to elderly senior citizens, and adequately disclosing on one page or less how that policy works for them, so that there is a specific line that has a plus or a minus on it that says: In year 3, this policy is a plus for you, or in year 3, this policy is a minus for you, and it has very clear disclosures in uniform terms. And I believe that that has been positive. It is under consideration in a number of States. I know it has already been adopted in Iowa, and we think it is having positive effects already.

Senator GRASSLEY. Could you elaborate on what remedies are currently available to people like those on the first panel who feel that they have been mislead by a policy illustration?

Mr. LYONS. Let me refer to Mr. Keating, his examples. One of the largest concerns I had with his testimony is that I only recognized one or two names out of that long list of names he read off, and that is because the majority of consumers and purchasers do not contact their State regulators with their concerns. If they contact us, as soon as they understand that they may have a problem, even if it just might be a problem, the sooner they contact us, the better.

I think the practice as outlined, when it is intentional, we have both administrative action authority and civil action authority. For example, if we found an intentional misrepresentation to an individual, first of all the company can be sanctioned to the point where they are no longer authorized to write business in the State of Iowa. The agent which sells the project can be banned from ever writing business in the State of Iowa again. And additionally those two actions, administrative actions, are now reported to a national database, so that we are linked to other States, so they will be aware that a company or an agent has done that action in the State of Iowa and can take appropriate steps in other States.

Additionally we can require that there be reimbursements made to the consumer. We can also make reference to them for private action or civil action for them to recover on their own behalf. In egregious circumstances, we work with both the office of the attorney general in the State of Iowa and with the local area prosecutions in each of the counties to refer criminal activity on, and we have done so in insurance areas.

Senator GRASSLEY. Is there any way that we can make certain policies simple enough for the average consumer to understand?

Mr. LYONS. We have been fighting with that one. There is a balancing of interest. At what point do you say enough information is enough information?

In the past, insurance—and let me just speak personally—in the past, I have always been of the opinion that, well, it is more information, but it cannot hurt. Let us just go ahead and provide more information. There may be certain consumers that will take advantage of it.

But when you provide too much information, when you provide stacks and stacks of papers, it becomes daunting for the consumer to try to wade through.

So what we have essentially done in Iowa—and it is beginning in the NAIC; there are several good examples of it—is to develop a balance between short, understandable statements, uniform in application, and sufficient information by which the consumer can still protect themselves.

For example, you have seen how in many word processors now you can have software which will tell you how understandable your memorandum or your letter is, based upon a software review, and it will give you—I know ours has three different levels, you know, a particular level of high school, you know, graduate and post-graduate. I think what we need to do is to develop that kind of an approach to making sure that these policies are understandable and upfront where all consumers can understand them, not just those who have a Ph.D. in economics.

Senator GRASSLEY. I thank you, Mr. Lyons. Mr. Chairman, I yield.

Senator METZENBAUM. Thank you very much, Senator Grassley.

Let me just ask both of you, Mr. Keating was understandably concerned about some retaliation against him, and Senator Grassley, I, and Senator Thurmond have indicated that if John Hancock were to take any action, that we would be at the ready.

Is it fair to say that the NAIC could be called upon if a witness before a Federal committee were discriminated against or terminated by reason of his testimony, not necessarily with the company claiming that, but just doing it for allegedly other reasons, that you would also be willing to be helpful in protecting the man's job?

Mr. LYONS. There are two things relating to that portion of the testimony that cause concerns. But in response to yours, the NAIC has no official enforcement power. The NAIC has no official sanctioning power. To the extent to which we can provide support for the oversight and investigation necessary for this subcommittee to do its work, we will do that. But I want to make it clear that we have no official authority.

Senator METZENBAUM. I understand you have no enforcement power, but John Hancock would not like to get in your bad graces nor any other company.

Mr. LYONS. I think that is called power by self-evident design.

The second part of it was, I was a little bit concerned because—and Mr. Keating—I know this issue has been discussed before—but Mr. Keating had a lot of—there may be lawsuits involved, so I do not want to prejudice anyone by making any comments myself, other than saying my concern is that he is mentioning Iowa and U.S. policyholders that are having buyer's remorse or may have been misled, and that is of major concern to me, and that relates to State law, and that is my responsibility, and that is your oversight.

His other problem, if you noted, that he pointed out was relating to ERISA, which cannot be regulated at the State level, and as I understand it, it is very difficult to get any action on at the Federal level. So that is another area where together I can take care of some State issues, and on ERISA reform, you can take care of his concerns at the national level.

Senator METZENBAUM. Do you think Mr. Garamendi would be helpful?

Mr. RAKICH. I would not like to be John Hancock's CEO at the first meeting with John Garamendi after they did something to Mr. Keating.

Senator METZENBAUM. Thank you.

Mr. Lyons, during the 1992 hearing on consumer disclosure, the subcommittee examined several common illustrations. Items that were often found to be omitted from the illustrations or hidden in the footnotes were the annual cost of mortality—that is, the death benefit; the amount of each premium that will go to company expenses, which, as you know, in some instances is over 100 percent for the first year; and the surrender cancellation penalties that are especially severe in the period during which buyers are most likely to cancel or lapse their policies.

Do you believe these serious omissions and obfuscations will be remedied by the current efforts of the NAIC?

Mr. LYONS. Yes, I believe so. I think the policy illustrations have to be shortened and made more understandable. That is part of your concern pointed out by that information presented to us. I think they have start being consumer-friendly, which means they have clear, understandable terms, and that the most important issues to them in that policy are presented clearly and are presented up front in both the presentation for the sale and in the policy itself, and I also believe that a lot of the issues you have noted, that was noted in that testimony and noted today in testimony, that when there are nonguaranteed assumptions and those assumptions are not being met, that there have to be new illustrations and new notices provided to the consumers, and I think we will be able to do that through the work of this task force.

Senator METZENBAUM. Thank you. Policyholders such as Mr. Bohrer, who legitimately wonder what is the effect on them of policy options, how does a buyer know that choosing an option to allow the insurer to pay a missed premium out of accumulated cash value may also allow the company to help itself to a premium when the policyholder simply wants to get out of the deal?

Mr. LYONS. That is an issue of specific disclosure that the task force is looking at. In fact, the materials which you have also cite that as a problem.

Our concern is that when there is any activity relating to the premiums to be paid or the premiums already paid that significantly affect how that policy or how the cash value itself will operate for the consumer are clearly disclosed on the front end, and if significant changes occur during that policy lifetime that affect those same positions, that a new illustration or a new contact to the consumer occur.

Senator METZENBAUM. Even though the vast majority of insurance is sold by interstate companies, insurance contracts and insurance companies are regulated by the 50 States with assistance from the NAIC. I do not have to tell you that I have been quite critical of the NAIC in the past for not responding quickly enough to problems. Unfortunately NAIC's handling of consumer disclosure is another example of the NAIC's slow response.

The NAIC did not react to the real estate market downturn or the failure of the junk bond market until well after they had bankrupted many companies and threatened the solvency of many others.

When the NAIC does pass new model laws or regulations to address obvious problems, it has always taken a number of years before a majority of the States conform their laws and regulations. In short, while the States and the NAIC eventually get around to dealing with the most serious problems, the response time, as you well know, in too many instances has been very slow.

Now I believe you when you say that the NAIC is trying to deal with the well-known problems being discussed here today, and I commend them for that, and I commend you for your leadership, and I am confident that you will make every effort to improve things.

But if the insurance consumers of this country are to be well served, you have got to move faster. What can you say to the public that will assure them that the NAIC and the States will effectively address the problems they face in trying to understand their insurance policies and do so in the near future rather than in the far distant future?

Mr. LYONS. One of the things I would want to do is to point to the recent track record of the last 2 years. Of course, we can point out that we have been working on consumer disclosure all the way back to 1975. However, we can point out the serious amount of work that has gone into consumer disclosure in the last 2 years. We can also point to the fact that whether it is by regulation or by model, we operate somewhat the same as this oversight and investigation group would, and that is to create a public impression and change public attitudes, to educate consumers and to get companies and agents to voluntarily change their ways as well, when it is their consumer issues that are involved.

I think that the public understands how the States operate. I think one of the difficulties you point out, in that it is difficult to create a model law and then to have to take it back and get it passed in the States, which is actually a two-step process, I do not believe that is detrimental to the system, because I believe there is a lot of flexibility that has been developed and a lot of new changes going on. And maybe the NAIC does not have every model, but even just with two regulators here, you have heard two different versions of how we have approached specifically a similar problem, and they are not quite the same, but I think we are both developing them to most accurately reflect the needs of our local consumers. So you not only have a model, but you have got activated regulators.

And as far as making sure that this group continues to move quickly in the future on disclosure, I will just end by saying that the oversight of this group will certainly prod us to activity and to conclusion and to reporting back to you.

Senator METZENBAUM. Nothing would please me more, Mr. Lyons, than to conduct a hearing and, say, talk about all the things that the NAIC has done, and I really feel rather reassured that under your leadership you are going to try to do everything possible to protect the consumer, and I am looking forward to working with you, and I know I speak for the other members of this committee.

Mr. LYONS. Thank you, Mr. Chairman.

Senator METZENBAUM. Mr. Rakich, California's chief actuary, John Montgomery, testified to the NAIC about a version of your draft legislation, but told the commissioners the bill had been withdrawn in anticipation of a model regulation being presented by the NAIC.

Do you think waiting for the NAIC to come up with a model is the best way to serve consumers in your State?

Mr. RAKICH. I think waiting for the NAIC is, in general, not the best way to proceed, because sometimes, as you pointed out, the wait is just too long.

Our draft legislation, upon circulation, it was apparent to us that it did need some substantial tinkering. We had actually intended to pursue a regulation—you know, participate obviously with the NAIC process, but pursue adoption of a regulation based on our existing statutory authority. In looking at how the proposal, which initially was designed as legislation, was developing, it became apparent to us that our existing statute, probably our Unfair Practices Act, probably did not provide us a sufficient statutory basis to adopt a regulation. So we are back to either pursuing legislation that either has the specifics of the proposal or adopting some legislation which grants us broader authority to act by regulation in our own right.

So I do not think Mr. Montgomery was quite accurate if he left the impression that we were completely deferring to NAIC. We are actively participating in that process and looking at the two routes in California, adopting via legislation the specific proposal or enhancing our statutory authority to act by regulation.

Senator METZENBAUM. How difficult is it for you to pass insurance legislation in the General Assembly, and how strong is the insurance lobby?

Mr. RAKICH. We are having some difficulties this year. As you know, we have a pretty serious budgetary problem which has distracted the interest of most members, and it is very difficult to get the time to explain why these issues are so important.

They are running around dismantling the safety net that we have spent the last 25 years constructing, and their patience for issues other than health and welfare directly and education is small.

The life insurance industry and the property casualty industry are both formidable opponents in California. There is no question about it. We have a number of other issues that have made this year a very difficult year to operate on anything that is not a very high-profile public issue. And, in fact, that is one of the reasons why we are so pleased that this committee is continuing to push this agenda, because it is the only kind of thing that makes our members take note of some of these issues.

Senator METZENBAUM. Thank you very much, Mr. Rakich and Mr. Lyons. Your testimony has been very helpful. The testimony of the four witnesses who appeared before us has been extremely helpful, and the testimony of the two witnesses who declined to appear, I am sure, would have been very helpful, had they seen fit to do so.

This hearing stands adjourned.

[Whereupon, at 12:13 p.m., the subcommittee was adjourned.]

APPENDIX

ADDITIONAL SUBMISSIONS FOR THE RECORD

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC, September 18, 1992.

Commissioner WILLIAM MCCARTNEY, President,
Commissioner STEVEN T. FOSTER, President-Elect,
National Association of Insurance Commissioners,
Kansas City, MO.

Re: Consumer Disclosure

DEAR COMMISSIONERS MCCARTNEY AND FOSTER: As you know, the Subcommittee on Antitrust, Monopolies and Business Rights has held a series of oversight hearings on insurance industry practices and policies. On June 23, 1992, the Subcommittee held a hearing to explore the adequacy of information disclosed or available to consumers of life insurance. What we learned deeply concerns me. I am writing to urge the NAIC to take immediate action on these serious matters.

Our oversight work has made clear that life insurance companies do not provide certain fundamental facts that consumers need in order to make informed decisions. It is equally clear that state insurance regulations do not require that the companies provide that information. First, buyers of life insurance are not being provided essential pricing information that would allow them to understand fully the cost of the policy they are considering or to compare similar policies. Second, prospective buyers are being misled about the projected future values of the policies they are considering. Third, without clear, accurate knowledge about their policies' cost or value, policyholders are being easily convinced to cancel policies in which they have accumulated cash value in order to purchase new, less advantageous products. These problems are particularly apparent in whole life and other permanent and blended products, which offer inside build-up on so-called savings or investment portions of premiums.

In our oversight hearings the Subcommittee evaluated policies of five major companies. We learned that prospective buyers of these policies are not given a clear and accurate breakdown of policy-related administrative charges and other expenses they are forced to pay. Let me give some examples.

A prospective policyholder cannot calculate what will be left for savings or have a realistic expectation of the growth of the savings portion because there is no reliable accounting of how premiums will be allocated for administrative charges and death benefits. One type of expense that goes unmentioned is the size of agent commissions which are between 55 percent and 105 percent of the first few years' premiums. Another is that prospective policyholders cannot determine a policy's actual cash value at cancellation because surrender charges are not clearly indicated. Furthermore, excessive administrative charges and mortality expenses are often refunded to the policyholder as dividends or reflected as reductions of premium. But, if a policyholder does not know what those charges or expenses are, he or she has no means to detect misleading information about vanishing, reducing or level premiums.

Our oversight also shows that individual policies are being designed and manipulated by computer-generated sales illustrations to contemplate many scenarios which are not realistic. Prospective buyers do not understand that projections of non-guaranteed elements are unlikely. The Subcommittee has received testimony that less than 10 percent of policies bought in the 1980's will perform as illustrated. One witness testified that 15 of the largest 20 insurance companies in his state of Illinois had reported to regulators that they could not sustain, for even two years, the projected interest rate assumptions they were using in their illustration.

Overwhelming numbers of life insurance buyers do not even understand which, if any, elements of their sales illustrations are guaranteed. For instance, as we demonstrated in our hearing, an Alexander Hamilton illustration did not make it clear that there was no guaranteed death benefit after 12 years.

Another witness testified about his family's dilemma which came out of a misleading sales illustration. He said that in 1984 his family purchased a $3 million joint whole life policy on his parents from Crown Life of Canada, relying on an illustration which said that the policy would be fully paid within six years and would always have a face value of at least $3 million. They were not advised that the policy performance was conditional on a continued high dividend rate. Although they believed they had complied with the agreement, they were dismayed to learn recently that unless they pay $92,000 a year for the next four years and $22,000 a year thereafter, the policy would decline in value and perhaps lapse altogether. Since our hearing, we have received hundreds of calls and letters from similarly affected consumers.

Last, our oversight indicates that many policyholders are being encouraged, often against their best short and long term interests, to replace existing policies without sufficient information with which to compare their current policy to the replacing policy. One hearing witness testified that fewer than one in 10 of the replacement policies sold in recent years was marketed with the intent of upgrading benefits to the policyholders. Agents and companies sell replacement policies and collect up front commissions and administrative costs from the cash value in the original policies. Neither insurance companies nor selling agents demonstrate to buyers how many years a replacing policy must be kept before lost assets can be restored.

I am also concerned that buyers of life insurance have no way to learn how many of their premium dollars, allocated to administrative charges, are being spent on salaries, benefits and retirement packages for their companies' top executives. Fortynine states do not require companies to file compensation information with the regulators. Mutual company shareholders have nowhere they can seek information about their company's governance. Buyers of policies from stock companies, who can inquire of the SEC, are only slightly better off in this respect.

I am alarmed by the paucity of meaningful information available to consumers. I urge you and the appropriate NAIC task forces to create and pass model regulations that would protect consumers by assuring they have the ability to make informed life insurance purchases. The Subcommittee will continue to monitor and evaluate the adequacy of information available to consumers of insurance. It is imperative that state insurance commissioners actively and aggressively regulate and supervise the information given to consumers.

We look forward to working with you in a mutually constructive manner.

Very sincerely yours,

(Signed) Howard M. Metzenbaum

(Typed) Howard M. Metzenbaum,
Chairman, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, U.S. Senate.

Iowa Department of Commerce,
Insurance Devision,
June 1, 1993.

Hon. Howard M. Metzenbaum,
U.S. Senate, Washington, DC.

Dear Senator Metzenbaum: I just wanted to take a moment to thank you for the time and attention during the May 25th Oversight and Investigation hearing on Life Insurance Disclosure. I appreciated the opportunity to appear and testify on behalf of the NAIC, and it is my opinion that the increased attention which has been focused on Life Insurance Disclosures will result in significant advances in consumer protection nationwide.

During the Hearing, you expressed interest in several follow-up items from the NAIC. We will be following through with these items as noted below:

1) Your staff will be kept continually updated on the progress of the NAIC Life "A" Committee and its Life Disclosure Task Force. As I stated during my testimony, I think you will see very positive results this year.

2) We will review the issues involved with "internal replacement" of policies, to insure that the proper amendments to our existing Replacement Model have been made or are being considered.

3) I will send along a clean set of materials relating to the recently adopted disclosure protections for persons over 60 purchasing life insurance.

If there is any other information or follow-up you require, please feel free to contact me (or perhaps it is easiest for you to simply contact the NAIC office in Washington).

I would like to express my appreciation to your staff, and particularly Bonnie Goldstein, for all their work in preparation for a positive hearing. They were extremely professional and efficient.

Very truly yours,

(Singned) David J. Lyons

(Typed) DAVID J. LYONS,
Recording Secretary, NAIC, and
Commissioner of Insurance of the State of Iowa.

PREPARED ON SEP 13, 1984 BY THE PRUDENTIAL INSURANCE COMPANY OF AMERICA FOR USE IN CALIFORNIA

SIC 258 0300 0004

LEDGER STATEMENT

DAN SCHLESINGER
211 BABOA
SANTA BARBARA CA 93109

COVERAGE AND PREMIUM FOR A MALE
AGE 30, PREFERRED, ESTATE
INCLUDES WAIVER OF PREMIUM BENEFIT

ANNUAL PREMIUM PAYMENT SCHEDULE:

FIRST 35 YEARS	$1,232.00
AFTER 35 YEARS	1,182.00

	INITIAL ANNUAL PREMIUM
$100,000 LIFE BUILDER WHOLE LIFE POLICY	$1,232.00

DIVIDEND* USAGE ILLUSTRATED:

ACCUMULATE AT INTEREST

DISCUSS YOUR TOTAL
NEEDS WITH YOUR AGENT

PRESENTED BY:

E RUSSELL SMITH (PHONE 805-497-3713)
325 EAST HILLCREST DR. THOUSAND OAKS CA 91360

OFFICE BKFX CASE #" 131843

PAGE 1 OF 5

MALE AGE 30,PREFERRED,WP INIT ANNUAL PREM DIVDS ACCUMULATE
$100,000 DEATH BENEFIT $1,232.00

	POL YEAR -A-	ANNUAL PREMIUM -B-	GUARANTEED BASIS INTEREST RATE 4.00% CONTRACT FUND -C1-	CASH VALUE -C2-	DEATH BENEFIT -D-	ILLUSTRATIVE BASIS* ASSUMED INTEREST RATE 12.00% CONTRACT FUND -E1-		CASH VALUE -E2-	DEATH BENEFIT -F-
	1	1,232	929	0	100,000	950		21	100,000
	2	1,232	1,893	151	100,000	2,009		267	100,093
	3	1,232	2,891	1,127	100,000	3,191		1,427	100,502
	4	1,232	3,921	2,157	100,000	4,505		2,741	101,250
	5	1,232	4,986	3,241	100,000	5,968		4,223	102,360
6160	6	1,232	6,083	4,501	100,000	7,594	7392	6,012	103,837
	7	1,232	7,213	5,770	100,000	9,402	8624	7,959	105,713
	8	1,232	8,375	7,119	100,000	11,411	9856	10,155	108,007
	9	1,232	9,569	8,612	100,000	13,642	11088	12,685	110,747
12,320	10	1,232	10,794	10,146	100,000	16,118		15,470	113,954
	11	1,232	12,048	11,687	100,000	18,865		18,504	117,661
	12	1,232	13,332	13,332	100,000	21,914		21,914	121,902
	13	1,232	14,647	14,647	100,000	25,296		25,496	126,708
	14	1,232	15,992	15,992	100,000	29,048		29,448	132,312
18480	15	1,232	17,368	17,368	100,000	33,210		33,867	138,559
	16	1,232	18,774	18,774	100,000	37,828		38,788	145,546
	17	1,232	20,211	20,211	100,000	42,954		44,272	153,316
	18	1,232	21,680	21,680	100,000	48,646		50,486	161,937
23408	19	1,232	23,181	23,181	100,000	54,966		57,303	171,576
24640	20	1,232	24,714	24,714	100,000	61,982		64,905	182,110
43120	AGE 65	1,232	50,179	50,179	100,000	324,945		354,474	535,524
	AGE 73	1,182	64,110	64,110	100,000	735,242		819,898	1,027,823

SURRENDER INFORMATION

INTEREST RATE CREDITED -1-	AGE -2-	CASH VALUE -3-	PREMIUMS PAID -4-	NET RESULT COL 3 LESS COL 4 -5-	YEARLY LIFE INCOME (10 YEARS CERTAIN) GUAR. ANNUITY RATE (1/12TH PER MONTH) -6-	CURR. ANNUITY RATE (1/12TH PER MONTH) -7-
4.00%	65	50,179	43,120	7,059	3,450	5,371
	73	64,110	52,576	11,534	5,355	7,793
12.00%*	65	354,474	43,120	311,354	24,374	37,943
	73	819,898	52,576	767,322	68,478	99,667

MODAL PREMIUMS	ANNUAL	SEMI-ANNUAL	QUARTERLY	MONTHLY
FIRST 35	$1,232.00	$624.00	$315.00	$107.00
AFTER 35 YEARS	1,182.00	598.00	302.00	102.00

LIFE INSURANCE SURRENDER COST INDEXES* PER $1,000 AT 5% INTEREST

	10 YEARS	20 YEARS
GUARANTEED BASIS		
SURRENDER INDEX	$4.64	$5.20
CURRENT BASIS*		
SURRENDER INDEX	$.58	$(5.37)

INDEXES INCLUDE WAIVER OF PREMIUM BENEFIT

COST INDEXES ARE USEFUL ONLY FOR COMPARING RELATIVE COSTS OF TWO OR MORE SIMILAR POLICIES. GUARANTEED BASIS INDEXES ARE BASED ON THE GUARANTEED 4.00% INTEREST RATE CREDITED ON THE CONTRACT FUND. CURRENT BASIS* INDEXES ARE BASED ON THE ASSUMPTION THAT PRUDENTIAL'S CURRENT RATE OF INTEREST WILL BE CREDITED ON THE CONTRACT FUND.

EXPLANATORY NOTES ARE CONTINUED ON PAGE 3A.

EXPLANATORY NOTES:

*DIVIDEND AMOUNTS ARE INCLUDED ON THE BASIS OF THE CURRENT PRUDENTIAL SCALE AND ARE NOT GUARANTEES OR ESTIMATES FOR THE FUTURE. THE FIRST ANNUAL DIVIDEND FOR THE BASIC POLICY IS EXPECTED AT THE END OF THE 15TH POLICY YEAR. A TERMINATION DIVIDEND IS FIRST ILLUSTRATED UPON CASH SURRENDER OR DEATH AT THE END OF THE 13TH POLICY YEAR. ANY AMOUNTS INDICATED AS 'GUARANTEED' ARE BASED ON RATES CONTAINED IN THE POLICY. THOSE AMOUNTS DESIGNATED 'ILLUSTRATIVE' INCLUDE DIVIDENDS ON THE BASIS OF THE CURRENT PRUDENTIAL SCALE AND ARE BASED ON THE ASSUMPTION THAT THE ILLUSTRATIVE NON-GUARANTEED RATES OF INTEREST SHOWN BELOW WILL BE CREDITED TO THE CONTRACT FUND AND OUR CURRENT MORTALITY RATES WILL APPLY.

THE CONTRACT FUND IS EQUAL TO THE FUNDING PREMIUMS RECEIVED, PLUS INTEREST MINUS MORTALITY CHARGES AND ANY WITHDRAWALS. THE FUNDING PREMIUM IS THAT PORTION OF THE PREMIUM PAID THAT IS ADDED TO THE CONTRACT FUND. IT IS EQUAL TO THE TOTAL PREMIUM PAID MINUS THE FOLLOWING: THE POLICY CONSTANT, THE PREMIUM FOR ANY RIDER OR SUPPLEMENTARY BENEFIT, ANY ADDITIONAL PREMIUMS, AND THE EXPENSE CHARGE. THE INITIAL POLICY YEAR EXPENSE CHARGE IS 7.52% OF THE OF THE BASIC POLICY PREMIUM OF $1,152.00.

INTEREST RATES ILLUSTRATED FOR THE CONTRACT FUND:

GUARANTEED BASIS -- 4.00% GUARANTEED INTEREST RATE
ILLUSTRATIVE BASIS -- 6.00% ON FIRST $1,000 OF CONTRACT FUND
12.00% ON BALANCE OF CONTRACT FUND

AN ILLUSTRATION BASED ON PRUDENTIAL'S CURRENT INTEREST RATE OF 12.00% ON THE BALANCE OF THE CONTRACT FUND IS AVAILABLE UPON REQUEST.
ANNUAL PREMIUM PAYMENTS ARE ASSUMED. PREMIUM PAYMENTS AND DEATH BENEFIT AMOUNTS ARE AS OF THE BEGINNING OF EACH POLICY YEAR. CONTRACT FUNDS, CASH VALUES, AND DIVIDENDS BECOME AVAILABLE AT THE END OF THE POLICY YEAR ILLUSTRATED. EXCEPT FOR SURRENDER COST INDEXES, COST RESULTS DO NOT REFLECT THAT, BECAUSE OF INTEREST, A DOLLAR PAYABLE IN THE FUTURE HAS LESS VALUE THAN ONE PAYABLE TODAY.

ANY FIGURES WITHIN PARENTHESES REPRESENT NEGATIVE AMOUNTS.

THIS ILLUSTRATION ASSUMES THAT NO POLICY LOANS OR WITHDRAWALS ARE MADE.

ABBREVIATED PAYMENT ALTERNATIVE $100,000 DEATH BENEFIT DIVDS TO ACCUM

POL YEAR -A-	ANNUAL PAYMENT* -B-	GUARANTEED BASIS ------ INTEREST RATE 4.00% ------ CONTRACT FUND -C1-	CASH VALUE -C2-	DEATH BENEFIT -D-	ILLUSTRATIVE BASIS* -- ASSUMED INTEREST RATE 12.00% --- CONTRACT FUND -E1-	CASH VALUE -E2-	DEATH BENEFIT -F-
1	1,232	929	0	100,000	950	21	100,000
2	1,232	1,893	151	100,000	2,009	267	100,093
3	1,232	2,891	1,127	100,000	3,191	1,427	100,502
4	1,232	3,921	2,157	100,000	4,505	2,741	101,250
5	1,232	4,986	3,241	100,000	5,968	4,223	102,360
6	1,232	6,083	4,501	100,000	7,594	6,012	103,837
7	1,232	7,213	5,770	100,000	9,402	7,959	105,713
8	1,232	8,375	7,119	100,000	11,411	10,155	108,007
9	0	9,569	8,612	100,000	12,270	11,313	106,386
10	0	10,794	10,146	100,000	13,221	12,573	105,035
11	0	12,048	11,687	100,000	14,271	13,910	103,964
12	0	13,332	13,332	100,000	15,432	15,432	103,184
13	0	14,647	14,647	100,000	16,716	16,916	102,702
14	0	15,992	15,992	100,000	18,136	18,536	102,724
15	0	17,368	17,368	100,000	19,707	20,349	103,066
16	0	18,774	18,774	100,000	21,493	22,367	103,898
17	0	20,211	20,211	100,000	23,508	24,613	105,163
18	0	21,680	21,680	100,000	25,779	27,216	106,890
19	0	23,181	23,181	100,000	28,333	30,005	109,207
20	0	24,714	24,714	100,000	31,206	33,114	111,943
AGE 65	0	50,179	50,179	100,000	146,327	150,033	242,753
AGE 73	0	64,110	64,110	100,000	334,681	342,138	446,093

DAN SCHLESINGER OFFICE BKFX CASE # 131843 PAGE 4 OF 5

EXPLANATION OF THE ABBREVIATED PAYMENT PLAN

THE ABBREVIATED PAYMENT PLAN IS A WAY OF PURCHASING PERMANENT LIFE INSURANCE WITHOUT THE NEED FOR A PROLONGED OUT-OF-POCKET PREMIUM PAYMENT COMMITMENT. UNDER THIS PLAN, PREMIUMS ARE PAID IN CASH UNTIL FUTURE DIVIDENDS AND DIVIDENDS ALREADY ACCUMULATED PLUS PAST AND FUTURE EXCESS INVESTMENT RETURNS, ARE SUFFICIENT TO PAY THE REMAINING PREMIUMS ON AN ANNUAL MODE. AT THAT TIME, THE CLIENT MUST SUBMIT A REQUEST FOR THE NECESSARY WITHDRAWAL OF ACCUMULATED DIVIDENDS AND CONTRACT FUNDS, AND FOR A CHANGE OF PREMIUM PAYMENT MODE TO ANNUAL.

THE DIVIDENDS USED IN THIS ILLUSTRATION ARE BASED ON THE CURRENT NON-GUARANTEED SCALE AND THE VALUES ARE BASED ON HYPOTHETICAL INVESTMENT RESULTS WHICH ARE NOT GUARANTEED. ACTUAL RESULTS WHICH ARE MORE OR LESS FAVORABLE THAN THOSE ILLUSTRATED MAY REQUIRE CASH PREMIUM PAYMENTS FOR A SHORTER OR LONGER PERIOD. AFTER CASH PAYMENTS STOP, ANY FURTHER UNFAVORABLE RESULTS COULD POSSIBLY REQUIRE THEIR RESUMPTION. ALSO, CASH PREMIUM PAYMENTS MUST BE MADE FOR A LONGER PERIOD OF YEARS IF DIVIDENDS ARE WITHDRAWN PREMATURELY, OR IF A LOAN IS TAKEN ON THE CONTRACT.

GUARANTEED CASH VALUES AND GUARANTEED DEATH BENEFITS ARE NOT REDUCED UNDER THE ABBREVIATED PAYMENT PLAN.

SURRENDER INFORMATION

INTEREST RATE CREDITED -1-	AGE -2-	CASH VALUE -3-	PREMIUMS PAID -4-	NET RESULT COL 3 LESS COL 4 -5-	YEARLY LIFE INCOME (10 YEARS CERTAIN) GUAR. ANNUITY RATE (1/12TH PER MONTH) -6-	CURR. ANNUITY RATE (1/12TH PER MONTH) -7-
12.00%*	65	150,033	9,856	140,177	10,316	16,059
	73	342,138	9,856	332,282	28,575	41,590

BANNER LIFE INSURANCE COMPANY SUMMARY

L I F E U M B R E L L A S T E R L I N G I I

PRESENTED BY: PHONE:
AGENCY:
ADDRESS:

BASIC INSURED: DIANA L. LEE
AGE: 56 FEMALE PREFERRED
SPECIFIED AMOUNT: $ 150000
OPTION B LEVEL
PREMIUMS:
1035 EXCHANGE ROLL-OVER: $ 12203.00
ANNUAL PREMIUM: $ 1317.00
GUIDELINE PREMIUMS - SINGLE: $ 43684.79 LEVEL: $ 4039.36
MODIFIED ENDOWMENT 7-PAY PREMIUM: $ 7981.49

SUMMARY OF VALUES

			MORTALITY - CURRENT INTEREST - GUARANTEED - 4%			MORTALITY - CURRENT INTEREST - CURRENT - 8.00%		
AGE	PLAN YEAR	TOTAL ANNUAL PREMIUMS	NET ACCOUNT VALUE	NET CASH SURRENDER VALUE	NET DEATH BENEFIT	NET ACCOUNT VALUE	NET CASH SURRENDER VALUE	NET DEATH BENEFIT
61	5	18788.00	17089	11571	150000	21018	15499	150000
66	10	25373.00	25208	25208	90000	37276	37276	90000
71	15	31958.00	34551	34551	90000	62365	62365	90000
76	20	38543.00	44665	44665	90000	101719	101719	106805
81	25	45128.00	55131	55131	90000	161662	161662	169746
86	30	51713.00	65996	65996	90000	250889	250889	263434
91	35	53030.00	71498	71498	90000	375182	375182	393941
96	40	53030.00	71186	71186	90000	563972	563972	563972
100	44	53030.00	21650	21650	90000	792841	792841	792841
65	9	24056.00	23458	22355	90000	33412	32308	90000

THIS PROPOSAL IS NOT A CONTRACT. IT IS FOR ILLUSTRATION PURPOSES ONLY

CA - C3.0a TX274800/MX204600

BANNER LIFE INSURANCE COMPANY SUMMARY

L I F E U M B R E L L A S T E R L I N G I I

PRESENTED BY: PHONE:
AGENCY:
ADDRESS:

BASIC INSURED: DIANA L. LEE
AGE: 56 FEMALE PREFERRED
SPECIFIED AMOUNT: $ 150000
OPTION B LEVEL
PREMIUMS:
INITIAL LUMP SUM PAYMENT: $ 15240.00
ANNUAL PREMIUM: $ 1317.00
GUIDELINE PREMIUMS - SINGLE: $ 43684.79 LEVEL: $ 4089.38
MODIFIED ENDOWMENT 7-PAY PREMIUM: $ 9970.17

1st yr premium has to be paid, Otherwise, this proposal does not match

THE POLICY BECAME A MODIFIED ENDOWMENT CONTRACT IN YEAR 1

SUMMARY OF VALUES

NOT 7.81

			MORTALITY - CURRENT INTEREST - GUARANTEED - 4%			MORTALITY - CURRENT INTEREST - CURRENT - 11.50%		
AGE	PLAN YEAR	TOTAL ANNUAL PREMIUMS	NET ACCOUNT VALUE	NET CASH SURRENDER VALUE	NET DEATH BENEFIT	NET ACCOUNT VALUE	NET CASH SURRENDER VALUE	NET DEATH BENEFIT
61	5	21825.00	20798	15280	150000	30017	24499	150000
66	10	28410.00	28236	28236	150000	58183	58183	150000
71	15	34995.00	35216	35216	150000	108187	108187	150000
76	20	41580.00	40045	40045	150000	199840	199840	209832
80	24	46848.00	39559	39559	150000	322309	322309	338425
65	9	27093.00	26769	25666	150000	51239	50135	150000

THIS PROPOSAL IS NOT A CONTRACT. IT IS FOR ILLUSTRATION PURPOSES ONLY

CA - C3.0a TX274800/MX204600

National Life of Vermont

THE CHICAGO AGENCY—222 W. Adams Street, Suite 900, CHICAGO, IL 60606, 312-236-2500

Scott Freberg

PREPARED FOR: GARY A. GOTTFRIED
BY: SCOTT FREBERG & AL POMERANTZ

PEP Age	ADDITIONAL CASH OUTLAY	TOTAL CASH VALUE	NET CASH	DEATH BENEFIT
47	$ 298	$ 6,748	$ 6,450	$25,537
50	894	8,428	7,534	29,935
55	2,384	11,854	9,470	33,400
60	3,874	16,176	12,302	37,617
65	5,339	21,467	16,128	42,494
70	6,804	27,695	20,891	48,219
75	8,204	34,958	26,754	54,914

*Dividends continue to buy additions.

APEX Age	ADDITIONAL CASH OUTLAY	TOTAL CASH VALUE	NET GAIN	DEATH BENEFIT
47	$6,508	$ 5,596	$ (912)	$100,788
50	0	6,676	6,676	75,000
55	0	9,066	9,066	75,000
60	0	12,639	12,639	75,000
65	0	18,207	18,207	75,457
70	0	24,762	24,762	75,716
75	0	33,329	33,329	75,773

*Capital transfer $6,508 from Policy #1317464.

DIVIDENDS APPLIED TO PURCHASE ONE YEAR TERM INSURANCE
ANY BALANCE TO PURCHASE PAID-UP ADDITIONS

PREPARED FOR
LU TIEN-CHU
AGE 50M
PRESENTED BY
RANDAL W ROGERS

PLAN - $50,000 WHOLE LIFE

YEAR	BASIC PLAN YEARLY PREMIUM	DIVIDEND END OF PRIOR YEAR*	ONE YEAR TERM INSURANCE AMOUNT*	ONE YEAR TERM INSURANCE COST*	TOTAL PAID-UP DIVIDEND ADDI-TIONS BEG. YR*	TOTAL DEATH BENEFIT *++
1	$1,819					$50,000
2	1,819					50,000
3	1,819	$151	$2,750	$25	$299	53,049
4	1,819	214	4,100	41	700	54,800
5	1,819	280	5,450	59	1,195	56,645
6	1,819	375	6,850	81	1,834	58,684
7	1,819	454	8,200	107	2,568	60,768
8	1,819	533	9,650	138	3,380	63,030
9	1,819	614	11,050	173	4,262	65,312
10	1,819	696	12,450	213	5,201	67,651
11	1,819	779	13,800	259	6,186	70,361
12	1,819	865	15,100	311	7,209	72,709
13	1,819	952	16,450	371	8,254	75,179
14	1,819	1,041	17,800	440	9,308	77,683
15	1,819	1,129	19,150	518	10,354	80,179
16	1,819	1,221	20,550	609	11,376	82,701
17	1,819	1.313	21,900	710	12,360	85,135
18	1,819	1,407	23,300	828	13,286	87,586
19	1,819	1,501	24,700	961	14,130	89,955
20	1,819	1,591	26,100	1,112	14,864	92,214
26	1,819	2,191	31,900	2,186	17,607	101,132
27	1,819	2,235	30,226	2,235	17,607	99,508
28	1,819	2,277	28,446	2,277	17,607	97,778
29	1,819	2,317	26,659	2,317	17,607	96,041
30	1,819	2,357	24,944	2,357	17,607	94,376
31	1,819	2,395	23,322	2,395	17,607	92,804
AT 60	1,819	696	12,450	213	5,201	67,651
AT 62	1,819	865	15,100	311	7,209	72,709
AT 65	1,819	1,129	19,150	518	10,354	80,179

PREMIUM RATES - STANDARD RISK BASIS

	ANNUAL PREMIUM	WP BENEFIT PREMIUM	TO AGE
$50,000 WHOLE LIFE	$1,818.50	$94.50	65
50,000 ACCIDENTAL DEATH BENEFIT TO AGE 70	48.00		

NOT FOR USE IN COST COMPARISONS. DIVIDENDS ARE NOT GUARANTEED.
* ++FOR EXPLANATIONS AND FOOTNOTES, SEE FORM 11525 ON REVERSE.
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DIVIDENDS APPLIED TO PURCHASE ONE YEAR TERM INSURANCE
ANY BALANCE TO PURCHASE PAID-UP ADDITIONS

PREPARED FOR. PRESENTED BY
LU TIEN-CHU AGE 50M RANDAL W ROGERS

PLAN - $50,000 WHOLE LIFE

YEAR	GUARAN-TEED CASH VALUE	CASH VALUE OF PAID-UP ADDI-TIONS*	TOTAL CASH VALUE*++	TOTAL BASIC PLAN YEARLY PREMIUMS	TOTAL PAID-UP INSUR-ANCE AVAIL-ABLE*
1	$100		$100	$1,819	$250
2	1,400	$151	1,551	3,637	3,181
3	2,750	344	3,094	5,456	6,166
4	4,100	592	4,692	7,274	9,088
5	5,450	925	6,375	9,093	12,002
6	6,850	1,321	8,171	10,911	14,959
7	8,200	1,783	9,983	12,730	17,778
8	9,650	2,307	11,957	14,548	20,716
9	11,050	2,891	13,941	16,367	23,511
10	12,450	3,531	16,356	18,185	26,528
11	13,800	4,224	18,424	20,004	29,089
12	15,100	4,968	20,543	21,822	31,531
13	16,450	5,754	22,779	23,641	33,977
14	17,800	6,574	25,049	25,459	36,323
15	19,150	7,423	27,348	27,278	38,562
16	20,550	8,275	29,700	29,096	40,731
17	21,900	9,144	32,044	30,915	42,722
18	23,300	10,004	34,429	32,733	44,628
19	24,700	10,818	36,768	34,552	46,340
20	26,100	11,580	39,055	36,370	47,853
26	31,900	15,282	48,857	47,281	56,179
27	32,800	15,535	50,060	49,100	57,011
28	33,650	15,768	51,193	50,918	57,762
29	34,500	16,020	52,345	52,737	58,537
30	35,350	16,252	53,477	54,555	59,297
31	36,100	16,465	54,440	56,374	59,932
AT 60	12,450	3,531	16,356	18,185	26,528
AT 62	15,100	4,968	20,543	21,822	31,531
AT 65	19,150	7,423	27,348	27,278	38,562

AT AGE 65 TOTAL CASH OF $27,348 PROVIDES MONTHLY LIFE INCOME (AT LEAST YEARS) OF $170 AT GUARANTEED RATE OR $238 AT CURRENT ANNUITY RATE**+

NOT FOR USE IN COST COMPARISONS. DIVIDENDS ARE NOT GUARANTEED.
* ++***FOR EXPLANATIONS AND FOOTNOTES, SEE FORM 11525 ON REVERSE.
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DIVIDENDS APPLIED TO PURCHASE ONE YEAR TERM INSURANCE
ANY BALANCE TO PURCHASE PAID-UP ADDITIONS

PREPARED FOR LU TIEN-CHU — AGE 50M — PRESENTED BY RANDAL W ROGERS

PLAN - $25,000 WHOLE LIFE AND
$25,000 5 YEAR NON-RENEWABLE LEVEL TERM INSURANCE BENEFIT

YEAR	BASIC PLAN AND TERM RIDER YEARLY PREMIUM	DIVIDEND END OF PRIOR YEAR*	ONE YEAR TERM INSURANCE AMOUNT*	ONE YEAR TERM INSURANCE COST*	TERM RIDER DEATH BENEFIT	TOTAL PAID-UP DIVIDEND ADDITIONS BEG. YR*	TOTAL DEATH BENEFIT *++
1	$1,276				$25,000		$50,000
2	1,276				25,000		50,000
3	1,276	$185	$1,375	$12	25,000	$411	51,786
4	1,276	226	2,050	20	25,000	887	52,937
5	1,276	269	2,725	30	25,000	1,424	54,149
6	970	329	3,425	41		2,052	30,477
7	970	242	4,100	53		2,451	31,551
8	970	282	4,825	69		2,890	32,715
9	970	324	5,525	86		3,365	33,890
10	970	366	6,225	107		3,870	35,095
11	970	409	6,900	130		4,399	36,487
12	970	453	7,550	155		4,948	37,698
13	970	498	8,225	186		5,509	38,972
14	970	543	8,900	220		6,076	40,264
15	970	589	9,575	259		6,640	41,553
16	970	636	10,275	305		7,194	42,857
17	970	683	10,950	355		7,730	44,118
18	970	732	11,650	414		8,233	45,398
19	970	780	12,350	481		8,707	46,620
20	970	827	13,050	556		9,122	47,797
26	970	1,137	15,950	1,093		10,816	52,579
27	970	1,162	15,709	1,162		10,816	52,363
28	970	1,183	14,782	1,183		10,816	51,461
29	970	1,204	13,851	1,204		10,816	50,555
30	970	1,225	12,959	1,225		10,816	49,688
31	970	1,244	12,115	1,244		10,816	48,867
AT 60	970	366	6,225	107		3,870	35,095
AT 62	970	453	7,550	155		4,948	37,698
AT 65	970	589	9,575	259		6,640	41,553

PREMIUM RATES - STANDARD RISK BASIS

		MONTHLY PREMIUM	WP BENEFIT PREMIUM	TO AGE
$25,000 WHOLE LIFE		$80.80	$4.00	65
25,000 ACCIDENTAL DEATH BENEFIT	TO AGE 70	2.00		
25,000 5 YR LEVEL TERM BENEFIT	TO AGE 55	25.50	2.50	55

NOT FOR USE IN COST COMPARISONS. DIVIDENDS ARE NOT GUARANTEED.
*++FOR EXPLANATIONS AND FOOTNOTES, SEE FORM 11525 ON REVERSE.
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DIVIDENDS APPLIED TO PURCHASE ONE YEAR TERM INSURANCE
ANY BALANCE TO PURCHASE PAID-UP ADDITIONS

PREPARED FOR
LU TIEN-CHU AGE 50M

PRESENTED BY
RANDAL W ROGERS

PLAN - $25,000 WHOLE LIFE AND
$25,000 5 YEAR NON-RENEWABLE LEVEL TERM INSURANCE BENEFIT

YEAR	GUARAN-TEED CASH VALUE	CASH VALUE OF PAID-UP ADDI-TIONS*	TOTAL CASH VALUE*++	PLAN AND TERM RIDER TOTAL YEARLY PREMIUMS	TOTAL PAID-UP INSUR-ANCE AVAIL-ABLE*
1	$50		$50	$1,276	$125
2	700	$185	885	2,551	1,815
3	1,375	404	1,779	3,827	3,546
4	2,050	665	2,715	5,102	5,253
5	2,725	984	3,709	6,378	6,984
6	3,425	1,213	4,638	7,348	8,490
7	4,100	1,476	5,576	8,317	9,930
8	4,825	1,772	6,597	9,287	11,430
9	5,525	2,099	7,624	10,256	12,858
10	6,225	2,456	8,869	11,226	14,384
11	6,900	2,842	9,942	12,196	15,696
12	7,550	3,254	11,041	13,165	16,947
13	8,225	3,689	12,201	14,135	18,200
14	8,900	4,143	13,380	15,104	19,402
15	9,575	4,613	14,576	16,074	20,552
16	10,275	5,086	15,798	17,044	21,666
17	10,950	5,571	17,021	18,013	22,692
18	11,650	6,053	18,265	18,983	23,676
19	12,350	6,513	19,488	19,952	24,561
20	13,050	6,948	20,686	20,922	25,358
26	15,950	9,176	25,964	26,740	29,917
27	16,400	9,327	26,590	27,709	30,346
28	16,825	9,467	27,180	28,679	30,731
29	17,250	9,618	27,780	29,648	31,132
30	17,675	9,756	28,369	30,618	31,522
31	18,050	9,884	28,871	31,588	31,848
AT 60	6,225	2,456	8,869	11,226	14,384
AT 62	7,550	3,254	11,041	13,165	16,947
AT 65	9,575	4,613	14,576	16,074	20,552

AT AGE 65 TOTAL CASH OF $14,576 PROVIDES MONTHLY LIFE INCOME (AT LEAST 10 YEARS) OF $90 AT GUARANTEED RATE OR $124 AT CURRENT ANNUITY RATE**++

NOT FOR USE IN COST COMPARISONS. DIVIDENDS ARE NOT GUARANTEED.
* ++ **FOR EXPLANATIONS AND FOOTNOTES, SEE FORM 11525 ON REVERSE.
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NEW YORK LIFE INSURANCE COMPANY

16614(579)

Press release

Office of Fair Trading

No 18/93

18 March 1993

REPORTS ON LIFE INSURANCE INDUSTRY PUBLISHED

Sir Bryan Carsberg calls for better information for consumers

Sir Bryan Carsberg, Director General of Fair Trading, today called on the life insurance industry to make more information available to consumers.

He has published two reports: The Financial Services Act (FSA) Report* and The Fair Trading Act (FTA) Report ** (summaries attached).

The FSA Report to the Chancellor of the Exchequer follows the Director General's scrutiny of the regulations covering the marketing and sale of investment products linked to life insurance.

It concludes that certain rules of the Securities and Investments Board (SIB) and the Life Assurance and Unit Trust Regulatory Organisation (LAUTRO), have, or are likely to have, the effect of restricting or distorting competition to a significant extent.

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* The Marketing and Sale of Investment-Linked Insurance Products: The Rules of the Securities and Investments Board and the Life Assurance and Unit Trust Regulatory Organisation

** Fair Trading and Life Insurance Products : A Report by the Director General of Fair Trading

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The FTA Report is a more general report, bringing out the widely differing charges, surrender penalties and selling practices of different companies, and the effects these have on policy holders. It recommends more and better disclosure so that investors can be better informed and the competitive process made more effective.

Sir Bryan said:

'Under the Financial Services Act 1986, I am charged with examining the rules of SIB and LAUTRO, among other bodies responsible for the regulation of investment business. My task is to assess whether the effects of these rules are, or are likely to be, significantly anti-competitive.

'Last year, following a review initiated by the Government's response to my predecessor's report on this subject, SIB and LAUTRO introduced new rules. These rules were designed not to come into effect until I advised the Chancellor on their effects on competition. I give that advice today.

'In this report, I conclude that, while there have been useful improvements to the rules, four sets of rules have, or are likely to have, significantly anti-competitive effects. The rules relate to:

(i) disclosure of surrender values in the later years of a policy;

(ii) disclosure of the effect of charges in illustrations of future investment returns;

(iii) differential pricing amongst tied outlets; and

(iv) disclosure of commissions by independent financial advisers.

'When he has had time to consider my report, the Chancellor will wish to decide whether to seek further changes to the rules.

'My legal functions do not enable me to comment in the FSA report on rules which are absent or lacking, even though I may have identified areas where specific improvements would be desirable.

'I decided, therefore, to make a separate, more wide-ranging report under the responsibilities conferred on me by the Fair Trading Act 1973.

'In the FTA Report, I make it clear that consumers should be able to compare projected cash returns on different policies, taking into account charges and the surrender penalty practices of each company. The cost of life cover should be stated to enable the consumer separately to identify the investment element and to compare projected returns with those available on other products.'

Sir Bryan called for a rule requiring the publication of the persistency rates of companies, so as to indicate the proportion of each company's policies continuing after a particular period. This would restrain over-selling and indicate to consumers which companies took care to sell appropriate products.

He put forward his own ideas on these matters in an illustrative disclosure statement and called upon SIB, LAUTRO and the industry to respond constructively to the report by taking up the ideas contained therein in the further development of their rules and practices.

Linking the two reports together, Sir Bryan added:

'We now have the opportunity to make a step change in the quality of information made available to consumers in the marketing and sale of life insurance products. I feel confident that the industry and its regulators will rise to the challenge.'

NOTES FOR EDITORS

The Financial Services Act Report

1. Under section 122(4) of the Financial Services Act, the Director General is required to keep under review the rules of SIB and LAUTRO, and other Self-Regulating Organisations (SROs) in the financial services area. If, at any time, he is of the opinion that any such rules have, or are intended or likely to have, the effect of restricting, distorting or preventing competition to any significant extent he is required to report this to the Chancellor. Under section 122(5) he may also report if, in his opinion, any changes to these rules do not have, and are not intended or likely to have, any such effects.

2. Under section 119(2) and (3) and section 122(7), the Chancellor, after receiving the Director General's report, takes a view on whether the rules have, or are intended or likely to have, to a significant extent the effect of restricting, distorting or preventing competition; and, if so, whether that effect is greater that is necessary for the protection of investors. If he reaches an adverse conclusion on the rules on both grounds, he has certain powers to direct SIB and LAUTRO to alter their rules, or himself to make alterations to their rules; or, ultimately, to revoke the recognition of SIB and LAUTRO.

3. The former Director General made a report on the life insurance element of investment retailing in April 1990. The Government then asked SIB to make changes to its rules. SIB initiated a full retail regulation review in April 1991.

4. SIB published its rule changes on 22 July in their Release 118 The Financial Services (Miscellaneous Amendments) (No 21) Rules and Regulations 1992.

5. LAUTRO published its rule changes on 22 July in their Rules Bulletin No 53 LAUTRO (Disclosure of Status) Rules 1992 and LAUTRO (Product Disclosure) Rules 1992.

6. The Director General also made available today the independent research work entitled 'IFAs and the Impact of Commission Disclosure' which was undertaken for the Office by London Economics last year.

7. Copies of the Director General's report on the SIB and LAUTRO rules, and London Economics research work, may be obtained from Mr Jayatilleke on 071 269 8794.

The Fair Trading Act Report

8. Under section 2 of the Fair Trading Act 1973, the Director General is required to keep under review the carrying on of commercial activities in the United Kingdom that may adversely affect the economic interests of consumers. Under section 125(4) of the same Act he also has power to make reports - in addition to the annual report of his activities to the Secretary of State - in respect of any of his duties.

9. Copies of the Director General's report on Fair Trading and Life Insurance may be obtained from Mr Arnopp on 071 269 8816.

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FINANCIAL SERVICES ACT 1986

THE MARKETING AND SALE OF INVESTMENT-LINKED INSURANCE PRODUCTS

THE RULES OF THE SECURITIES AND INVESTMENTS BOARD (SIB) AND THE LIFE ASSURANCE AND UNIT TRUST REGULATORY ORGANISATION (LAUTRO)

A report by the Director General of Fair Trading

SUMMARY

1. In this report, the Director General sets out his findings from a wide-ranging review of the rules of SIB and LAUTRO, both the rule changes made last May and July, and the rules which have not been changed. There are a number of minor rule changes on which he has not commented because they did not appear to him to raise significant new or unresolved competition issues.

2. The process of settling a stable regime for life products has been a long one, and much progress has been made. But the markets are complex: life offices compete with each other and with other providers of investment products; tied agents compete with each other and with independent financial advisers (IFAs) in the retail market; and IFAs compete with each other in the advice market.

3. Competition can take place most effectively when investors have access to information of the right type and extent, at the right time, and in an understandable form. Timing of provision of information is particularly important: investors must have information at an early stage, because the range of potential choice is then widest, the level of commitment lowest. The framework in which investors' decisions are made calls for them to be able to estimate as closely as possible the payments they are to make, the impact of factors affecting receipts, and the likelihood of those factors and receipts arising. If material information likely to influence the investor's decision is not made available there could be significantly anti-competitive effects.

4. Among the strengthened rules on the disclosure of an intermediary's status, and the new rules on the disclosure of product details, which augment the amount and quality of information to be disclosed to an investor early in the selling process, the Director General does not find any significantly anti-competitive effects.

5. He does, however, do so in respect of the rules which prevent disclosure of indications of surrender values beyond a five year period. The wide variety of life offices' practices, and their effects on surrender values in later years, are such that the pattern of surrender values and their relationships to the sum assured vary significantly from office to office. Payments to a policyholder on surrender in later years are possible cash receipts from the policy and hence relevant to a decision on whether or not to buy the policy in question or indeed any life product. In limiting the investor's ability to make good choices among the products of different life offices and between life products and other investments, the rules are likely to restrict and distort competition in these markets to a significant extent.

6. He also makes such a finding in respect of the rules which require illustrations of possible future returns on investment to be based on standard levels of costs, as opposed to a life office's own costs, while requiring a separate form of disclosure of the office's own costs. Life offices' charges can have a significant bearing on product performance over time. The rules limit the ability of prospective investors to assess the effect of the life office's level of costs, because investors cannot calculate how the illustration would look if the office's current cost level was substituted for the standard level. In that investors will make different decisions from those they would make if they had better information, this is likely to restrict and distort competition among life offices to a significant extent.

7. The effect of the unchanged rules of SIB and LAUTRO on Best Advice, as they are currently interpreted, is to prevent a life office from offering a product at different prices through different tied outlets. There are, however, cost differentials among tied outlets which are not reflected in prices. By preventing life offices and their tied agents from reflecting in their prices to investors the different costs of distribution among tied agents, and hence limiting the likelihood that the most efficient means of distribution will prevail and reduce overall costs to investors, these rules restrict competition among life offices and tied outlets to a significant extent.

8. The rules of SIB and LAUTRO relating to the disclosure of commissions by IFAs have technically been replaced by new rules which are not different in their effect. They require IFAs to disclose commission at an early stage in the selling process only if asked to do so by the investor. Otherwise, the investor will receive such information only later, and from the life office rather than the IFA. The commissions which an IFA receives and which are paid for indirectly by the investor - for whom the IFA acts as agent - can be regarded as the price for the advice which the investor receives. Without early automatic disclosure of commissions, in actual cash amounts, an investor will not know the price of advice, and cannot compare it with that for the advice of other IFAs (including those remunerated by fees). The rules of SIB and LAUTRO serve to set the norm for conduct in this respect, and thus are likely to inhibit the provision by the adviser of information about the amount of commission earlier in the selling process. Without such disclosure, investors will not know the characteristics of the market in which they are dealing, and prices in that market, at a time when it could affect their decisions. This is likely to distort competition among IFAs and between them and other intermediaries to a significant extent.

MARCH 1993

FAIR TRADING ACT 1973

FAIR TRADING AND LIFE INSURANCE PRODUCTS

A report by the Director General of Fair Trading

SUMMARY

Main points

1. The report recommends greater transparency in the operations of the life insurance industry, particularly for regular premium life policies and personal pension plans.

2. The Director General proposes an illustrative disclosure statement which indicates the projected cash returns payable at maturity, on surrender at different stages of the policy, and on death. The statement also sets out the costs of life cover, details of charges and surrender penalties, and indicates their effects on the sums payable. The Director General also recommends that persistency rates of policies should be disclosed.

3. In addition to such an initial statement, annual "progress" statements should be provided to policyholders indicating company performances against the initial indications.

4. The Director General recognises that, even if such greater transparency were achieved, it would still have to be communicated to consumers in a useful and understandable form. He hoped the specialist financial newspapers would draw up industry-wide comparative tables of projected performances, and that the messages from such comparisons would be taken up by the more general press. But further steps may be needed.

5. It would be for SIB and LAUTRO to introduce regulatory requirements to implement the above proposals, insofar as they have powers to do so. The Director General encourages SIB and LAUTRO to introduce new disclosure requirements on the lines suggested, and a rule requiring the disclosure of persistency rates before the point of sale. It would be for SIB and LAUTRO to decide whether they have powers to require annual "progress" statements, but, if they do not, the Director General encourages the industry as a whole to adopt such statements on a voluntary basis.

The costs of life cover.

6. The report recommends that the costs of life cover should be disclosed. Often these costs amount to only a few % of premiums. Such disclosure would enable prospective policyholders separately to identify the investment element in these products and to compare the projected returns with those available on other financial products.

Charges.

7. Disclosure of specific charges would encourage competition in charging levels, and put more competitive pressure on high charge companies.

8. The report indicates the considerable potential advantage from taking a policy with a low charge company rather than a high charge company - an advantage amounting to up to 30% or 40% in terms of projected cash returns.

Surrender penalties.

9. Surrender penalties are a very important item of information for consumers. Overall, it seems that only a minority of consumers keep their policies to maturity, and consumers should therefore be very interested in surrender values. Yet surrender penalties are sometimes expressed obscurely, and in the case of with-profits products, they are not indicated at all.

10. Early surrender values vary sharply from company to company, and after 2 years of a policy may average under half the premiums paid. At that stage some companies pay nothing, while others pay towards 70% and even 90% of premiums paid.

11. There are similar variations in the surrender values of with-profits policies in later years. For example, at the 15 and 20 year stages of 25 year endowment policies, some major companies pay surrender values 30% above the industry average, while other major companies appear to impose very severe surrender penalties in paying around 30% below the industry average.

Persistency rates.

12. There are no authoritative figures on persistency rates, i.e. the proportion of policies that are being kept up after a particular period. The survey commissioned by SIB in 1991 indicated that persistency rates on regular premium policies after 2 years averaged only 70%.

13. Most companies have been reluctant to disclose their persistency rates to the specialist financial publications, but the rates disclosed indicate very wide variations between companies.

14. Persistency rates should be disclosed so that prospective policyholders can know which companies are taking most care to sell appropriate policies.

MARCH 1993

Office of Fair Trading

FINANCIAL SERVICES ACT 1986

THE MARKETING AND SALE OF INVESTMENT-LINKED INSURANCE PRODUCTS

THE RULES OF THE SECURITIES AND INVESTMENTS BOARD AND THE LIFE ASSURANCE AND UNIT TRUST REGULATORY ORGANISATION

A report by the Director General of Fair Trading to the Chancellor of the Exchequer

MARCH 1993

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From the Director General of Fair Trading
Sir Bryan Carsberg

The Rt Hon Norman Lamont, MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

Dear Chancellor,

FINANCIAL SERVICES ACT 1986:
THE RULES OF THE SECURITIES AND INVESTMENTS BOARD AND THE LIFE ASSURANCE AND UNIT TRUST REGULATORY ORGANISATION

Pursuant to section 122(4) and (5) of the Financial Services Act, I enclose a report on the rules of these bodies relating to the marketing and sale of investment-linked insurance products.

Yours sincerely

Bryan Carsberg

Sir Bryan Carsberg
Director General of Fair Trading

March 1993

FINANCIAL SERVICES ACT 1986

THE MARKETING AND SALE OF INVESTMENT-LINKED INSURANCE PRODUCTS

THE RULES OF THE SECURITIES AND INVESTMENTS BOARD AND THE LIFE ASSURANCE AND UNIT TRUST REGULATORY ORGANISATION

A report by the Director General of Fair Trading to the Chancellor of the Exchequer

MARCH 1993

CONTENTS

PART 1: INTRODUCTION

1.1 This report is the result of a wide-ranging review which I have conducted of the regulatory requirements relating to the marketing and sale of investment products linked to life insurance (life products).

1.2 In May 1992 the Securities and Investments Board (SIB) made changes to its Core Rules governing product disclosure and suitability. In July, SIB and the Life Assurance and Unit Trust Regulatory Organisation (LAUTRO) then made changes to their Conduct of Business rules affecting, principally, how intermediaries who advise on and sell life products are to disclose to investors their own status, and details of the products which they offer; and also the standards of advice which those intermediaries must meet. Some of the existing rules of SIB and LAUTRO remain unchanged.

1.3 The rule changes follow a long period in which SIB and LAUTRO have progressively reviewed, consulted on, and re-defined their rules. In fact, this process has been virtually continuous since the self-regulatory regime was established following the implementation of the Financial Services Act 1986 ('the Act').

1.4 Under section 122(4) of that Act, I am required to keep under review the rules of SIB and LAUTRO, and of other Self-Regulating Organisations (SROs) in the financial services area. If, at any time, I am of the opinion that any such rules have, or are intended or likely to have, the effect of restricting, distorting or preventing competition to any significant extent, I am required to report this to you. Under section 122(5), I may also report to you if, in my opinion, any changes to these rules do not have, and are not intended or likely to have, any such effects.

1.5 The process of developing rules to which I have referred has, latterly, taken place against a growing debate on the way in which the products in question are marketed and sold, and on its regulation. In recent months, public and media attention has focused on these matters, perhaps to a greater degree than at any time since the implementation of the Act. The regulatory organisations and practitioners alike have examined the practices within the life products industry not only with regard to the regulatory requirements, but also to their enforcement; and now against the background of current proposals for the establishment of a single retail investment regulatory organisation, the Personal Investment Authority (PIA). I have therefore taken the opportunity afforded by this report on the rule changes of SIB and LAUTRO to examine the overall effect of the package of rules which has emerged.

1.6 I understand that, after experiencing a prolonged period of uncertainty, practitioners will wish to have some assurance that the regime settled following this process has a reasonable chance of operating with a degree of stability for some time to come. I have sought to bear this in mind, so far as consistent with my statutory duties, along with the need to ensure effective competition without imposing undue regulatory costs. But it is clear from this report that I believe further work needs to be done before these aims can be met. In this context, I note that it is open to me to comment here on only those rules which have been made: I cannot in general comment on rules which are absent or lacking even though I may have identified areas where specific improvements are desirable.

1.7 I have therefore been considering some of the wider issues of public concern, such as the need further to develop investor information and understanding, which have been raised in the recent public debate. I have decided that I should produce, under the responsibilities conferred on me by the Fair Trading Act 1973, a separate, more general, report on the effects of the charging and selling practices in the industry: I am making this publicly available today, with a view to taking forward the debate and providing ideas which the industry and its regulatory organisations can consider in developing both industry practice and regulation. This is complementary to my present report to you, since there are some common themes, but does not affect the advice I give you here, which is necessarily concerned with the competition questions mentioned above.

1.8 When you have considered my advice, you will wish to decide whether to seek further changes in the rules of SIB and LAUTRO. Although there have been useful improvements, I find some of the changed rules still to have significantly anti-competitive effects which you will wish to consider carefully in making your decision.[1] You will also wish to take account of my similar findings on certain other rules of SIB and LAUTRO which have not been changed, and to decide whether to call on SIB and LAUTRO also to consider these further.[2]

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1 Summarised at Part 6, paragraphs 6.7 & 6.8.

2 Summarised at Part 6, paragraphs 6.9 & 6.10.

PART 2: BACKGROUND

2.1 In this Part, I describe:

- the products and the markets; and

- the background to the current rules.

I then go on in Part 3 to indicate how I have approached the overall assessment of competition effects in the detailed analyses which form Parts 4 and 5.

The products and the markets

2.2 Typical life products such as endowment policies provide a return on an investment, together with life insurance, over an agreed term. The products can be free-standing, linked to a mortgage, or 'packaged' as a personal pension plan. Many life offices offer an option to participate in profit sharing, a product known as a with-profits policy. Life products are designed and produced by firms who undertake this as their sole activity and also by, for example, banks and building societies with their own financial services operations. These are all termed 'life offices' here. Their products may be sold to investors by intermediaries who sell the products of one life office only: these are 'tied agents', which term is used in this report to encompass appointed representatives and company representatives - including the employees or salesmen of the life office. They may also be sold by another type of intermediary known as Independent Financial Advisers (IFAs), whose role in this context is to offer advice to investors on products available from the broad range of life offices.

2.3 This distinction between the two types of intermediary is known as 'polarisation', because those selling life products are regulated as belonging to one type or the other. The concept of polarisation was implemented in 1987 by SIB's Core Rule on Standards of Advice, which requires an intermediary to give an investor the best advice possible on product choice from within the range available to the intermediary; hence:

- tied agents must take reasonable steps to inform themselves about the range of products from the one life office they represent, and cannot recommend the products of another life office; and

- IFAs must take reasonable steps to inform themselves about the range of products which are generally available on the market and on which they can advise.

Neither a tied agent nor an IFA can recommend a product if they are aware of another product within their field which would better meet the needs of the investor.[3] This concept is known as 'Best Advice'. Underlying these rules are the separate 'Suitability' rules of SIB and LAUTRO, which require both types of intermediary to recommend to an investor only that product, or products, which suit the investor's circumstances.[4]

2.4 There is, therefore, an element of advice in the service offered by tied agents, as they may recommend one product over another. However, as the scope of this advice is limited to the products of one life office, it is clearly of a different kind from that provided by the IFA. Thus, polarisation both assumes and reinforces the existence of two separate markets: that for the provision and distribution, or retailing, of investment products; and that for the provision of independent financial advice, notwithstanding that IFAs also constitute a distribution, or retail, channel.

2.5 Life products are thus sold through three distribution channels (including direct-response advertising as well as tied agents and IFAs). These channels compete with each other in the retail market. The life office has some control over the first two channels, direct response and tied agents; but does not control the IFA channel in which its products compete with others' life products. IFAs are sometimes remunerated from fees which they charge directly to investors, or more usually from commissions on the sale of products. IFAs compete directly with each other in the advice market.

2.6 The Act requires individuals or firms conducting investment business, which includes the design, marketing and selling of life products, to be authorised. The activities of life offices and, through them, those of their tied agents, are generally authorised and regulated by LAUTRO, although some are authorised and directly regulated by SIB. IFAs range from

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[3] SIB: Core Conduct of Business Rule 17 - Standards of Advice on Packaged Products.

[4] SIB: Core Conduct of Business Rule 16 - Suitability, and Conduct of Business Rule 5.01. LAUTRO: Schedule 2 - Code of Conduct for members and company representatives, rule 2.8.

individuals to large firms. Some firms are engaged wholly or mainly in advising on and arranging life insurance and investments, and are regulated by the Financial Intermediaries, Managers and Brokers' Regulatory Association (FIMBRA). Others, such as solicitors, accountants, tax advisers and general insurance brokers conduct such business as an ancillary activity. These are generally authorised and regulated by a Recognised Professional Body (RPB) such as the Law Society, an Institute of Chartered Accountants or the Insurance Brokers' Registration Council.

2.7 The rules of SIB and LAUTRO cover not only the life products which are the subject of this report, but also a wide range of other investment products. If you accept the advice in this report, you will wish to consider requiring further changes to the rules of SIB and LAUTRO relating to life products. The rules relating to unit trusts, collective investment trusts, certain personal equity plans and single premium policies have yet to be revised. SIB and LAUTRO may want, therefore, to consider, in those revisions, the extent to which my present observations could also be relevant to aspects of the marketing and sale of some of those other products. In due course, it will no doubt also be necessary to consider any rule changes made by FIMBRA and the other regulatory organisations.

The background to the current rules

2.8 In his report of April 1990 to the then Secretary of State for Trade and Industry on the disclosure of information about life products, my predecessor wrote:

> "The degree of transparency which the regulatory regime imposes upon the industry, and the amount of readily-comparable information which intending investors can take into account in making their purchasing decisions, remain of crucial importance not only to the savings industry but also to the nation's capital market."[5]

This statement was made against the background of the concern which he had previously expressed, to the effect that high-

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[5] The disclosure of information about life insurance products and commissions paid to independent financial advisers. The new requirements of the Securities and Investments Board. (OFT, April 1990), p 8.

pressure selling techniques in this industry may to some extent lead to the misapplication of the nation's savings.[6]

2.9 The main concerns expressed in that report were that:

- charges and expenses were not required to be disclosed on a timely basis;
- the forms of disclosure required for charges, expenses and commissions made comparisons between products difficult;
- the commissions available to IFAs were not required to be fully disclosed; and
- the investor was informed of the level of commissions by the life office rather than the IFA.

The Secretary of State concluded that the rules were unsatisfactory. He therefore asked SIB to make changes which would not only take into account the need of the investor to have comparable and timely information in a comprehensible fashion, but would also avoid burdening the industry with unnecessary costs and ensure that any changes did not distort competition between IFAs and tied agents.[7]

2.10 SIB responded to this request by initiating, in April 1991, a full review of retail investment regulation ('the Review'). The matters considered in the Review included:

- the disclosure of information on charges, expenses, commissions and the status of tied and independent intermediaries; and
- the polarisation of the retail and independent financial advice markets, and the standards of advice for retail investment.

2.11 Separate studies were also made of the ambit of the retail investment SROs and the boundaries between them; and of

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6 The Life Assurance and Unit Trust Regulatory Organisation (OFT, March 1988), part 1, p 2.

7 Written Reply to Parliamentary Question from Mr Graham Riddick MP (Colne Valley) by the Rt Hon Peter Lilley MP, Secretary of State for Trade & Industry (7 December 1990).

the arrangements for funding the Investors' Compensation Scheme (ICS).[8,9] The first recommended the formation of the PIA, and plans have been made for it to commence operations later this year. Any assessment of competition issues arising from the formation of the PIA, from its rules, or from changes to the ICS, will be for consideration as and when proposals mature.

2.12 During the Review SIB and LAUTRO produced a number of discussion papers and consultative bulletins culminating, in May 1992, in SIB's policy statement making changes to its Core Rules on product disclosure and suitability and, in July 1992, in revisions made by both SIB and LAUTRO to their Conduct of Business rules.[10,11,12] These and other of the principal reference documents are listed in Annex A.

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8 Retail Regulation Review: Report of a study by Sir Kenneth Clucas on a new SRO for the Retail Sector (SIB, March 1992).

9 Retail Regulation Review - Discussion Paper No. 1: Financing the Compensation Liabilities of FIMBRA Members (SIB, June 1991).

10 Policy Statement: Retail Regulation Review - Disclosure and Standards of Advice (SIB, May 1992).

11 The Financial Services (Miscellaneous Amendments) (No.21) Rules and Regulations 1992. Release No. 118 (SIB, July 1992).

12 Rules Bulletin No. 53 (containing the Disclosure of Status Rules 1992 and Product Disclosure Rules 1992) (LAUTRO, July 1992).

PART 3: FACTORS AFFECTING THE COMPETITION ASSESSMENT

3.1 This Part sets out how I have approached the assessment of competition effects. The criterion I have used is that set out in the Act; namely what effect, in my opinion, the rules have, or are intended or likely to have. In relation to the rule changes, much of the assessment must necessarily concern itself with the likely effects, taking account of the views expressed by both practitioners and investors or their representatives and, where available, surveys and other research designed to test those effects.

3.2 Where I find that a rule is likely to have the effect of restricting, distorting or preventing competition (which I term anti-competitive effects), I have sought to indicate which of those effects is likely to occur. I have not sought to distinguish 'likely' effects from 'intended' effects: it seems to me that the assessment of intention is generally of a second order of importance in the current context. I have no reason to believe that, in making their rules, SIB or LAUTRO have sought deliberately to restrict, distort or prevent competition: indeed, I am sure that they have sought to address the competition issues squarely and to strike what they feel is the right balance on the strength of the arguments presented. But I find, in particular, that some of the rules prevent or inhibit the provision of sufficient useful information for the average investor to use in making informed investment decisions. (By 'average', I mean here a person with no special training in, or knowledge of, the products and markets in question.)

3.3 My predecessor pointed out that investors not only benefit from such information in making their decisions, but also benefit from effective competition - competition among IFAs, competition between IFAs and tied agents as alternative marketing channels, and competition among life offices, and hence their products. He saw a need to establish that the regulatory requirements do not advantage or disadvantage one type of intermediary against another, that the forms of disclosure allow the information to be readily understood, and that relevant information is available when needed so that it can be taken into account in the investor's decision.[13] I have taken the view that anti-competitive effects are likely to arise if an investor

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[13] The disclosure of information about life insurance products and commissions paid to independent financial advisers. The new requirements of the Securities and Investments Board. (OFT, April 1990), pp 1 & 2.

does not have ready access to sufficient information on the advice he or she is receiving, and on the products on which that advice is being given, in an understandable form and, so far as possible, before a decision is made.

3.4 I say this because I believe that investors will base their decisions on their perceptions of the relative size, and incidence over time, of the payments which they are to make and the receipts which may arise. They will estimate these, taking account of the different circumstances which may affect receipts, in particular, and of the reliance which they place on both the likelihood of those circumstances arising and on other factors in their estimates. Not every piece of relevant information can be made available, or at the same time: there are costs attached to its provision; both financial costs to the life office or intermediary, and the cost to an investor of a defective decision resulting from information overload. The question is one of striking an optimal balance between those factors in terms of the relevant information which may materially affect an investor's estimates and eventual decision. If such information is withheld, or not provided in a timely fashion, and it is likely materially to influence that decision, then the relevant rules may give rise to significantly anti-competitive effects.

3.5 It is worth briefly rehearsing a typical selling process in order to place in context the analysis which is made along the above lines in Parts 4 and 5 which follow. (I exclude 'execution only' sales, where investors may respond directly to a life office's advertisement, having decided that they are interested in purchasing a given product.)

3.6 One or more meetings may take place between an investor and an intermediary. The intermediary (tied agent or IFA) has to disclose his or her status and, if an IFA, the fact that he or she is remunerated by commission. The intermediary must identify the investor's personal circumstances by a 'Fact-Find'. This is often conducted by questionnaire, and forms the basis for judging whether a product suitable for the investor is available on which the intermediary can advise. If so, an illustration of the possible returns on investment, and information on the costs of a product are to be shown to the investor. These may be based on example characteristics, such as age and health, or may be produced to match the investor's own circumstances. If the intermediary is then able to recommend a product, further details of the product are given to the investor. If the recommendation is accepted, the policy instrument is then written and signed and a cancellation period, normally of 14 days, generally comes into effect.

3.7 Strictly, the point of sale is reached at the end of the cancellation period, since the investor may decide to reverse his decision within that period. However, it is widely accepted that, in practice, the point of sale is reached once a recommendation is made and accepted. Further information, which may include details of the product in a client-specific form, is sent before the start of the cancellation period, if the investor has not previously requested it. Any further information which the investor seeks may be sent at any time before or after the point of sale.

3.8 It is worth noting that this process, and particularly the early stages, may take place on very different timescales. One encounter could bring an investor to an investment decision. This underlines that precisely what information is provided, in what sequence, at what time and in what form, can crucially affect the investor's decision. Some mandatory early disclosure is necessary in this market because of the generally low level of investor awareness that has been evidenced in regard to the nature of the advice and the products that are available; and only its provision on a timely basis can enable the investor to recognise the choice of competing services and products that are available.

3.9 The impact which such disclosure can make on competition is broadly as follows.

- Disclosure of information about the status of the intermediary informs investors about the nature of the service they are getting and hence the market they are operating in. Competition between IFAs and tied agents will be distorted if investors are not fully aware of any limitations on the advice they are receiving, or believe they are paying for advice from an IFA of a quality which a tied agent could offer 'free'. Conversely, competition between life offices will be distorted if investors are not fully aware that both tied agents and IFAs are retailers as well as advisers. These facts need to be brought home through the market signals provided by suitable disclosure of information about the life offices' total charges and expenses out of which tied agents and IFAs are paid, and about commissions paid to IFAs.

- Without knowledge of commissions on the part of investors, there will be less restraint on the levels of commission and muted competition among life offices on product price and quality; and without knowledge of commissions, there will be reduced competition among IFAs, who would otherwise seek to improve cost efficiency in order to offer commission rebates and align charges more closely to costs.

- Lack of price transparency will constrain non-price competition also, in the design and quality of products and in the breadth and quality of advice. Products should have to earn the recommendation of advisers, and advisers themselves have to justify the fees or commissions they earn.

- Disclosure of life offices' charges and expenses or of projected receipts for investors, based on those charges and expenses, is central to the maintenance of competitive pressure on the overall levels of charges. It is this which gives life offices the incentive to minimise charges and maximise the proportion of investors' premiums invested. These disclosures should extend to showing the effects of all the principal policies and practices which may affect the potential value to the investor over the term of the investment, in the interest both of competition between products and of the development of products with the characteristics that investors want. Where an investor is not wholly confident of keeping an insurance policy to term, for example, the likely consequences of earlier surrender will need to be weighed in the balance. That evaluation may affect not only the investor's choice among different life products, but also the choice between a life product and another savings vehicle such as bank or building society deposits, or a choice not to invest.

3.10 Those whose services and products respond to these conditions will enhance their market shares at the expense of their competitors, which will in turn be reflected in the more efficient allocation of resources in line with consumer preferences. This is particularly important given the size of the industry, the sales value of whose products totals more than £10 billion a year, with new annual sums assured of more than

£100 billion.[14] The accumulated value of life insurance and pensions investments, together, accounts for some 44% of the stock of personal savings.[15] On sums of these scales, the economic detriment from any significant restriction, distortion or prevention of competition would be very large indeed.

3.11 It is against the foregoing criteria that I make my assessment of the rules of SIB and LAUTRO. As required by the Act, I seek to describe what any significantly anti-competitive effects are likely to be. Where I do not find such effects, I make no adverse finding.

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14 Based on ABI figures.

15 Independent Financial Advisers and the Impact of Commission Disclosure. London Economics Ltd (OFT, October 1992), p 12.

PART 4: THE CHANGED RULES

4.1 This Part examines those aspects of the marketing and selling process which are affected by the rule changes of SIB and LAUTRO. It considers only those rules which may, in my opinion, have a significant effect on competition in the terms described in Part 3, and assesses the likely nature and extent of that effect. The rules in question are those which concern:

- disclosure of an intermediary's status;
- disclosure of product details; and
- disclosure of a life office's charges in illustrations.

Some of the rule changes are intended to have effect immediately on being brought into force; others provide for a transitional period to full implementation.

Disclosure of an intermediary's status

4.2 The relevant rules and rule changes are listed in Annex B. The existing rules, on which my predecessor reported in 1990, imposed certain requirements designed to ensure that an investor could know whether he or she was dealing with a tied agent or an IFA. They focused on drawing attention to the status of tied agents, because of the risk that an investor might otherwise be allowed to believe that he or she was receiving independent advice, or advice on a wider range of products than would be the case with a tied agent. This was to be done in advertising, on business cards and in the Buyer's Guide which had just been introduced for use at the outset of the selling process. My predecessor found that the requirements did not convey clearly enough that tied agents do not, and cannot, give independent advice.[16]

4.3 One perspective on the issue here is that it is concerned with whether a level playing field exists as between tied and independent intermediaries. If an investor is fully aware that he or she is dealing either with a retailer of the products of one life office, or with someone who is offering

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16 The disclosure of information about life insurance products and commissions paid to independent financial advisers. The new requirements of the Securities and Investments Board. (OFT, April 1990), p 17.

advice on the choice of a broad range of products, then that investor will be able to consider whether he or she is in the right market for his or her needs, and to shop around further if necessary. To the extent that this choice is not fully brought home to the investor, distortions are likely to occur as between these two markets.

4.4 The rule changes of SIB and LAUTRO strengthen the extent to which the investor's attention is drawn to the distinction between the tied agent and the IFA. Business cards and stationery must now make clear statements, not only as to the status of a tied agent, but also as to the extent of the range of products which the agent can offer, including if these are provided by a firm in the same marketing group. Similar information must also be displayed in business premises; and the requirements in relation to advertisements have been strengthened and extended to the advertising of mortgage broking and mortgage lending services which are provided in conjunction with investment business.

4.5 The rule changes also provide for the introduction of a **Client's Guide** in place of the former Buyer's Guide. A pro-forma Client's Guide for use by each of tied agents and IFAs is at Annex C. Clearer statements are now prescribed on the status of the intermediary, along the lines indicated above, and the Guide discloses how the intermediary is paid: that is, in the case of tied agents, from the expenses charged for any product bought; or, in the case of IFAs - generally - by commission.

4.6 I believe these changes, and the form of the new Client's Guide in particular, are a useful development. I note also that the intermediary's status is recorded in the document called 'Important Information' which is to be sent to the investor after he or she has made a decision but before the cancellation period has begun. SIB and LAUTRO therefore clearly recognise that the status of an intermediary may not be fully absorbed by the investor early in the selling process, or may be forgotten later but while there is still time for it to influence his or her decision. I agree, and accordingly believe that this repeated disclosure requirement could usefully be extended to any other key documents which are not already covered by the requirement. The scope for any such further reinforcement merits consideration by SIB and LAUTRO.

Conclusion on status disclosure

4.7 The rules on status disclosure have been usefully strengthened. I do not find that they are now likely to have any significantly anti-competitive effects.

Disclosure of product details

4.8 The relevant rules and rule changes are listed in Annex D. The existing rules of SIB and LAUTRO were based on three levels of information to be given to an investor, broadly in increasing order of detail and client-specificity and at set times. At the first level, the rules of SIB placed a general obligation on all intermediaries to give the investor, before or at the time of a product's being recommended, enough information about the product, and the financial implications of buying it, for the investor to make an informed decision. By the same time, the investor was to be given notice of any cancellation period that would apply in which, after 'cooling off', the investor could cancel the commitment he or she had made; and what the length of this period would be. LAUTRO prescribed in addition only that a general description of the product in question should be given and that, if early surrender values would be less than the premiums paid, a warning to that effect should be given.

4.9 At the second level, SIB and LAUTRO required the cancellation notice itself, together with certain 'Product Particulars', to be sent to the investor before the start of the cooling off period. The information to be contained in Product Particulars was quite extensive. It included details of premiums, benefits, bonuses, charges and expenses, tax liabilities, surrender values over five years, and other matters affecting the value of the investment. The effect of charges and expenses was to be shown as a percentage reduction in yield against assumed levels of return on investment set for these purposes by LAUTRO. Commissions paid to IFAs were also to be shown, expressed as a percentage of premiums. These last two matters are considered further under 'Disclosure of a life office's charges in illustrations' and 'Disclosure of commissions paid to independent financial advisers', respectively, below.

4.10 At the third level, certain optional information such as a With-Profits Guide and a description of the firm's investment activities could also be made available on request. SIB required, however, that Product Particulars should contain no further information than that specified, and LAUTRO specifically precluded the inclusion of data on the life office's past performance. SIB and LAUTRO allowed projections and illustrations of any unguaranteed future benefits to be given only if they were calculated in accordance with specified assumptions and accompanied by a series of 'health warnings' as to those assumptions. I consider these illustrations also under 'Disclosure of a life office's charges in illustrations' below.

4.11 My predecessor's April 1990 report expressed concern that the forms of disclosure for commissions, charges and expenses made comparisons between products difficult and, in particular, that the vast majority of the information to be provided was required to be made available only after the point of sale, by which time investors might find it difficult to change their minds. As a result of these factors, investors would have limited ability to compare the products concerned with each other and with other investments, and competition would therefore suffer. They would not necessarily be helped to determine their own needs by the general information that was available in the financial press; and competitive pressure on the level of life offices' expenses would be muted. These factors amounted to a lack of transparency in the markets for advice and for investment products, which my predecessor found likely to restrict and distort competition to a significant extent.[17]

4.12 For the reasons I have given in Part 3, I broadly share the approach which my predecessor adopted to the assessment of competition in this area. I see a need, also, to distinguish clearly between those matters on which an investor needs information in order that competition in the relevant market is not significantly adversely affected, and the requirement for an optimal level of consumer information and awareness which I perceive as calling for a higher level of disclosure.

4.13 On the latter, the separate report which I have prepared under the responsibilities placed upon me by the Fair Trading Act sets out a number of proposals designed both to lead to enhanced information for the public, and also to be of use to SIB and LAUTRO in developing the product disclosure regime.[18]

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[17] The disclosure of information about life insurance products and commissions paid to independent financial advisers. The new requirements of the Securities and Investments Board. (OFT, April 1990), pp 27-29.

[18] Fair Trading and Life Insurance Savings Products: A report by the Director General of Fair Trading (OFT, March 1993).

4.14 SIB and LAUTRO's rule changes formalise the step by step approach to product disclosure in the form of a **'Three Tier'** regime. The most important change is that the first tier, before or at the time a recommendation is made to an investor, includes a mandatory requirement to provide the investor with a document showing the Key Features of the product. An example of the form in which Key Features may appear is shown in Annex E. This brings together, at an early stage in the investor's deliberations, a number of generalised items of information about the nature of the product, including some illustrative details of the possible costs and benefits, but not in a form specific to the circumstances of the investor unless requested.

4.15 The Key Features document emphasises that the product offers life insurance, and contains warnings about the uncertainties attaching to the investment element of the product, the fact that early surrender could lose the investor money, and that charges and expenses are met from the premiums. A table showing possible surrender values for the first five years of the policy is included, together with a separate form of disclosure of the effect of charges and expenses over the life of the policy - again assuming standard rates of return on investment prescribed by LAUTRO. This effect is expressed both in terms of the approximate number of pence absorbed from each pound of premium paid by the investor, and in terms of the reduction in the yield that the investor might obtain.

4.16 The second tier of information, which is to be given before the start of the cooling off period, is based on the Product Particulars document required under previous rules but which is now called 'Important Information'. It covers the same matters as Key Features, but does so in a form specific to the circumstances of the investor. (The Key Features document gives generic details of the product against 'typical' investor characteristics. Important Information, whilst still assuming standard returns on investment, is based on the life office's own charges as they would apply to the investor in question, as well as the actual premiums to be paid.) For a two year transitional period, however, indicative surrender values and the effects of indicative charges and expenses may be used in Important Information.

4.17 The third tier of information consists of that which an investor may request at any time, being somewhat expanded compared to the items prescribed in the previous rules of SIB and LAUTRO.

4.18 Key Features, and to a lesser extent Important Information, are distinct improvements on what was required before. The question I have to answer is whether, either in what they require in the positive sense, or what they may be inferred as bringing about by remaining silent or unspecific on any matter, they address the existing distortions of competition, or exacerbate them, or indeed create new ones.

4.19 I note first two areas in which concerns might arise about the competition effects of these new requirements, but which I do not find to be significantly anti-competitive.

Charges and expenses to term

4.20 The first area of possible concern is one which my predecessor noted, concerning the potential usefulness of the disclosure of charges and expenses as a percentage of projected investment yield. He was not convinced that this, on its own, would be meaningful to an investor.[19] Further, it was not consistent with the way commissions were to be disclosed: this matter is considered later. The relevance of charges and expenses to the new product disclosure rules lies in the use made of them in Key Features and Important Information. Key Features retain the reduction in yield measure, but add the separate measure of deduction from premium, shown as 'Xp from every £1 you paid us'. The role of these disclosures must be considered against the framework that investors are concerned to assess their prospects for cash receipts from life products but that where these are not guaranteed they depend on various factors, including future charges.

4.21 The immediate question is whether the two measures together may confuse an investor and hence distort competition. But it is made clear that the two measures are equivalents, and since the deduction from premium measure is a cash calculation which should be understood by the majority of investors, material confusion is not now likely to arise.

4.22 A related question is whether these measures together serve to focus too much attention on charges, to the detriment of a balanced overall assessment of the product by the investor. There is potentially quite a large number of further indicators

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[19] The disclosure of information about life insurance products and commissions paid to independent financial advisers. The new requirements of the Securities and Investments Board. (OFT, April 1990), p 28.

which would be of possible value to the investor. Some of these are already available in the specialist financial press. The past maturity value of a fund is one such: I have considered whether such an indicator would serve to counter-balance any excessive focus on charges and expenses, but concluded that it has no substantive value in assessing future performance - because past investment performance is generally a poor guide to future performance - and is open to both misunderstanding and abuse. But there are other indicators, such as longer term projections of surrender values, and explanations of methods of calculating surrender values, showing the effects of underlying practices such as surrender 'penalties' which may depress those values, and which could be material to an investor's decision.[20] I consider these further below.

Client-specific information

4.23 The second area of possible concern is that product information specific to an investor is required to be given to him or her only after a recommendation has been made, unless the investor seeks it prior to that time. My predecessor stressed, as I do in Part 3, that such information should be available as early as possible in the selling process.

4.24 I recognise that some life offices may, voluntarily, provide this information earlier than is required by the rules, and that SIB and LAUTRO encourage its earliest possible provision. But, to the extent that this leads to differences in practice, there is likely to be some distortion in competition between those life offices and intermediaries who provide client-specific information on, for example, the premium to be paid, and those whose Key Features may show an indicative premium which

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20 A specific penalty for early surrender is often explicitly attached to a unit-linked product, for example as a percentage of premiums paid or to be paid. In the case of with-profits policies, however, premiums less expenses, plus investment returns, constitute the accumulated funds or 'asset share': when a policy is surrendered, life offices decide whether to pay out these accumulated funds, or a greater or lesser amount. In this report, I use the term 'penalties' to apply to circumstances where lesser amounts are paid out, whatever the reasons for that practice; for example in order to pay enhanced amounts to those who retain their policies. The extent to which this constitutes a penalty on those who surrender policies early is, in this context, clearly a matter of degree.

turns out to be different when client-specific details are produced. Although fully client-specific information is required to be made available in Important Information after a two year delay, it must be made available at any time an investor asks for it. I am disappointed that greater efforts have not already been put into addressing and overcoming the two year delay and, indeed, providing client specific information earlier in the selling process, for example in Key Features. But I do not find the new rules to have a significantly adverse effect on competition.

Surrender values

4.25 I now turn to an issue on which I have serious concerns. This is that the rules of SIB and LAUTRO permit the tables of surrender values in Key Features and Important Information to cover a period of only the first five years of what may be a long term policy - for example, a 25 year policy - notwithstanding the fact that they now require life offices to indicate the point at which the surrender value may equal or exceed the amount paid by the investor if it does not appear in the table.

4.26 The rules of SIB and LAUTRO relating to projections and illustrations (see next section) prevent life offices from extending the disclosure to a longer period. Any projections beyond five years must be given on a standard basis, as in illustrations, and cannot therefore show the effects of life offices' own policies and practices in relation to surrender values. In these later years there are nonetheless effects deriving from those policies and practices which can give the products of individual life offices quite different characteristics from the products of other offices. I refer to several of these in my separate report. For example, the benefits conferred by one life office on those continuing a 25 year investment to full term may be much greater, proportionately, than those available if the investment is discontinued in an intermediate year, or even as late as year 24, while another life office may adopt a smoother progression of benefits. The incidence of charges and expenses, the differing emphases that may be laid on high surrender values or high terminal bonuses, and the existence or otherwise of surrender penalties may all affect the nature of the product.[21] These

[21] Fair Trading and Life Insurance Savings Products: A report by the Director General of Fair Trading (OFT, March 1993), part 3.

differences between products are masked when surrender values are projected for only a small part of the investment period, and this is likely to cause a distortion of competition as between these different products.

Conclusion on surrender values

4.27 I welcome the rule changes in so far as they help to underline to the investor that he or she may be committing to an investment which is illiquid and long term, and hence bring out the general nature of that investment. But the possible effects of the life office's policies and practices on surrender values for later years are of great importance. The rules prevent disclosure of indications of surrender values in the later years of a policy. Payments to a policyholder on surrender in later years are possible cash receipts from the policy and hence relevant to a decision on whether or not to buy the policy in question or indeed any life product. The rules limit the investor's ability to make good choices among the products of different life offices and between life products and other investments; and hence they are likely to restrict and distort competition in these markets to a significant extent.

The 'halo effect', and differential pricing

4.28 I now make two general observations on product details. First, the point has often been made to me that there is a 'halo' effect on perceptions of investment-linked insurance products. This may derive from the existing relationship between an investor and, say, a bank or building society manager, whom an investor may regard as his or her adviser on personal finance generally: the investor may therefore overlook the fact that the bank or building society may also act as a tied agent or have its own life office subsidiary, and hence provide a narrower range of advice or have a special interest in selling a given product. Provided, however, that the rules on status disclosure and product suitability are properly implemented, I see this inbuilt bias as best addressed through greater general investor awareness.

4.29 A separate kind of halo effect may also arise for the investment element of a life insurance product. An investor may see a life insurance commitment as inherently responsible, for example with regard to his or her dependents; but may not fully grasp the scale of the investment element, which in the majority of cases constitutes the dominant feature of the product. Some of the organisations I consulted saw practical difficulties in quantifying separately the costs of the life insurance and investment elements of a packaged product. I did, however, note some acceptance of the need to remind the investor of the dual nature of such products and of the possibility of buying 'pure' life insurance products, and thus encourage the investor to check that the product is both what he or she is expecting and what best meets his or her needs. I put forward my own views on this problem in my separate report.

4.30 My last point on the disclosure of product details concerns the fact that the investor may not be aware, or be made aware, that a product may be obtainable at different prices from different intermediaries. In this market, unlike those for other commodities, the investor may assume that there is a common price for a given product, and may not compare similar products from different distribution channels. The underlying causes of such an assumption lie, however, along with the remedy, in the field of general investor information rather than the rules.

Disclosure of a life office's charges in illustrations

4.31 I treat this as a separate topic because, although disclosure of charges and expenses (here called simply 'charges') is regulated under the product disclosure rules, charges are an important element in competition - perhaps, given the factors set out below, the most important - and may manifest themselves in different ways in different documents.

Projections/illustrations

4.32 I have referred to the fact that tables of surrender values are calculated on the basis of the life office's own charges in Key Features and Important Information, over a five year period. However, other projections, showing possible returns over the full term of an investment, are also permitted to be shown to investors under the rules of SIB and LAUTRO. These are normally termed **illustrations**, and they typically show the sums that would be paid out in the period up to full term if specified percentage rates of return were achieved on the investment. Their use is not mandatory, but they are a powerful marketing tool since they can show an investor some very large potential long term cash pay-outs in return for a regular premium. It is therefore right that their form should be controlled because they would otherwise be open to abuse by any unscrupulous intermediary. The relevant rules and rule changes are listed in Annex F.

4.33 The requirement to use standardised rates of return in these illustrations reflected concern that there had indeed been misuse of projections of future benefits, including the use of data about the past performance of life offices. For example, a life office might bid up terminal bonuses in order to enhance the apparent attractiveness of a product, whilst other investors pay for this through depressed earlier surrender values; or the use of such data might foster a belief on the part of the investor that good past performance could be projected forward. Such results would distort competition. I see the force in both these arguments - because I have no grounds for believing that future performance generally bears any fixed relationship to past performance - and hence I agree with the need for standardised assumptions to be used when projecting possible returns on investment.

4.34 Under the rules of SIB and LAUTRO the effects of charges on these possible returns is also required to be calculated in accordance with standardised levels set by reference to a range of charges as current from time to time among life offices. The argument on which this requirement was based was essentially that the charges of a life office could change over time and that, since the indicated returns were purely illustrative or hypothetical, so should be the indicated charges.

4.35 There are two difficulties with this approach. First, it clearly reduces the downward pressure on life offices' own charges because it diminishes the incentive for them to compete with each other in this respect. Those life office which have bid up commissions, for example, will have the effect of this practice damped in their illustrations. Secondly, although own charges can change over time, in practice they are relatively unlikely to change so fundamentally as to affect the overall picture given by an illustration which is based on such charges: this is principally due to the widespread practice of loading charges - particularly commissions - on to the early years of an investment. Charges are thus known with a high degree of certainty by a life office for the initial years. Even for later years, life offices' actuaries will make projections of own charges in preparing internal assessments of the future performance of the funds under management to inform the making of policy recommendations - indeed they have to do so in order to calculate the reduction in yield and deduction from premiums figures shown in Key Features and Important Information. It is thus difficult to understand why the impact of these charges should not be shared with the investor in the illustrations.

4.36 My predecessor criticised the effect of the use of standardised charges in illustrations in his 1988 report on the rules of LAUTRO, and undertook to keep this rule under review for any significantly anti-competitive effects.[22] In 1991 it appeared that SIB had accepted the counter-arguments cited above and were preparing to require illustrations to show the effects of a life office's own charges in place of the standardised ones.[23] In the event, however, SIB revised that view and instead changed its rules to require some own charge data to be shown alongside illustrations based on standardised charges. These illustrations will thus show maturity values based on standard returns and standard charges, together with the first five years' surrender values based on the life office's own charges for the product in question, and the overall effect of own charges expressed in terms of deduction from premium and reduction in yield, as in Key Features and Important Information. The illustration will be required to make clear what total premium payments are assumed to be, and various explanatory and warning statements are also required.

4.37 In assessing these requirements, I have considered the following factors. Illustrations are often made available before the point of sale and may thus be more likely to affect an investor's choice of product than some of the information provided later. The premium and the charges effectively indicate the price to be paid for insurance cover and future investment management. Illustrations based on standardised charges as well as standardised rates of return, even when the assumptions used are explained, may give investors the impression that all life offices have similar costs and performance and limit competition to comparison of premiums. There are, as I have indicated, good reasons why projections of performance based on past performance or on unguaranteed future benefits should not be used. But limiting competition to premiums by standardising charges for computational purposes would distort competition significantly. This is because it decreases the pressure on all companies to reduce charges and means that those life offices showing a low premium would gain competitive advantage without having an incentive to enhance other aspects of the product, including the enhancement obtained by reducing charges; and because those with charges already below the industry standard would not be able

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[22] The life Assurance and Unit Trust Regulatory Organisation (OFT, March 1988), part 2, p 22.

[23] Retail Regulation Review - Discussion Paper No. 3: Disclosure (SIB, October 1991), p 10.

either to benefit fully from this fact or have any incentive further to reduce charges.

4.38 I have therefore to consider whether the new own charge information now required by SIB and LAUTRO will offset these anti-competitive effects which, in the absence of any rule change, would in my view be significant.

4.39 SIB's policy statement argued that the main reason for retaining the use of standard charges was for investor protection purposes. Illustrations were conjectural and should be treated with caution. Moreover, small variations in calculations of current charges, having little significance in themselves, could be magnified over a 25 year span, encouraging investors to select investments on apparent rather than real differences. Lastly, SIB argued that the Key Features showing the likely effects of charges would be a better means for comparison than would illustrations.[24]

4.40 It is true that illustrations are conjectural. But the early costs are likely to be known with some degree of accuracy, and the practice of 'front-end loading' means that these will make up a significant part of the total costs. Costs may also be relatively hard to alter in later years. The fact that small differences in costs translate into large differences in future returns has a double effect. It can be argued to place too much emphasis on costs alone, so that any life office which has high charges but better than average performance will not be able to use the fact in illustrations: however, the fact that salesmen have an incentive to highlight good past performance is likely to mitigate any such adverse effect and life offices can improve the guaranteed payments to investors if they are confident of reducing costs. The main point is that illustrations based on own charges will bring home to investors that charges affect product performance.

4.41 Illustrations based on standardised measures of returns and charges, and showing the effect of own charges information in the same document may, moreover, in themselves produce an undesirable effect. Investors seeing an illustration based on a standardised charge may be satisfied with the projected investment values, believe that these represent the true effects of charges, and read no further (the rules do not in my opinion

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[24] Policy Statement: Retail Regulation Review - Disclosure and Standards of Advice (SIB, May 1992), p 7.

require sufficient prominence to be given to own charge information to prevent this from happening, nor do they require a clear enough warning that the illustration is purely hypothetical). Alternatively, an investor who sees both standardised and own charge information may become confused because they are shown in different ways. There is a significant risk that investors will not take on board the own charge information provided with the illustration.

4.42 Illustrations are currently the only tabular indication of possible long term cash returns, including the effects of charges, which is permitted to be shown to an investor. They may be used at any time in the marketing and selling process, and they may be used by different life offices and intermediaries to the extent that they overshadow the mandatory disclosure documents. It is therefore regrettable that they fail to differentiate between the cost patterns of different life offices.

Conclusion on illustrations

4.43 Consultations with the industry revealed that while, overall, opinion was divided on the use of standardised assumptions throughout illustrations, most agreed that illustrations were a very important marketing tool. Few believed that there would be additional costs in producing illustrations based on own charges, and life offices are in any event obliged to produce own charge data for the calculations required in Key Features. Indeed, most conceded that the use of standardised charges was misleading. I agree and, further, take the view that these rules limit the ability of prospective investors to assess the effects of the life office's level of costs, because investors cannot calculate how the illustration would look if the office's current cost level was substituted for the standard level. In that investors will make different decisions from those they would make if they had better information, this is likely to restrict and distort competition among life offices to a significant extent.

PART 5: OTHER RULES

5.1 This Part considers two aspects of the rules of SIB and LAUTRO which are not altered, either in form or effect, as a result of the rule changes following the Review. They concern the rules relating to:

- 'Best Advice' and differential pricing among tied agents; and
- disclosure of commissions paid to independent financial advisers.

These seem to me to raise significant issues of competition which have yet to be resolved.

'Best Advice' and differential pricing among tied agents

5.2 The 'price' at which a life office currently offers a given product to a given investor reflects the premiums to be paid for the benefits offered, taking account of the life office's charges and expenses including commissions paid to the intermediary. The price may differ depending on whether the investor purchases through an IFA or through one of the life office's tied outlets (that is, from its direct sales force or company representatives, or from its appointed representatives such as the financial services arms of banks and building societies and the latters' own company representatives). For example, the levels of commission available to IFAs and tied agents may be different; and IFAs may choose to rebate part of the commission to the investor. The price to the investor will therefore reflect to some extent the fact that the costs associated with distributing products through these two types of outlet differ.

5.3 Among tied outlets, however, a given product is made available at only one price - even though there may be significant cost differentials between different tied outlets of the same life office which could be reflected in different prices. There is no specific rule which prohibits such differential pricing, but the Best Advice obligation, as applied to tied agents by the rules of SIB and LAUTRO, has the effect of preventing the practice. This is because it requires tied agents to provide an investor with the best advice as to the choice of product among those available from the life office they represent and which they are authorised to sell: this has been interpreted by the industry generally as meaning that a tied agent cannot therefore recommend a product if an equally suitable, but cheaper, one is available from another tied agent. In this context, if an identical product is available at two prices from different tied agents, the cheaper of the two is the better: a tied agent could not currently recommend a product at one price if it were available from another tied agent at a lower price.

5.4 The relevant rules of SIB and LAUTRO are listed in Annex G. The effect of these is, it is argued, that while a life office is free to make a product available through tied agents at different prices, it could only ever be sold at the lowest price and so it would be pointless offering it at a higher one. Hence there is an effective prohibition on differential pricing in this segment of the market.

5.5 In 1989, SIB planned to remove this prohibition and proposed draft rules to that effect.[25] The consultative process was, however, interrupted by the Review. SIB nonetheless continued to promote the ending of the prohibition on differential pricing, arguing in a 1991 discussion paper that life offices should be free to adopt a pricing policy which enables intermediaries to pass on to investors the benefits of cost differentials, and that regulatory requirements should not compel life offices to cross-subsidise between tied outlets.[26] However, despite a significant number of representations in favour of this proposal, SIB's rules have not been changed so as to allow life offices and tied agents to do this.

5.6 A number of arguments for and against allowing differential pricing were also elicited in my own consultations. The first, and potentially most important, argument against it was that it would become impractical to monitor and enforce Best Advice for tied agents, since the quality of advice would depend on the price charged by one tied agent compared to that charged by another. If these varied widely, SIB argued, it would be pointless to keep this rule, which would leave investors protected only by the Suitability rule. They might then obtain suitable products, but not necessarily the most suitable or the cheapest.

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25. Life Assurance and Unit Trust Disclosure: Outstanding Matters - Consultative Paper 30 (SIB, November 1989), Annex 2, pp 17-19.

26 Retail Regulation Review - Discussion Paper No. 3: Disclosure (SIB, October 1991), p 10.

5.7 It is not obvious that the likely extent of differential pricing would make it impossible to retain a Best Advice rule. The same argument could be advanced, perhaps even more strongly, against differential pricing in the IFA segment of the market, where keeping track of the products and prices available is arguably more difficult than it would be among tied outlets: this has not, however, prevented SIB from allowing differential pricing among IFAs whilst imposing a Best Advice requirement on them. I believe that differential pricing could be accommodated among tied agents, too, within a modified Best Advice framework, for example by providing for tied agents to make it clear that the advice they are giving is best advice within only the range of prices which they can offer as well as of the products on which they can advise.

5.8 Other arguments advanced were less convincing. They were as follows.

- Life offices might raise the prices of some products to particular tied agents, so that these products could then never meet the Best Advice requirement and the life office would save the costs of training the agents concerned in those products. This would effectively reduce the range available from those agents and so compromise Best Advice. My view is that, while the Best Advice concept may have to be modified, this need not result in lower standards in terms of value to the investor.

- Some product prices would be driven up to reflect outlets' higher distribution costs, and investors would be penalised for using high-cost outlets. My view is that this would occur only if there is existing cross-subsidy to them. Those investors who are currently paying higher prices for low-cost outlets would gain. Purchasers who deal with high-cost outlets normally pay more in competitive markets.

- There would be upward pressure on product prices anyway, since life offices would find their profit margins under pressure. My view is that life offices might indeed find their profit margins under pressure as a result of investor awareness of differential pricing, but if this is not the case at present it is because competition is not working effectively.

- Since tied agents are required to call themselves representatives, investors would be misled into thinking they would receive the same service at the same price as from another representative, when they would not. In addition, if the larger tied agents negotiated discounts for particular classes of customer and advertised these, it would blur the investor's understanding of the agent's tied status. I do not believe that this would be the case, provided that the revised status disclosure rules took account of these factors. (The point was also made to me that the product disclosure rules would also need to be amended. That may in any event be necessary.)

5.9 Finally, there were four points made to me as to why allowing differential pricing was unnecessary. These were that some cost differentials were small; that there were costs associated with systems changes and cost allocation; that pooling costs between more profitable and less profitable outlets is efficient; and that little advantage is currently taken of the possibility of differential pricing between tied agents and IFAs. It was argued that allowing differential pricing among tied agents would not, therefore, change life offices' pricing practices. These are, however, not reasons for retaining the rules in a form which is interpreted as imposing the present restriction: it is important to remember that it is only the question whether the rules and their interpretation should be such as to create the restriction which is at issue, not whether life offices should be forced to adopt differential pricing among tied agents.

5.10 The consequences of that restriction principally affect competition between the tied agents of each life office - although, to the extent that cost pressure may be muted overall, the effects are likely to spill over into the product competition between different life offices. The first issue that arises, however, is whether there are cost differentials significant enough to cause concern if they are not reflected in prices. In my discussions with life offices, evidence was gathered that product distribution costs do in fact vary widely among the different tied outlets of some life offices, and among these and other organisations consulted there was a fair degree of support for allowing pricing to reflect these differences. It was argued that the savings from using low-cost outlets could be passed on to consumers in enhanced benefits for the same level of premium, or in reduced charges. It was further argued that the present situation has suppressed the more widespread development and use

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of low-cost outlets (for example, greater use of outlets such as estate agents, whose overheads are spread across business other than investment). The full scope for cost differences to emerge has not therefore been realised. If it were, it appears likely that even wider price differentials would potentially become available.

5.11 This potential price competition between tied agents of a life office is, however, effectively eliminated by the current restriction. This has a number of consequences, as follows.

- Investors who buy from lower cost outlets will pay a price higher than is justified by costs.

- There will be less pressure on tied agents to reduce their costs.

- Life offices' choices of distribution channels will be distorted and they will be less likely to use a range of different types of outlet. For example, a 'no-frills' tied agent will not prove attractive to investors if his prices are the same as a more lavish alternative. The range of alternative distribution outlets available to investors is, therefore, likely to be reduced.

- Competition between tied agents will be confined to non-price factors such as the quality of service and after-care, and the ambience of sales premises. This is less effective than price and quality competition together.

<u>Conclusion on differential pricing among tied agents</u>

5.12 By preventing life offices and their tied agents from reflecting in their prices to investors the different costs of distribution among tied agents, and hence limiting the likelihood that the most efficient means of distribution will prevail and reduce overall costs to investors, the rules of SIB and LAUTRO which prevent differential pricing by life offices in their dealings with different tied outlets restrict competition among life offices and tied outlets to a significant extent.

Disclosure of commissions paid to independent financial advisers

5.13 This section primarily concerns the competition between IFAs in the market for independent financial advice. It also raises issues relevant to the competition between IFAs and tied agents in the retailing of the products in question.

5.14 As noted under 'Disclosure of an intermediary's status' above, the Client's Guide will tell the investor how a life office remunerates the intermediary concerned. If the intermediary is an IFA, it will tell the investor that the IFA is normally remunerated by commission, and that details of the commission will be made available either on request to the intermediary, or later by the life office whose product the investor buys. In the latter case, the rules of SIB and LAUTRO require these details to be given to investors automatically, as early as reasonably practicable, and generally no later than the start of the cooling off period. This means, in practice, that automatic disclosure takes place in the Important Information which is sent to an investor by that time. As described under 'Disclosure of product details' above, the commission will be shown as a percentage of premiums. It is left to IFAs to decide whether to disclose commissions at an earlier stage: this is known as a 'soft' commission disclosure regime. It has not been altered by the new rules of SIB and LAUTRO, although these technically replace the previous rules with rules having the same effect. The rules on commission disclosure are listed in Annex H. I have, however, reviewed the long-running arguments as to whether this regime has, or is likely to have, significantly anti-competitive effects; and, if so, whether a 'hard' commission disclosure regime (that is, one which requires the amounts of commissions to be disclosed automatically before the point of sale) would remedy any such effects.

5.15 My predecessor expressed the view in 1988 that the Maximum Commissions Agreement (MCA) then in operation in the industry and adopting rates set by LAUTRO, together with the soft commission disclosure regime, distorted competition to a significant extent.[27] Had both these rules been changed, as my predecessor advised, the expected effect would have been downward pressure on IFA commissions. In the event, however, although the MCA was subsequently abolished, no change was made to the commission disclosure regime. The result was that commission levels rose and have continued to do so quite sharply.

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[27] The Life Assurance and Unit Trust Regulatory Organisation (OFT, March 1988), part 1, p 22.

5.16 My predecessor looked at commission disclosure again in 1990. He stressed its importance, first because it would give information to which the investor is entitled, because the IFA is his or her agent, and the commission is a fee which the investor is indirectly paying; secondly, because that information was needed to encourage competition between IFAs in the cost of their service - in their 'prices' - and to prevent life offices competing for business through the level of commissions rather than through the quality of their products; and thirdly, because it paved the way for a move to a more rational fee system for remunerating IFAs.[28]

5.17 The arguments then advanced against hard commission disclosure were the complexity in calculating commission (even though this had to be disclosed on request); the possible disadvantage to IFAs if investors perceived an investment purchased from them as more expensive than one purchased from a tied agent; the possibility of investors attaching too much importance to levels of commission alone rather than, say, overall charges; and, as a result of these factors, a significant reduction in the IFA segment of the market and a corresponding diminution in the availability of independent advice.

5.18 These, and other arguments cited below, were deployed in SIB's Review, during which SIB continued to argue that commission disclosure before the point of sale would adversely affect the independent advice segment of the market. SIB conducted a survey of these possible effects.[29] SIB also produced a memorandum on the topic. This is included in a separate study commissioned by my Office, which also included two surveys examining recent empirical evidence and analysing the effect of information asymmetries on competition in the relevant markets.[30]

5.19 Before rehearsing the arguments, it is worth stressing that the market for independent advice currently contains

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28 The disclosure of information about life insurance products and commissions paid to independent financial advisers. The new requirements of the Securities and Investments Board. (OFT, April 1990), p 22.

29 Consumer research by Taylor Nelson Financial, SIB Disclosures Research (SIB, January 1992).

30 Independent Financial Advisers and the Impact of Commission Disclosure. London Economics Ltd (OFT, October 1992).

features which distinguish it from a normal advice market. It is by no means obvious that this should be so. In a normal advice market, the price of advice should bear some relationship to the costs associated with the provision of that advice. There may not be an exact correlation, particularly if a price for the advice is quoted and agreed in advance of the service being provided. But an investor who receives a great deal of an adviser's time might reasonably expect, and be expected, to pay more for this service than if much less of the adviser's time were taken up. The advice market is more likely to work in this way if advisers charge fees, as some IFAs do.

5.20 IFAs are, however, generally remunerated by commission. In these circumstances, the payment which the IFA receives depends not on the time and costs taken in giving advice, but on the value to the life office of any business it obtains as a result of the advice which the IFA gives to the investor. If the advice results in the sale of a high-value product, the commission will be correspondingly higher even if the effort required of the IFA in advising on it and on the alternatives was very limited and the advice itself relatively straightforward. The price for advice will therefore bear little relationship to the cost of providing it. There will also be cross-subsidy from that investor to another who demands and receives more time and attention but buys a lower value product, or none at all. If investors knew the price for advice - and in current circumstances this generally means the amount of commission - they could judge whether it is reasonable and negotiate around it.

5.21 In the long run, this may lead to more IFAs seeking remuneration by fee and rebating commissions against fees. The price for advice would thus be brought to reflect more closely the IFA's costs. Those who argue that it is right for remuneration to be based instead, as at present, on the value of business to the life office generally do so on the grounds that the IFA is a retailer as well as an adviser. But the fact is that polarisation creates a separate advice market, and they cannot, therefore, have it both ways. An evident lack of relationship between the costs of advice (which are time-related) and reward shows that the market for advice is not working well. It is against this background that I have considered carefully the arguments put to me on this subject.

<u>The arguments</u>

5.22 First, it was put to me that the new product disclosure regime provides for early disclosure of charges, of which commission is only a part, and that this is the proper basis for price competition; and that hard disclosure of commission even at an early stage would not influence such competition because investors would not respond to it. On the former, although overall disclosure of charges is one element of competition in the retail market, it does not allow competition in the advice market. On the latter, the surveys conducted both for SIB and for my Office gave some support for this view, but there was equally evidence that some investors are extremely surprised by the levels of commission earned when these are expressed in an understandable way. Few investors claim that commission disclosure would have no effect on their choices, and hence on competition.

5.23 Secondly, it was argued that investors should be aware of the possibility of 'commission bias' - that is, of an IFA's recommendation being influenced by the level of commission payable on a given product, rather than its inherent qualities for the investor. The bias could be between products that carry commission and others that do not; between different products of one life office; or between the products of different life offices. The counter-argument is that this is best tackled through Best Advice and the Suitability rules, and the strengthened status disclosure rules. But there is little evidence to suggest that investors fully understand the differences in the standards of advice required of tied agents and IFAs, and the effect of these regulatory standards may be reinforced if the operation of market forces is facilitated by transparency. Disclosure of IFAs' commissions could help investors to understand better the nature of the sources of investment advice; for example, the similarities between fee- and commission-remunerated IFAs and the differences between IFAs and the various forms of tied agent. Disclosure of commission by the life office, rather than the IFA, may confuse the investor or blur the investor's understanding of the status of the IFA and the nature of the advice given.

5.24 Third, there is an issue about whether commissions are in some sense the price for advice from an IFA. Since, under the law of agency, the IFA is the investor's agent, it can be argued that the investor pays for the advice through the commission. This is an important part of the investor's understanding of the market for independent financial advice and the fact that commission is the price ultimately paid by the investor for that advice. SIB has not accepted this analysis, arguing that both tied and independent intermediaries provide advice, and that this advice is 'free'. Moreover, commission is paid to both tied agents and independents and can be regarded as a reward paid by a life office rather than a charge to an investor.[31]

5.25 I find this counter-argument unconvincing. While, as noted in Part 2, there is an element of advice in the service offered by a tied agent, the advice is of a different kind from that provided by an IFA. Best Advice aims to ensure that IFAs offer advice across products from the broad range of life offices, whilst tied agents are restricted to advising on the products of only one life office. IFAs therefore operate in a different market from tied agents and life offices recover the costs of commission from investors through premiums. While both tied agents and IFAs may be remunerated by commission, tied agents are agents of the life office whose products it is their purpose to sell; whereas IFAs are agents of the investor and their purpose is to provide independent financial advice (this was one of SIB's central arguments in their discussion paper when proposing commission disclosure for IFAs).[32]

5.26 Fourth, it is argued that, because the quality of advice is difficult to ascertain, price competition will lead IFAs to reduce the quality of advice. This seems not to follow. If quality is hard to assess, there may be little incentive to improve it anyway beyond the protection provided by Best Advice and the Suitability rules. Furthermore, there are other aspects of the quality of an IFA's service which are visible to the investor, such as after-sales service, and on which IFAs may choose to compete.

5.27 Finally, there is the important question as to whether hard commission disclosure could cause the IFA market to diminish and perhaps even disappear in the long term. The size and health of this market must depend, once the conditions for proper competition are in place, on the demand for independent advice; there is no other objectively correct measure of what its size and turnover should be. Recent surveys provide no evidence to substantiate the claim that commission disclosure will

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31 Retail Regulation Review - Disclosure, Polarisation and Standards of Advice: Consultative Paper 60 (SIB, March 1992), p 14.

32 Life Assurance and Unit Trust Disclosure: the regime for 1990 (SIB, December 1988), pp 21-22.

necessarily and materially diminish the size of the independent sector; nor has anyone been able to demonstrate the mechanism that might bring this about. There is an argument that, since the value of advice is not obvious to the investor, most investors would be unwilling to pay for it and will be attracted to the 'free' advice of tied agents. Against this, the existence of fee-charging IFAs shows that some investors are already prepared to pay for advice. The risk of others turning to tied agents depends on investors' not understanding the difference between tied agents and independent financial advisers. It is doubtful whether full commission disclosure would, in itself, cause IFAs to lose business to the tied sector on any significant scale.

Comparisons between IFAs

5.28 I have referred in Part 2 to the fact that some IFAs are engaged wholly or mainly in advising on, and arranging, life assurance and investments, while others do so as ancillary activities. Advisers of both types charge fees or receive commission, or both. However, for many of the second type including solicitors, accountants and tax advisers, hard disclosure of commission is a mandatory requirement of their RPBs. It follows that, without a common disclosure requirement, there is some distortion in competition between these advisers and other IFAs.

Comparisons between IFAs and tied agents

5.29 As noted in Part 2, polarisation has created two markets - the retail market and the advice market. Tied agents and IFAs compete in the retail market; IFAs (whether commission - or fee-remunerated) compete in the advice market. Different prices are charged in these two markets. Tied agents are representatives of the life offices, and the price they charge is the total charge for the product (including commission, marketing costs, and other charges). IFAs are the agents of the investors and the prices they charge for their advice is the commission paid by the life office to the IFA, the cost of which is borne ultimately by the investor. Investors can affect the price for advice by negotiating a rebate with the IFA but cannot so readily negotiate the price in the retail market.

5.30 It is against this background that I consider the argument put to me by some that, if commission is to be fully disclosed, a similar requirement should be placed on tied agents as well IFAs, because both types of intermediary distribute and sell life products. This argument is that commission is the main charge for IFA advice, and is an important element in the initial charges of life offices. If a system could be applied fairly to both tied agents and IFAs, investors would have some way of comparing one element of the charges levied by a life office irrespective of the status of the intermediary. Investors may then be helped in making choices between products, although the effectiveness of status disclosure may be compromised and standards of advice reduced.

5.31 It would be difficult, but not impossible, to devise a means of measuring and comparing the remuneration of both tied agents and IFAs. The main problem is that of cost allocation. IFAs receive variable rates of commission depending on their relationship with a life office; whereas the tied agent often has a quite different remuneration system with incentives such as company cars, bonus payments, and help with back-up office costs. A comparable system of remuneration disclosure would involve estimating how much a tied agent receives from each sale, whatever the elements which make up that agent's remuneration. This estimate could be certified by the life office actuary in those cases where tied agents were remunerated on a basis other than commission. It is, however, arguable whether such an estimate could be fairly compared with the commissions received by IFAs.

5.32 Although disclosure of remuneration across the board is feasible, I take the view that the costs would probably outweigh the usefulness. The regulatory organisations have already accepted that there is a fundamental difference between the retail and advice markets by making different rules for disclosure by tied agents (charges and expenses) and IFAs (charges and expenses and soft commission disclosure). If hard disclosure of remuneration were to apply to all intermediaries, investors may take less account of the status of the intermediary and the value of the advice they are receiving. By blurring the effectiveness of status disclosure, this could partially recreate a single market for product distribution reminiscent of the pre-1986 regime.

<u>Form of disclosure</u>

5.33 My predecessor wrote in 1990 of his concern that the existing rules provided for commission to be disclosed only in terms of the percentage of premium. There would be less competitive pressure on the cost of the services of IFAs, because percentage of premiums relate commission to the price of the policy, not to the cost of the IFA's advice. Disclosure as a percentage of premium would do little to help investors understand the independent nature and cost of an IFA's advice.[33] I share this concern, which therefore remains. If commission disclosure is to be meaningful it should be in terms, such as cash, which are easily understood by investors.

Disclosure by life offices

5.34 It is also disappointing that the Review did not address my predecessor's concern about the disclosure of commission being made to the investor by the life office rather than by the IFA. Since the IFA acts as the agent of the investor, the investor should be told by the IFA the price he or she is to pay for advice. Disclosure by the life office serves rather to confuse this relationship between the investor and the adviser.[34] Moreover, it serves to undermine both the effectiveness of the status disclosure made in the Client's Guide, and wider efforts to make investors aware of the nature of the advice offered by the two types of intermediary.

Conclusion on commission disclosure by IFAs

5.35 SIB acknowledged in its October 1991 discussion paper that commission disclosure reduces the risk of some of the malign effects (such as overselling and company- and product-bias) of a commission-remunerated independent advice market.[35] SIB has since maintained, however, that hard commission disclosure will provide information that is important or interesting rather than vital. I do not find that the balance of the arguments, which I have set out fully above, bears this out. The rules of SIB and LAUTRO provide for commission details to be provided to investors by life offices, late in the selling process, and in a less than easily understandable form. As a result, an investor does not know the price he or she is paying for independent financial advice, cannot compare the cost of advice from other IFAs, and

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[33] The disclosure of information about life insurance products and commissions paid to independent financial advisers. The new requirements of the Securities and Investments Board. (OFT, April 1990), pp 25-26

[34] The disclosure of information about life insurance products and commissions paid to independent financial advisers. The new requirements of the Securities and Investments Board. (OFT, April 1990), p 26.

[35] Retail Regulation Review - Discussion Paper No. 3: Disclosure (SIB, October 1991), p 11.

is unable to decide if the price is reasonable. The risk of commission bias remains, and there is little to act as a restraint on the bidding up of commissions which has taken place since the abolition of the MCA.

5.36 If SIB and LAUTRO had not made a rule calling for limited commission disclosure, it is likely that IFAs (probably all of the fee-remunerated IFAs and many of the larger commission-remunerated IFAS) would generally disclose commission early in the selling process. But as IFAs are not required to make such a disclosure, there is a clear signal that withholding this information is acceptable to the regulatory organisations. The rules therefore serve to set the norm for conduct in this respect and are likely to inhibit the provision by the adviser of information about the amount of commission earlier in the selling process. Without such disclosure investors will not know the characteristics of the market in which they are dealing, and prices in that market, at a time when it could affect their decisions. This is likely to distort competition among IFAs and between them and other intermediaries to a significant extent.

PART 6: SUMMARY AND CONCLUSIONS

6.1 In this report, I have set out my findings from a wide-ranging review of the rules of SIB and LAUTRO, both the rule changes made last May and July, and the rules which have not been changed. In a number of places, I refer to my predecessor's published reports on retail regulation, a list of which is given in Annex I.

6.2 There are a number of minor rule changes on which I have not commented because they do not appear to me to raise significant new or unresolved competition issues. Where rule changes or existing rules do seem to me to raise competition issues I summarise these below.

6.3 The process of settling a stable regime for life products has been a long one, and much progress has been made (Part 1). But the markets are complex: life products compete with each other and with other investment products; they compete with each other within the product range of individual life offices as well as with those of other life offices; life offices compete in the design, distribution and retailing of products; tied agents compete with each other and with IFAs in the retail market; and IFAs compete with each other and, to a more limited extent with tied agents, in the advice market (Part 2).

6.4 I believe that competition can take place most effectively when investors have access to information of the right type and extent, at the right time, and in an understandable form. Timing of provision of information is particularly important: investors must have information at an early stage, because the range of potential choice is then widest, the level of commitment lowest. The framework in which investors' decisions are made calls for them to be able to estimate as closely as possible the payments they are to make, the impact of factors affecting receipts, and the likelihood of those factors and receipts arising. They need an optimal set of information in order to make this evaluation, consistent with what can be given cost-effectively whilst concentrating on the more relevant data. If material information likely to influence the investor's decision is not made available there could be significantly anti-competitive effects (Part 3).

6.5 Among the strengthened rules on the <u>disclosure of an intermediary's status</u>, I believe the new Client's Guide in particular will be a useful development. Some further reinforcement could be helpful, but I do not now find any significantly anti-competitive effects in these rules (Part 4, paragraphs 4.2 - 4.7).

6.6 The new rules on the <u>disclosure of product details</u> augment the amount and quality of information to be disclosed to an investor early in the selling process, notably through the use of Key Features. I regret that fully client-specific information will be required to be disclosed in the second tier of information only after a two year transitional period. But I do not find any significantly anti-competitive effects in this aspect of the new rules (Part 4, paragraphs 4.8 - 4.24).

6.7 I do, however, make such a finding in respect of the rules which prevent disclosure of indications of <u>surrender values</u> beyond a five year period.[36] The relevant table will give investors the general message that they are entering on a long-term commitment and that they may not get their money back if they surrender the policy within that, or some longer, period. But the wide variety of life offices' practices, and their effects on surrender values in later years, are such that the pattern of surrender values and their relationships to the sum assured vary significantly from office to office. Payments to a policyholder on surrender in later years are possible cash receipts from the policy and hence relevant to a decision on whether or not to buy the policy in question or indeed any life product. In limiting the investor's ability to make good choices among the products of different life offices and between life products and other investments, the rules are likely to restrict and distort competition in these markets to a significant extent (Part 4, paragraphs 4.25 - 4.27).

6.8 I also make such a finding in respect of the rules which require <u>illustrations</u> of possible future returns on investment to be based on standard levels of costs, as opposed to a life office's own costs, while requiring a separate form of disclosure of the office's own costs.[37] Life offices' charges can vary widely; are known with some accuracy; are likely to have more stability over time than returns; and can have a significant bearing on product performance over time: the illustration may therefore give the impression that the effect of charges is less

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36 The principal rules are SIB's new Conduct of Business rule 5; and LAUTRO's new Conduct of Business rule 5 and Schedules 4 and 6.

37 The principal rules are SIB's new Conduct of Business rule 5; and LAUTRO's new Conduct of Business rule 5 and Schedules 4 and 5.

predictable, material, and different among life offices than is the case. It also limits the ability of prospective investors to assess the effect of the life office's level of costs, because investors cannot calculate how the illustration would look if the office's current cost level was substituted for the standard level. In that investors will make different decisions from those they would make if they had better information, this is likely to restrict and distort competition among life offices to a significant extent (Part 4, paragraphs 4.31 - 4.43).

6.9 The effect of the unchanged rules of SIB and LAUTRO on Best Advice, as they are currently interpreted, is to prevent a life office from offering a product at different prices through different tied outlets.[38] There are, however, cost differentials among tied outlets which are not reflected in prices. Prices, and hence competition, are thus artificially restricted among these outlets. I note, moreover, that there is no prohibition on differential pricing among IFAs. By preventing life offices and their tied agents from reflecting in their prices to investors the different costs of distribution among tied agents, and hence limiting the likelihood that the most efficient means of distribution will prevail and reduce overall costs to investors, these rules restrict competition among life offices and tied outlets to a significant extent (Part 5, paragraphs 5.2 - 5.12).

6.10 I have also considered the unchanged rules of SIB and LAUTRO relating to the disclosure of commissions by IFAs. These have technically been replaced by new rules, but which are not different in their effect.[39] They require IFAs to disclose commission at an early stage in the selling process only if asked to do so by the investor. Otherwise, the investor will receive such information only later, and from the life office rather than the IFA. I consider that the commissions which an IFA receives and which are paid for indirectly by the investor - for whom the IFA acts as agent - can be regarded as the price for the advice which the investor receives. Without early automatic disclosure of commissions, in actual cash amounts, an investor will not know the price of advice, and cannot compare it with that for the advice of other IFAs (including those remunerated by fees). The

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[38] The principal rules are SIB's Core Rule 17 and Conduct of Business rule 5; and LAUTRO's Conduct of Business rule 3 and Schedule 2.

[39] The principal rules are SIB's Conduct of Business rule 5 as revised; and LAUTRO's new Conduct of Business rule 5 and Schedule 6, and Schedule 7 as revised.

rules of SIB and LAUTRO serve to set the norm for conduct in this respect, and thus are likely to inhibit the provision by the adviser of information about the amount of commission earlier in the selling process. Without such disclosure, investors will not know the characteristics of the market in which they are dealing, and prices in that market, at a time when it could affect their decisions. This is likely to distort competition among IFAs and between them and other intermediaries to a significant extent (Part 5, paragraphs 5.13 - 5.36).

6.11 Finally, I wish to record that I have been greatly assisted in my work by the views and advice proffered from a wide range of sources including the regulatory organisations, practitioners, and commentators outside the industry. The principal persons and organisations consulted, or from whom I received representations, are listed in Annex J. There are others also: to all of these I should like to extend my grateful thanks.

ANNEX A

PRINCIPAL REFERENCE DOCUMENTS

Rule Releases

New Core Rules contained in an Annex to the Retail Regulation Review, Policy Statement: Disclosure and Standards of Advice. (SIB, May 1992)

The Financial Services (Miscellaneous Amendments)(No.21) Rules and Regulations 1992. Release No. 118. (SIB, July 1992)

Rules Bulletin No. 53 (containing the Disclosure of Status Rules 1992 and Product Disclosure Rules 1992). (LAUTRO, July 1992)

Consultative Documents

Life Assurance and Unit Trust Disclosure: the regime for 1990. (SIB, December 1988)

Life Assurance and Unit Trust Disclosure: Outstanding Matters. Consultative Paper 30. (SIB, November 1989)

Retail Regulation Issues for Review. (SIB, April 1991)

Retail Regulation Review - Discussion Paper No. 1: Financing the Compensation Liabilities of FIMBRA Members. (SIB, June 1991)

Retail Regulation Review - Discussion Paper No. 2: Polarisation. (SIB, September 1991)

Retail Regulation Review - Discussion Paper No. 3: Disclosure. (SIB, October 1991)

Consultative Bulletin No. 11: Disclosure. (LAUTRO, October 1991)

Retail Regulation Review - Disclosure, Polarisation and Standards of Advice: Consultative Paper 60. (SIB, March 1992)

Consultative Bulletin No. 13: Product Disclosure, Illustrations, Indirect Benefits and Other Matters. (LAUTRO, March 1992)

Retail Regulation Review: Report of a study by Sir Kenneth Clucas on a new SRO for the Retail Sector. (SIB, March 1992)

Fiduciary Duties and Regulatory Rules. Consultation Paper No. 124. (Law Commission, April 1992)

Policy Statement: Retail Regulation Review - Disclosure and Standards of Advice. (SIB, May 1992)

Other Documents

Written Reply to a Parliamentary Question from Mr Graham Riddick MP (Colne Valley) by the Right Hon Peter Lilley MP, Secretary of State for Trade and Industry. (Official Report, 7 December 1990)

Consumer research by Taylor Nelson Financial. SIB Disclosures Research. (SIB, January 1992)

Disclosure of Intermediary Status and Expenses. Taylor Nelson Financial. (SIB, February 1992)

Independent Financial Advisers and the Impact of Commission Disclosure. London Economics Ltd. (Office of Fair Trading, October 1992)

ANNEX B

THE RULES ON STATUS DISCLOSURE

Note: this is not intended as an authoritative statement of the rules, for which reference should be made to the individual rulebooks.

SIB - EXISTING RULES

SIB Core Rules

Rule 4 establishes polarisation.

Rule 11.2 requires status disclosure.

SIB Conduct of Business Rules

Rule 2.09 concerns clarity of status disclosure.

Rule 5.11B requires Buyer's Guide in form given in Appendix E and says when it must be handed over.

Rule 5.12 requires Product Particulars to be sent when, or as soon as practicable after, a recommendation has been made.

Rule 5.14 requires content of Product Particulars to conform to Appendix D.

Appendix D Section 2.13 requires an intermediary's status to be disclosed in Product Particulars.

Appendix E prescribes wording for Buyer's Guide.

Rule 6.03 requires stationery and business cards used by Company Representatives to disclose the extent of the range of products available from them.

Rule 7.28 concerns status disclosure in advertisements.

Rule 7.29 requires advertisements not to disguise non-independent status of tied agents.

SIB - RULE CHANGES

SIB Conduct of Business Rules

Rule 5.11B substitutes 'Client's Guide' for 'Buyer's Guide'.

Appendix (Rule 5.11B) prescribes wording for Client's Guide (replaces Appendix E which prescribed wording for the Buyer's Guide).

Rules 6.03 and 6.04 contain new status disclosure statements for business stationery used by tied agents.

Rule 6.05 requires Appointed Representatives to display their status in business premises.

Rule 7.28 concerns status disclosure in advertisements including some mortgage advertisements.

LAUTRO - EXISTING RULES

LAUTRO Conduct of Business Rules

Rule 3.2(4) restricts tied agents to selling only products of the life office to which they are tied.

Rule 3.5(D) concerns status disclosure on business stationery used by Appointed Representatives.

Rule 5.10C requires Product Particulars to disclose the source of a tied agent's remuneration.

Schedule 2 is the Code of Conduct which prescribes tied agents' behaviour when carrying out relevant investment business.

Schedule 2A sets out the prescribed wording for the Buyer's Guide.

LAUTRO - RULE CHANGES

LAUTRO Conduct of Business Rules

Substitute 'Client's Guide' for 'Buyer's Guide' throughout.

Rules 3.5D and 3.9 (Amending) concern status disclosure on business stationery and in premises, and clarity of status disclosure.

Rule 6.23 concerns status disclosure in mortgage advertisements.

Schedule 2 (Code of Conduct) Para 4(1) (Amending) concerns status disclosure on Company Representatives' business cards.

Schedule 2A prescribes the wording for the Client's Guide.

ANNEX C

THE CLIENT'S GUIDE

1. This annex contains the two forms of the Client's Guide laid down in the rules of SIB and published in Rulebook Amendments and Additions Release 118. The first is that to be used by tied agents and the second is that to be used by independent financial advisers. The Client's Guide prescribed in LAUTRO's new rules is identical to the former, with all references to SIB replaced by references to LAUTRO. The Client's Guide may be in company livery.

CLIENT'S GUIDE FOR TIED AGENTS:

CLIENT'S GUIDE

This guide tells you what you should keep in mind when someone is giving you advice on life assurance, personal pensions or unit trust products. Issuing this guide is a requirement of SIB* (the Securities and Investments Board).

Do you know what sort of advice you are getting?

- People who offer these products are
  EITHER representatives of one company
  OR independent advisers.

  - The person who gave you this guide is a representative of §.

Our representative

- Our representative, unlike an independent adviser, will advise you on only one range of life assurance, pensions and unit trusts - the § range. § accepts responsibility for the advice our representative gives you about these products.

Our representative's duties to you

- Our representative, who is bound by the rules of SIB which are designed for your protection:

  - will ask you about your personal and financial circumstances, in order to judge which products are suitable for you and
  - if there is a product that is suitable for you, will explain the main points which you need to consider.

Who pays the representative?

- Our representative (or his firm) will be paid by us out of the total expenses of any product you may buy.

Further information

- If you would like any more information, or if anything is unclear to you, please ask our representative.

  [Option for firm to include reference to non-polarised products.]

* SIB is the authority that regulates the UK investment industry. SIB, Gavrelle House, 2-14 Bunhill Row, London EC1Y 8RA. *Tel:* 071-638 1240

§ Here insert name of firm or of marketing group as appropriate.

CLIENT'S GUIDE FOR INDEPENDENT FINANCIAL ADVISERS:

CLIENT'S GUIDE

This guide tells you what you should keep in mind when someone is giving you advice on life assurance, personal pensions or unit trust products. Issuing this guide is a requirement of SIB* (the Securities and Investments Board).

Do you know what sort of advice you are getting?

- People who offer these products are
  EITHER representatives of one company
  OR independent advisers.

  - **The person who gave you this guide is an independent adviser.**

Your adviser

- Your adviser, unlike a representative, can advise you on more than one range of products. He will act on your behalf and he or his firm is responsible for the advice he gives you.

Your adviser's duties to you

- Your adviser, who is bound by the rules of SIB which are designed for your protection:

  - will ask you about your personal and financial circumstances in order to judge which products are suitable for you and

  - if there is a product that is suitable for you, will explain the main points which you need to consider.

Who pays?

- Unless you come to some other arrangement with him, your adviser (or the firm he works for) will normally receive commission by the company whose product you buy. Commission forms only part of the company's expenses.

- If you ask your adviser he will give you details of the commission. In any case, details of the amount of commission will be sent to you later from the company whose product you buy.

Further information

- If you would like any more information, or if anything is unclear to you, please ask your adviser.

  [Option for firm to include reference to non-polarised products.]

* SIB is the authority that regulates the UK investment industry. SIB, Gavrelle House, 2-14 Bunhill Row, London EC1Y 8RA. Tel: 071-638 1240

ANNEX D

THE RULES ON PRODUCT DISCLOSURE

Note: this is not intended as an authoritative statement of the rules, for which reference should be made to the individual rulebooks.

Whilst aspects of illustrations and projections are dealt with in the rules on product disclosure the rules relating to them have been listed separately in Annex F. Similarly for rules on commission disclosure, which are listed in Annex H.

SIB - EXISTING RULES

SIB Principles

Principle 5 requires intermediaries to give investors sufficient information in a timely and comprehensible way to enable balanced and informed decisions to be made.

SIB Core Rules

Rule 9 requires that communications are fair and not misleading.

Rules 11 and 12 require sufficient information on the buying process and life products to be given to enable private investors to make informed decisions.

Rule 12 introduces the Product Particulars requirement.

Rule 17 requires that tied agents must know their life office's products and IFAs must know what is generally available on the market.

Rule 38.3 allows certain information not to be supplied if it will duplicate information that has already been given.

SIB Conduct of Business Rules

Rule 2.09 requires disclosure to be made in a readily understandable form.

Rule 5.11C requires With-Profits Guides to comply with the relevant LAUTRO rules.

Rule 5.14 requires Product Particulars to be sent with the cancellation notice or, if there is no cooling off period, as soon as reasonably practicable after a transaction is made; and to conform to Appendix D.

Rule 7 covers advertisements.

SIB - RULE CHANGES

SIB Core Rules

Rule 12 requires intermediaries to provide Key Features.

Rule 16 requires a 'reason for recommendation' in writing to be given to a private investor.

SIB Conduct of Business Rules

Rule 5.01 requires 'reasons for recommendation' for long-term commitments or relinquishments.

Rule 5.11C requires With-Profits Guides to comply with the relevant LAUTRO rules.

Rule 5.12 requires Key Features to comply with the relevant LAUTRO rules.

Rule 5.12A requires Key Features to be given to a private investor before or at time of recommendation, with sufficient information for investor to make an informed decision, together with notice of cancellation rights and further details. It requires client-specific details to be supplied, if requested.

Rule 5.14 requires the provision of 'Important Information' to comply with the relevant LAUTRO Rules.

Rule 5.14D requires a statement to be sent to a private investor confirming that a transaction was advice-free in the case of execution-only transactions.

Rule 7.24 requires 'off-the-page' advertisements (direct offer advertisements) for a life policy to comply with the relevant LAUTRO Rules.

Rule 16.06A requires a record to be maintained of each written 'reason for recommendation' for a period of three years.

LAUTRO - EXISTING RULES

LAUTRO Conduct of Business Rules

Rule 3.11 requires records to be kept of each transaction.

Rules 5.10 and 5.10(A) require that Product Particulars, including a statement of charges, must be supplied no later than the start of the cooling off period, and set out the contents.

Rule 5.10B requires 'Effect of Charges and Expenses' to be shown as reduction in yield as calculated in accordance with Schedule 4A. May be shown as a table of specimen values and must accord with the LAUTRO-prescribed basis for calculations.

Rule 5.13 requires wording on the effect of inflation on projections.

Rules 5.16A, 5.16B, 5.16C and Schedule 8 require and define the content of With-Profits Guides.

Rule 5.16F requires the With-Profits Guide to be given or sent to investors if they request it.

Rule 6 sets out the requirements for advertisements.

Schedule 2 (Code of Conduct) 5 prohibits the use of any written material not authorised by the life office.

Schedule 2 6A states that a general description of the contract must be given, including, if it is the case, the fact that the surrender value will be less than the sum of the premiums paid if surrendered early.

LAUTRO - RULE CHANGES

LAUTRO Conduct of Business Rules

Rule 5.4 makes general provisions as to projections and surrender values and requires projections to be confirmed in writing and records kept for 3 years.

Rule 5.5 states that no document can contain a projection unless it also contains information on 5 year surrender values, overall charges on the basis of reduction in yield and equivalent deduction from premium basis as contained in Key Features.

Rule 5.6 and Schedule 5 prescribe generic statements to accompany projections.

Rule 5.7 requires information to be given in accordance with rules 5.8 and 5.9 and Schedule 2. Information must be fair, clear and not misleading; changes to prescribed wording and layout may be made but the life office must be prepared to justify them.

Rule 5.8 introduces the Key Features requirements, in accordance with Schedule 6 (with some exceptions). Allows Key Features to be in a stand-alone document or in a brochure.

Rule 5.9 requires 'Important Information', in accordance with Schedule 6, to be sent to the investor no later than when the cancellation notice is sent or, if there is no cancellation notice, as soon as is reasonably practicable after the contract is made.

Rule 5.10 requires the effect of charges and expenses to be calculated in accordance with Schedule 4A.

Rule 5.11 relates to the provision of Key Features and Important Information to the trustees of occupational pension schemes which provide money purchase benefits.

Rules 5.14 - 5.19 and Schedule 8 set out the requirements for With-Profits Guides.

Rule 6 is altered, in particular to accommodate the introduction of the three tier system with regard to Category 'C' advertisements (direct offer advertisements).

Schedule 2 (Code of Conduct) 6A implements Key Features, and requires client-specific information to be supplied if requested, which may be in the form of specimen tables (this provision for 2 years from a date to be decided); together with information about cancellation, warnings on higher volatility fund contracts and property fund contracts.

Schedule 4A gives the definitions and formulae for the calculation of reduction in yield and deduction from premiums.

Schedule 5 gives the wording to accompany projections including on the effect of inflation.

Schedule 6 sets out the basic information to be contained in Key Features, Important Information, Other Important Information and specifies additional warnings.

ANNEX E

EXAMPLE OF 'KEY FEATURES'

1. The following is an example of the Key Features document as required by SIB and LAUTRO. It reproduces the wording prescribed in LAUTRO's Rules Bulletin 53 for the boxed section marked 'IMPORTANT', the first paragraph and the table in the section marked 'What if you stop the policy early on?', and the section marked 'How do our expenses affect your benefits?'.

2. For other sections, the content but not the wording is prescribed. In these cases, the wording in the example provided in SIB's Consultative Paper 60 has been reproduced. There is, however, no prescribed text or example for the paragraph immediately underneath the table of surrender values: an original text has been inserted here in the overall style of the document.

3. Key Features may appear in a stand alone document or in another document such as a brochure. However, if they are included in another document, LAUTRO's rules state that they should be prominent and in a style that does not make them seem less important than the rest of that document.

XYZ Company	ENDOWMENT ASSURANCE WITH PROFITS

KEY FEATURES

IMPORTANT	Please read this. It tells you about the key features of the XYZ With Profits Endowment Policy. The figures given are only examples. If you apply for a contract you will be sent more precise figures later. If you want to compare the details of our product, including our expenses, with those offered by other companies please ask now for a personal version of these Key Features. If there is anything which you do not understand, or if you would like more information about any aspect, just ask.

You pay a regular amount for a chosen period

For example you might pay:

£100 per month
for 25 years

What you would get in return for your payments

You would get paid a minimum guaranteed sum at the end of 25 years. The exact amount will depend on things like your age and sex. As an example, if you were a man (non-smoker) aged 35 next birthday when you start the policy you would get a minimum guaranteed sum of

£28,000*

* On top of this amount we would also pay any 'bonus additions' - these are explained later.

What if you die?

If you died at any time before the end of the 25 years we would still pay

£28,000*

* plus any 'bonus additions'.

Bonus additions

The type of insurance policy selected is called a 'with profits' policy. The money you pay in is invested by XYZ in a range of investments which may make profits. From those profits XYZ will add bonus additions from time to time to the minimum guaranteed sum of £28,000; so that the total sum paid in 25 years time might be more than £28,000. Of course we cannot say for certain how much the bonus additions will be - that will depend on how well the investments perform. Those investments may be in things like the shares of companies and property, the prices of which can go down as well as up over the years.

What if you stop the policy early on?

BE CAREFUL! You will probably get back less than you paid in if you stop the policy early on. You should get the best value from the contract if you keep it up for the full 25 years. Don't buy unless you expect to go on paying the premiums. The table below shows how much you might get back if you cashed in the policy early on. The figures are only a rough guide and are not guaranteed.

At end of year	Amount paid in £	What you might get back £
1	1,200	500
2	2,400	1,200
3	3,600	1,900
4	4,800	2,900
5	6,000	4,200

Assuming things turn out as shown above then it would be about 7 years before you could get back more than you paid in by cashing your policy. This is due to the costs of setting up the policy and of providing life cover.

How do our expenses affect your benefits?

Not all of your money will be used to provide you with benefits under the policy. As with other savings contracts, some of your money will go to meet our expenses. These include such things as marketing, administration and investment management costs.

The expenses are higher in the early years but if you held your policy for the full 25 years and if each year we received an investment return of 7% then on average the overall effect of our current expenses would be:

about the same as if we had deducted 14p from every £1 you paid us

Or to put it another way, our expenses would have the effect of reducing the investment return from 7% a year to 6% a year:

a reduction in the investment return of 1% each year

More detailed information

More information about bonus additions and other factors affecting what you get from this policy is given in our 'With Profits Guide'. If you would like a copy of the Guide, or if there is anything you do not understand, please ask your adviser.

THE RULES ON ILLUSTRATIONS

Note: this is not intended as an authoritative statement of the rules, for which reference should be made to the individual rulebooks.

SIB - EXISTING RULES

SIB Conduct of Business Rules

Rule 5.11 lays down general requirements relating to illustrations.

SIB - RULE CHANGES

SIB Conduct of Business Rules

Rule 5.11 requires illustrations to comply with the relevant LAUTRO rules, and lifts previous prohibition on the provision of illustrations to the trade press.

LAUTRO - EXISTING RULES

LAUTRO Conduct of Business Rules

Rules 5.1 and 5.3 define terms.

Rule 5.4 allows projections to be issued only in respect of certain contracts, and requires projections issued to investors to be confirmed in writing and records of them kept for at least 3 years.

Rule 5.5 makes general provisions.

Rule 5.6 concerns projections in Product Particulars, requires projection of surrender values for the first 5 years to be included.

Rule 5.7 requires calculation of projections to be made in accordance with relevant premiums and projection tables.

Rule 5.8 requires that where a projection table is inappropriate the calculation must be made in accordance with Schedule 4.

Rule 5.9 defines assumptions that must be used, and assumed rates of return.

Rule 5.10 requires Product Particulars for every contract where a cancellation notice is given.

Rule 5.10A sets out the information to be given in Product Particulars.

Rule 5.10B requires Product Particulars to contain the 'Effect of Charges or Expenses' shown as a reduction in yield calculated in accordance with Schedule 4A (shown either as a specific figure or as a table).

Rule 5.11 allows a life office to issue a projection at any time and requires benefits to be calculated in accordance with Appendix A. Sets assumed rates of return.

Rule 5.13 sets out the wording to accompany projections.

Rule 5.16F requires 'With-profits' Guides to be given on request.

Rule 6.6(2) requires advertisements not to contain a projection not permitted under Rule 5 if the contract is recommended by a Company Representative.

Rule 6.12(6) an advertisement must not contain any projection unless it also contains a statement in accordance with Schedule 5 and (with exceptions) Schedule 6.

Schedule 4 concerns the calculation of projections.

Schedule 4A concerns the calculation of reduction in yield.

Schedule 5 gives the statements to accompany projections and surrender values and sets prescribed rates of return.

Schedule 6 gives the formula for calculating the effects of inflation.

LAUTRO - RULE CHANGES

LAUTRO Conduct of Business Rules

Rule 5.3 requires projections to conform to Rule 5 and Schedule 4 (with some exceptions) and prohibits the issuing of projections for higher volatility contracts.

Rule 5.4(1) requires projections to be confirmed in writing and records kept for a minimum of 3 years.

Rule 5.4(2) requires projections in certain circumstances to be calculated in accordance with Schedule 4.

Rules 5.4(3)-(5) concern projections for personal pensions.

Rule 5.4(6) requires projections to show premiums paid.

Rule 5.5(1) requires projections to be accompanied by information on surrender values, cash values, reduction in yield and deduction from premium.

Rule 5.6 concerns statements required with projections (relevant statements are given in Schedule 5).

Rule 5.13(1) says the Board of LAUTRO may direct a life office to issue a projection.

Rule 5.13(2) states that a life office needs the Board of LAUTRO's permission in writing before issuing any projection other than those conforming to the rules of Rule 5 and Schedule 4.

Schedule 4 sets out the general provisions for the calculations of projections.

Schedule 4A sets out definitions and methods for calculating the reduction in yield and the deduction in premium.

Schedule 5 prescribes the statements to accompany projections.

THE RULES RELATING TO DIFFERENTIAL PRICING AMONG TIED AGENTS

Note: this is not intended as an authoritative statement of the rules, for which reference should be made to the individual rulebooks.

SIB EXISTING RULES

SIB Core Rules

Rule 17 requires firms to ensure that their agents are aware of the available products of their own marketing group and will not sell a packaged product to a private investor, if they are aware of one that better suits the investor's needs within the marketing group. Similarly, IFAs must not advise the purchase of a packaged product if aware of a packaged product generally available, which would better meet the investor's needs.

SIB Conduct of Business Rules

Rule 2.08(1) requires that a firm shall not charge unfairly or unreasonably for the services it provides.

Rule 5.02 prevents tied agents from recommending a life product unless it is suitable and there is no better product which the agent could recommend.

Rules 6.01 and 6.02 prevent tied agents from recommending the products of anyone but the life office to which they are tied; however, they can refer an investor to an IFA.

LAUTRO EXISTING RULES

LAUTRO Conduct of Business Rules

Rule 3.2(1) requires life offices to ensure that their Company Representatives are authorised to sell every category of their product range; and that if the office is a member of a marketing group, the Company Representatives must be authorised to sell the products of every range of all members of that marketing group, whether or not all members of it are LAUTRO Members, with some exceptions relating to competence.

Rule 3.2 (3) exempts a tied agent from complying with 3.2(1) if Schedule 2, para 8(3) of the Code of Conduct applies.

Schedule 2 (Code of Conduct) para 7 requires a Company Representative not to advise on a contract unless he is authorised to do so.

Schedule 2 para 8(1) allows an individual Company Representative to recommend only products which are suitable for the investor and to ensure that there is no other contract available from the life office/marketing group which would secure the investor's objectives more advantageously.

Schedule 2 para 8(2) says that if a Company Representative considers that a contract he is not authorised to sell ought to be recommended, he must refer the investor to a fellow Company Representative who is authorised to sell it.

Schedule 2 para 8(3) states that 'Best advice' does not apply to certain investment contracts including products where the IFA or Company Representative is prepared to offer commission rebate to the benefit of the investor.

ANNEX E

THE RULES ON COMMISSION DISCLOSURE

Note: this is not intended as an authoritative statement of the rules, for which reference should be made to the individual rulebooks.

The requirements for commission disclosure have not changed significantly but the rules have been rewritten as part of the general restructuring of the rulebooks.

SIB - EXISTING RULES

SIB Core Rules

Rule 18.2 requires the disclosure of the basis or amount of any charges or remuneration for providing investment services to a private investor.

SIB Conduct of Business Rules

Rule 5.13 requires that an IFA may not recommend a commission-paying life product without disclosing both that commission will be received and that the amount will be disclosed in due course. Handing over the Client's (formerly Buyer's) Guide is sufficient to comply with the first requirement. The disclosure of the amount must be in writing and sent as soon as reasonably practicable after the recommendation has been made.

Rule 5.13A requires an IFA to send, after the point of sale, a written statement of the amount of commission payable, in relation to a life product, where the investor has specifically requested it.

Rule 5.14 requires Product Particulars, with details as defined in Schedule D, to be sent no later than the cancellation notice, if applicable, or as soon as reasonably practicable thereafter. Product Particulars contain the amount of commission paid to an IFA expressed as a percentage of premiums.

Rule 5.14A obliges IFAs to let investors know, as soon as practicable, by means of a written statement, the details of any revised commission, in whatever detail the investor has requested.

SIB - RULE CHANGES

SIB Conduct of Business Rules

The relevant rules are those relating to LAUTRO rules governing the provision of Key Features and Important Information (see Annex D on product disclosure).

LAUTRO - EXISTING RULES

LAUTRO Conduct of Business Rules

Rule 4 defines commission and regulates its payment.

Rule 4.14 states "An investor who has purchased an investment contract from a Member [of LAUTRO] through an independent intermediary may request from the Member a written statement setting out the commission which the Member has paid or will pay to the intermediary in respect of that contract, and the Member shall give the investor the statement without undue delay."

Rule 5.14 requires Members to include a statement under the heading 'Commission' in Product Particulars telling the investor that commission is payable to an IFA in a particular form (as set out in para 2 of Schedule 7).

Rule 5.15 states that in transactions arranged by an IFA, where a cancellation notice is not needed, Members are required to send a written statement of commission details (as set out in para 2 of Schedule 7) to the investor, as soon as reasonably practicable.

Rule 5.15A requires Members to give investors the new rate or scale applicable where an IFA's commission is increased.

Schedule 7 sets out the tables which must show commission payments as percentage of the premiums.

LAUTRO - RULE CHANGES

LAUTRO Conduct of Business Rules

Rule 5.9 governs the provision of Important Information Specific to the Investor (with some exceptions).

Rule 5.11(2) relates to occupational pension schemes.

Rule 5.12 gives the disclosure of commission in special cases.

Schedule 6 sets out the contents of Key Features and Important Information.

ANNEX I

RELEVANT REPORTS BY THE DIRECTOR GENERAL OF FAIR TRADING

The Securities and Investments Board. (March 1987)

The Securities and Investments Board and the Friendly Societies. (March 1987)

The Securities and Investments Board (Supplementary Report). (April 1987)

The Financial Intermediaries, Managers and Brokers' Regulatory Association. (December 1987)

The Investment Management Regulatory Organisation. (January 1988)

The Life Assurance and Unit Trust Regulatory Organisation (Part 1). (2 March 1988)

The Life Assurance and Unit Trust Regulatory Organisation (Part 2). (28 March 1988)

The disclosure of information about life insurance products and commissions paid to independent financial advisers. The new requirements of the Securities and Investments Board. (April 1990)

Regulatory costs and the availability of independent financial advice. The rules of FIMBRA and other regulatory bodies. (April 1990)

ANNEX J

PERSONS CONSULTED OR HAVING MADE REPRESENTATIONS

Allied Dunbar
Association of British Insurers
Association of Investment Trust Companies
Association of Investors
Barclays Bank
Bradford & Bingley Building Society
British Bankers' Association
British Insurance & Investment Brokers' Association
Confederation Life Insurance Company
Consumers' Association
Financial Intermediaries, Managers and Brokers' Regulatory Association
Friends Provident
Halifax Financial Services
Harington, Mr H
IFA Promotions
Joffe, Mr J
Law Society
Life Assurance and Unit Trust Regulatory Organisation
Life Insurance Association
Linked Life Assurance Group
London & Manchester Assurance
MI Group
National Federation of Consumer Groups
Noble Lowndes
Pahor, Mr A L
Provident Life
Prudential Corporation
Ravenscroft, Mr A
Royal London Insurance
Scurfield, Mr H
Securities and Investments Board
Sedgwick Financial Services Group
Skandia Life
Society of Pension Consultants
Standard Life
Sun Alliance Life & Pensions
Sun Life Assurance Society
Towry Law Financial Planning
TSB Group
Tunbridge Wells Equitable
Wessex Asset Management
Young, Mr P A

NB Representations made to SIB under the Retail Regulation Review were also made available to the Office.

Office of Fair Trading

FAIR TRADING AND LIFE INSURANCE SAVINGS PRODUCTS

A report by the Director General of Fair Trading

March 1993

FAIR TRADING ACT 1973

FAIR TRADING AND LIFE INSURANCE SAVINGS PRODUCTS

A REPORT BY THE DIRECTOR GENERAL OF FAIR TRADING.

1. Introduction.

2. Transparency of Charges.

3. Transparency of Surrender Penalties and Persistency Rates.

4. Transparency through Disclosure Statements.

5. Transparency through Annual Statements to Policyholders.

6. The Impact of Greater Transparency - Publicity and Consumer Awareness.

7. Summary and Proposed Actions.

MARCH 1993

FAIR TRADING AND LIFE INSURANCE SAVINGS PRODUCTS

A REPORT BY THE DIRECTOR GENERAL OF FAIR TRADING.

1.1 This is one of two separate reports on the life insurance industry which I am publishing today. In this report I examine certain features of the industry from the standpoint of my general consumer protection responsibilities. Under section 2 of the Fair Trading Act 1973, I have a duty to review commercial activities in the United Kingdom that may adversely affect the economic interests of consumers, and this report is made under my powers in section 125(4) of that Act. In my other report I am giving my advice to the Chancellor of the Exchequer, under the Financial Services Act 1986, on the competition effects of the retail regulation rules made by the Securities and Investments Board (SIB) and the Life Assurance and Unit Trust Regulatory Organisation (LAUTRO).

1.2 I have published this report as a contribution to the current debate about the marketing practices of the life assurance industry. I also see it as a complement to the report under the Financial Services Act. In that report, I carry out a statutory duty to give my conclusions as to whether the rules of SIB and LAUTRO have, or are intended or likely to have, the effect of restricting, distorting or preventing competition to any significant extent. It is not within the scope of my Financial Services Act report to comment on rules that are absent or lacking or to contribute more widely to the debate about identifying an ideal package of disclosures; but I do that here. This report is also a follow up to the reports by two consumer finance consultants, Jeremy Mitchell and Helena Wiesner, published by my Office in June 1992 in a paper entitled "Savings and Investments: Consumer Issues". They raised a range of questions about the way in which life insurance was sold.

1.3 This continuing work has focused on life insurance products designed for savings and investment purposes, primarily from the position of the consumer. From this work I identified some key issues which I set out in September 1992 in a speech to the Chartered Insurance Institute:-

- the need for comparisons of investment prospects based on companies' own charges;

- the questioning of heavy penalties arising on early surrender of policies;

- concern over the low persistency rates of many life offices;

- the merit of disclosing the costs of life cover within life insurance savings products;

- concern over the distortions that might arise from the front-end loading of commissions;

- the need to switch the focus of competition away from who provided the highest commission to who provided the best products.

1.4 In the light of the further work by my Office, I would now add a seventh concern, the severity of surrender penalties imposed by some companies, even in the later years of policies. Surrender penalties, both in the early and later years, are of particular concern given the high proportions of policyholders that surrender their policies.

1.5 The analysis in this report focuses on endowment products, but many of the points and proposals arising apply equally to personal pension plans, and to other life insurance products. Before outlining my proposals on how the above concerns might be tackled, I do wish to acknowledge the considerable efforts and achievements made by the regulators with more specific responsibility for this industry. I do not doubt that the proposals they have made, and on which I have commented in my other report, would represent an advance on the previous position. But I believe it is necessary to go further and bring about a higher degree of transparency, and in this report I indicate what further information might be provided. Without the disclosure of more and better information, the competitive process cannot function effectively. I recognise that additional information must be justified on the grounds that its benefits outweigh any costs and that the information is understandable to customers who will make the effort necessary to absorb it. I believe that these conditions will be met for enhanced disclosure on the lines proposed in this report.

1.6 My Financial Services Act report finds that the following rules have, or are likely to have, the effect of restricting, or distorting competition to a significant extent.

(i) The rules which prevent disclosure of indications of surrender values in the later years of a policy. Payments to a policyholder on surrender in later years are possible cash receipts from the policy and hence relevant to a decision on whether or not to buy the policy in question or indeed any life product. The rule limits the investor's ability to make good choices among the products of different companies and between life products and other investments; and hence they are likely to restrict and distort competition in these markets.

(ii) The rules which require illustrations of possible future returns to be based on standard levels of costs, as opposed to a life office's own costs, while requiring a separate form of disclosure of the company's own costs. These rules limit the ability of prospective investors to assess the effect of the company's level of costs, because investors cannot calculate how the illustration would look if the company's current cost level was substituted for the standard level. This is likely to restrict and distort competition among life offices in that customers will make different decisions from those they would make if they had better information.

(iii) The rules whose interpretation has the effect of preventing a company from offering a product at different prices through different tied outlets. These rules restrict competition among life offices and tied outlets by preventing companies and their tied agents from reflecting in their prices to investors the different costs of distribution among tied agents, and hence limit the likelihood that the most efficient means of distribution will prevail and reduce overall costs to customers.

(iv) The rule which requires independent fiancial advisers to disclose the commission paid to them by the life company at an early stage in the selling process only if asked to do so by the investor. I see this rule as setting a norm which is likely to inhibit the provision by the adviser of information about the amount of commission by the adviser, earlier in the selling process. Without such disclosure investors will not know the characteristics of the market in which they are dealing, and prices in that market, at a time when it could affect their decisions. This is likely to distort competition among independent financial advisers and between them and other financial intermediaries.

1.7 The fundamental perspective of this report is that the generality of life insurance policies are properly regarded as part pure insurance, part investment. For the types of products considered here, investment is normally much the larger part. Regulation should therefore focus on giving customers the same kind of information they receive for other investments. The essence of an investment decision is to assess the cash payments and cash receipts that will arise in different circumstances, infer the possible rate of return (yield), and ask whether this is sufficient, taking account of the risks. The returns on life insurance products are inevitably uncertain, as they are with equities and other investments. However, when one buys equities, one can think generally about the prospects for profits in businesses of the type concerned. Insurance companies, by analogy should, and do, give investors a broad description of the underlying investments on which the eventual outcome depends. Further, purchasers of insurance experience difficulty in assessing prospective returns, either through the withholding of information or the complicated presentation on <u>how</u> surrender values and bonuses are calculated, and the extent to which earnings by the insurance company on its investments are passed on to policyholders. I would like to see insurance companies required to give such information, before the purchase decision is made, in enough detail to be useful.

1.8 I also advocate the following additional disclosures:-

- <u>transparency of charges</u>, including the costs of life cover within these savings products, and showing the likely amount and timing of charges based on actual current costs, so that investors have a sound basis for comparisons among companies, and also some means of exerting pressure over levels of expenses;

- <u>transparency of surrender penalties</u>, enabling consumers to be aware of the widely differing and often severe surrender penalties imposed by some companies, not only when policies are surrendered early but also at later stages;

- <u>transparency of persistency rates</u>, i.e. the percentages of policies sold that are still being kept up by policyholders after a particular number of years; this would help consumers to judge which companies, directly and through their intermediaries, were taking care to sell suitable policies.

1.9 Most importantly, I should like this greater transparency to be achieved through an initial <u>disclosure statement</u> which would bring out the relationship between the cash inputs, i.e. the premiums, and <u>projected cash outputs</u>, if a policy is held to maturity, if a policy is surrendered, or if the policyholder dies. Such a statement would be on an "own charge" basis, ie it would reflect the charges of the life office concerned for that line of business. It would be tailored to the particular policy proposed for the particular customer. It would also indicate the expenses or charges within the policy, the surrender penalties, and their respective effects on returns. The costs of life cover would also be stated. An illustration of the kind of disclosure statement I have in mind is shown on page 8. I shall discuss some of the details in later chapters.

1.10 Such a disclosure statement should be given and explained to any prospective policyholder at an early stage of the sales process, and ideally before he or she is asked to complete an application form for a policy, of the type that has been illustrated.

1.11 I also believe that companies should produce more informative annual statements to policyholders, linked to the information in the disclosure statement. This would enable consumers not only to understand better what is happening to their savings, but also to observe the extent to which companies were following, or indeed improving upon, the charging and surrender practices originally indicated, and the investment returns originally assumed.

1.12 It would be for SIB and LAUTRO to introduce regulatory requirements to implement my proposals, insofar as they have powers to do so. I believe they have the powers to require the initial disclosure statements I have suggested, and the disclosure of persistency rates before the point of sale. I would encourage them to introduce such requirements. But it will be for SIB and LAUTRO to decide if a requirement for more informative annual statements is also within their powers. If it is not, then I encourage the industry as a whole to adopt such annual statements.

1.13 Even when improved disclosure is attained, it will be important to recognise that considerable difficulties will arise in making it understandable to consumers. There are several ways these could be tackled. First, I hope that the information disclosed will be used by the specialist financial services publications to draw up comparative tables of projected company performances on an industry-wide basis. They would have available much better data than now, and I would hope the picture conveyed by such league tables would filter down to consumers through the more general media. Secondly, the messages from such comparisons might also have to be conveyed to consumers through more general information programmes. Last, and not least, there would be the challenge of stimulating a higher degree of consumer interest in financial matters. This is partly a matter of general education, but I hope it will be facilitated by the greater confidence in financial products which these advances will create.

AN ILLUSTRATIVE DISCLOSURE STATEMENT

YOUR 25 YEAR WITH PROFIT ENDOWMENT POLICY

Your policy will provide:-

(a) a capital sum on maturity, arising from the investment of your premiums less expenses, or

(b) a smaller capital sum if you surrender before maturity, or

(c) a sum payable on your death equal to the sum assured and bonuses attaching at that time.

SUMS PAYABLE ON MATURITY OR SURRENDER

The table below shows, in turn, how your premiums of £600 each year would accumulate, assuming an investment return of 7.5% p.a., before taking account of expenses, column 1, after expenses (2), and after surrender penalties (3). The annual investment returns you would achieve on maturity, or on surrender at different stages, is shown in column 4.

Number Of Years Premiums Paid	Total Accumulated Premiums Including Investment Return (1)	Total Accumulated Investment Underlying Your Policy After Expenses (2)	Projected Cash Available On Surrender Or Maturity After Penalties (3)	Your Investment Return To Date Of Surrender Or Maturity (4)	Sum Assured And Attaching Bonuses (5)
	£	£	£	% p.a	£
1	640	129	105	-82.3	15,548
2	1,325	748	724	-28.8	16,116
5	3,694	2,876	2,852	-1.4	17,949
10	8,968	7,566	7,542	4.4	21,479
15	16,496	14,179	14,155	5.7	25,703
20	27,257	23,517	23,493	6.2	30,758
24	39,172	33,752	33,728	6.5	35,509
		AT MATURITY			
25	42,746	36,808	36,808	6.5	36,808

If the actual investment return were 5% p.a., the capital sum at maturity would be <u>£11,083 LESS</u>, or, if it were 10% p.a., the capital sum at maturity would be <u>£16,664 MORE</u>.

COST OF LIFE COVER, EXPENSES AND SURRENDER PENALTIES

The cost of life cover, which averages £18 each year, has been taken into account in column 1.

The expenses comprise an initial charge of £450, reflecting the setting up cost, and annual charges of £25, for administration, and 0.25% of the 'Accumulated Investment Underlying Your Policy', for investment management. The effect of these expenses is shown by the difference between columns 1 and 2.

The effect of surrender penalties is shown by the difference between columns 2 and 3. The deduction of £24 represents a charge for administration.

MATURITY SUM PAYABLE - GUARANTEED SUM PLUS BONUSES

The projected sum payable at maturity is equivalent to a guaranteed minimum sum of £15,000, plus bonuses allocated to your policy over the 25 years. With an assumed investment return of 7.5% p.a. the equivalent bonus rate would be 3.7% p.a. compound. If the investment return were 5% p.a. this bonus rate would reduce to 2.2% p.a., and if the investment return were 10% p.a. it would increase to 5.2% p.a..

SUM PAYABLE ON YOUR DEATH

If you were to die during the period of the policy, the amount payable would be £15,000 plus bonuses attaching at that time, as shown in column 5. The bonus rates applicable at various levels of investment return would be as indicated above.

TRANSPARENCY OF CHARGES.

2.1 In considering the information that should be provided to buyers of life insurance investment products, I believe the focus should be on those factors that are relevant to the assessment of returns to policyholders and that are largely within a life company's knowledge or control. The most important of these appear to be charges, or expenses, and, as discussed later, surrender penalties.

2.2 A desirable first step is that consumers should be aware of what they are paying for in these dual nature products. In particular, they should know how much of their premiums might be required to provide life cover, and how much would be invested after covering charges and costs. This would focus attention on the nature of life products and help comparisons with other investments.

2.3 Companies seek to recoup their various costs, on commissions, marketing, fund management and administration, through charges on their various products (and also through surrender penalties, as discussed later). With unit-linked policies, whilst charges are stated, they are often presented in a form which consumers might find difficult to understand. Much the same is true of with-profits policies. Disclosure of expenses in the form of pence in the pound deductions from premiums and as reductions in yield are useful for purposes of comparisons assuming policies run to maturity. But separate disclosures of first year expenses and subsequent annual expenses, on the basis of current experience and as absolute amounts, would be both more understandable to consumers and more relevant to the objective of projecting cash returns.

2.4 Accordingly, I should like to see greater transparency which would:-

- reveal the costs of life cover within these products, and thereby enable consumers to compare the savings and investment elements with other financial products;

- bring out how differences in charges may significantly affect the returns to consumers;

- restrain increases in charges by giving more focus to the level and effect of charges; and foster competition between companies in levels of charges.

Revealing the costs of life cover.

2.5 Consumers generally are not aware of the costs of life cover within life insurance products. In many cases these may be relatively small; for example, for a 30 year old taking a 25 year with-profit endowment policy with a minimum sum assured of £15,000, the cost of life cover might average only £18 a year, as compared with premiums of £600 a year. If consumers knew such costs were as small as this, they could consider them as an extra, bringing potential benefits in protection for actual or future dependants, or less welcome costs if dependants were not a factor. Consumers could then focus on what would clearly be the main function of the products, i.e. savings and investment. They could compare the merits of such plans with alternative financial products. But if the costs of life cover are not disclosed, consumers cannot make such comparisons.

Returns from low and high charge products.

2.6 The variations in charges among life companies, expressed as "reduction in yield," (RIY), are illustrated below for different endowment products.

(Reduction-in-Yield: %)

	Unit-Linked (1)		With-profits (2)	
	10 yrs	25 yrs	10 yrs	25 yrs
Highest	4.2	2.7	5.8	2.6
Average	2.9	1.6	3.0	1.2
Lowest	1.2	0.8	1.4	0.4

Note - RIYs for personal pension plans vary in much the same way; for example, for 10 year with-profits policies they range from 1.4% to 6.5% (3).

2.7 As the above comparisons show, there are considerable differences in RIYs both for unit-linked and for with-profits policies. Other factors being equal, the projected pay-outs at maturity on the 10 year products with lowest charges would be towards 30% higher than on the products with highest charges. With 25 year products, the lowest charge products would have projected pay-outs some 40% higher than the highest charge products. A great number of policies, however, are not held to maturity. Among the limitations of the concept of RIYs is the assumption that they all are. Yet differences from company to company in projected pay-outs on surrender before maturity can be very significant.

2.8 The actual pay-outs on policies will depend also on the investment performances of fund managers. The relative investment performances of different fund managers cannot be assumed to be stable over time and hence cannot be predicted accurately. Investment performance might help reduce or even overcome the "handicap" of high charges, but, by the same argument, poor investment performance by higher charge companies would lead to even wider differences in pay-outs.

Restraint on increases in costs and charges.

2.9 In recent years, what has been aptly termed the "struggle for outlets" has led to average commission levels for 25 year endowments for independent financial advisers (IFAs) rising by November 1991 to 126% of the old LAUTRO scale (still used to compare levels) and to 144% for tied agents (4). As one industry manager has put it, "commission rates have been pushed up by over 30% ... and that 30% + increase must go straight through to the policyholder either by higher premium rates or lower bonuses" (5).

2.10 Indeed, one specialist financial publication has noted, for example, that average RIY figures for 10 year with-profits endowments rose by some 9% in 1991 (6). Such increases are presumably being reflected in lower bonus rates. Many companies have recently announced reductions in their bonus rates, and these may result from increased costs, as well as lower investment returns, although they are generally presented as resulting from the latter.

2.11 Giving the level of charges more prominence should act as a restraint on increases in charges. It should also encourage companies to compete through offering lower charges, these being reflected in higher projected returns. One way in which this might be done is illustrated in the Disclosure Statement. I should also like to see companies required to base all their illustrations, including those carried in general advertisements, on their own current level of charges as opposed to an industry average.

The future life insurance market - bancassurance companies

2.12 I believe it is particularly appropriate to propose such improvements in transparency at a time when the industry may experience changes in market structure. High transparency will improve the likelihood that the companies which gain market share will be those that offer the best value for money. Many people expect that the "bancassurance" companies, i.e. the insurance companies owned by the banks and building societies, will have a pivotal role in the 1990s. In France, for example, such "bancassurance" companies have grown rapidly, and similar trends are now apparent in the UK. For example, new premium income on endowments sold by the main 4 UK bank-owned insurance companies rose on average by 21% in 1991, compared with an average of 5% among some 55 other insurance companies (7). Further bank and building society-owned companies have been launched this year. Such companies may have the ability to launch products with innovations, for example on charging structures or on surrender values, which could strongly influence the market.

TRANSPARENCY OF SURRENDER PENALTIES AND PERSISTENCY RATES.

3.1 Company practices on surrender penalties are probably the next most important item of information for consumers after charges. Indeed they may in some cases be more important. As discussed later under persistency rates, perhaps under half of all policies reach maturity. More policyholders therefore must expect to receive surrender rather than maturity pay-outs. Consumers should therefore be as much, if not more, concerned about a company's practices in calculating surrender values as about its projected maturity values. A further reason why surrender penalties are so important is that practices differ so much from company to company, both in the earlier and later years of policies.

3.2 In principle, it might be expected that surrender values should simply be the funds obtained from the premiums, less charges and costs, and increased to reflect investment returns. In practice, many companies appear to impose significant penalties on the accumulated funds before they pay out cash on surrender. However, in any effectively competitive market, surrender penalties might be no more than a small administrative charge. Yet surrender penalties are often substantial. They can be expressed in ways that are difficult to understand, or, in the case of with-profits policies, not indicated at all. It seems highly desirable that companies should be required to give clear explanations of <u>how</u> they calculate surrender values, before an investor has made a commitment to buy a policy, with enough information for investors to assess the effect on projected cash receipts in different circumstances. High surrender penalties are sometimes justified by reference to the fact that insurance policies are contracts between insurer and insured, and the argument that the insured person who seeks an early exit from the contract should expect to suffer a penalty. However, I propose no restriction on the size of the penalty. The key requirement is that prospective policyholders should be aware of factors which affect the level and uncertainty of their cash receipts from a policy before they make a commitment.

Early surrender values.

3.3 For most life insurance policies, early surrender values are well below the premiums paid. A recent consumer analysis provided data on the projected surrender values on the 25 year low cost endowment policies of 40 companies (19 unit-linked policies, 20 with-profits policies, and 1 unitised with-profits policy). After two years, surrender values averaged £735 compared with premiums paid of £1,664 - an average "loss" for consumers of £929 in cash terms alone, or 56% of premiums paid (8).

3.4 Moreover, in the above case, the surrender values varied considerably from company to company:-

Endowments

2 year surrender values as % of premiums paid.	Number of companies.
0-20%	5
20-40%	10
40-60%	16
60-80%	8
80% plus	1
	40

3.5 One factor behind low average surrender values is the high proportion of charges which arise in the first year or two of a policy. This has the effect of penalising "early leavers" - those who decide to surrender their policies during the first few years of its intended life.

3.6 As for the variations in surrender values from company to company, one factor is the differences in charges among companies, but these appear unlikely to account for more than a small fraction of the wide variations in surrender values shown above. What appears to be the dominant factor is that some companies impose surrender penalties, sometimes severe enough to reduce surrender values to zero even after 2 years of the policy.

3.7 Similar variations occur with unit-linked personal pension plans, as shown below for some 90 companies in a recent survey (9). The widespread differences in the projected transfer values suggest that "transfer penalties" of some companies are often severe.

Personal Pension Plans

2 year transfer values as % of premiums paid.	Number of companies.
0-25%	14
25-50%	33
50-75%	33
75-110%	10
	90

Later surrender values.

3.8 Policies may also be subject to surrender or transfer penalties in later years. For example, unit-linked policies may have penalties like "a stated percentage of the premiums still due under the policy". This would be a surprising penalty in a competitive market because it does not seem related to the costs caused by early surrender. Companies managing with-profits policies have particular flexibility to vary surrender values and maturity values, and many of them appear to adopt surprising practices on the less-publicised surrender values at intermediate stages of policies. This may be illustrated in various ways.

(a) **same investment periods, but policies of different durations**

3.9 For example, the surrender values after 10 years on 25 year with-profit endowments may be compared with the maturity values on 10 year endowments. The same premiums are being paid over the same periods, and one assumes that the investments are being handled by the same managers. The actual pay-outs on £50 a month policies at 1 February 1992 are compared between 4 major companies (10):-

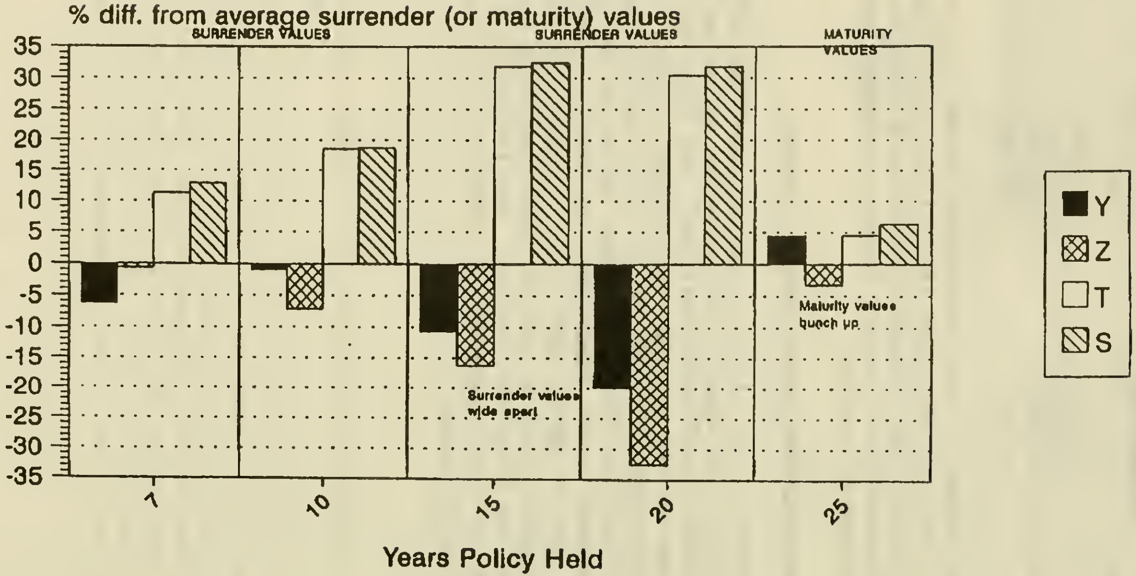
Companies	A - Surrender (£) value after 10 yrs. on 25 year endowments.	B - Maturity value of 10 yr. endowments.	Differences B over A.
A	12,877	13,693	+ 6%
B	9,695	12,921	+33%
C	8,034	12,730	+58%
D	6,763	12,048	+78%

3.10 For company A, the differences between the two columns may reflect the higher initial charges arising on 25 year policies. For companies B, C, and D, however, the differences may largely reflect surrender penalties of increasing severity.

(b) Same policies, but different stages.

3.11 Another way of illustrating how surrender value practices differ is to compare the surrender values at different stages of particular policies. The chart on page 17 shows how the surrender values and maturity values of 4 other major companies compare with the averages for the 20 companies with the highest levels of new premium business. Thus companies S and T have surrender values at both 15 and 20 years over 30% above the average, while companies Y and Z have surrender values as low as 20% or over 30% below the average. But the maturity values of all the four companies are within 6% of the average maturity values.

Later Surrender Values and Maturity Values for 25-Year Endowments Variations Illustrated by Showing Values on Policies of 4 Major Companies and Comparing them with Averages of the Top 20 Companies.



Data for 25-year endowments at 1st February 1992:
Source of Raw Data: Money Management, May 1992

3.12 In money terms the differences are equally striking. The table below relates to £50 a month endowment policies surrendered or matured at 1 February 1992. Thus the 20 year surrender values of companies S and T are almost double those of company Y.

Companies	Surrender value after 20 years of 25 year policy	(£)	Maturity value at 25 years
S	54,172		102,473
T	53,600		100,723
Average *	41,390		96,406
Y	32,931		100,732
Z	27,719		93,251

(* - the average is based on the pay-outs of the top 20 with-profits companies).

3.13 It comes as no surprise that there is an active secondhand market in with-profits endowment policies, perhaps particularly for certain companies. But any potential gains to policyholders from selling to this market rather than surrendering will have to be shared with others, including the market dealer and any introducing IFA, and of course the purchaser of the policy.

3.14 Again, similar differences appear with personal pension policies. For example, in one survey of with-profits policies, the companies ranking 3 and 4 out of 27 in retirement funds had transfer values ranking 22 and 26, again out of 27 (11).

(c) pay-outs in the last years of policies.

3.15 Substantial differences between surrender values and maturity values appear even when surrender values 1 year before maturity are compared with maturity values, as shown in a survey of the with-profits policies of some 32 companies (12). Companies with the highest ratios of surrender values to maturity values have patterns of pay-outs to policyholders broadly consistent with the growth in the value of investments. Those with low ratios have pay-out structures little related to growth in investments.

	9 year surrender values as % of 10 year maturity values	24 year surrender values as % of 25 year maturity values
5 Companies with highest ratios	80-85%	87-90%
5 Companies with lowest ratios.	60-67%	35-71%

3.16 It is notable that, for both 10 year and 25 year policies, two of the "bottom five" companies, in terms of ratios of surrender values to maturity values, paid maturity values high enough to get among the highest ten maturity pay-outs. This enabled them to be featured amongst the "top performers" in various specialist financial publications, mortgage publications, and presumably consumer advice columns. Clearly some maturity values, often paid to few maturing policies, could tell incomplete or misleading stories.

<u>Implications for consumers.</u>

3.17 As indicated by the above discussion and illustrations, surrender value practices vary significantly among companies:-

- at the early stages of policies, surrender values are below the premiums paid, reflecting in part the up-front nature of charging structures; but the wide variations among companies reflect not only differences in levels of charges, but perhaps in particular the imposition of differing surrender penalties.

- at the later stages of policies, surrender values reflect charges and investment performance, but they can be dramatically affected by heavy surrender penalties;

3.18 As discussed below, many policyholders appear to surrender their policies rather than keep them to maturity. Indeed, many of such surrenders apparently arise from changes in personal circumstances which could not have been foreseen. I conclude that surrender values are important elements of cash returns from life policies; prospective customers, therefore, should pay attention to the projected surrender values of policies as well as to the maturity values. Companies should set out their practices in calculating surrender values, throughout the periods of policies, in a manner prospective purchasers can understand. Otherwise customers would be entering a lottery with unknown prizes.

Persistency rates.

3.19 In addition, I think that consumers should be better informed about the "persistency rates" of companies. Such rates, which indicate the percentages of policyholders maintaining their policies after a particular number of years, are of considerable relevance not least because they may indicate the relative likelihood of high pressure selling and selling of inappropriate products.

3.20 Concern over persistency rates was aroused by the publication in late 1991 of a survey commissioned by SIB (13). This suggested that persistency rates on regular premium policies after two years averaged only 70%, and were as low as 60% for unit-linked policies sold through direct sales. Lapses of policies occurred as much on pension plans as on endowments. The losses to consumers through such lapses are high; the first year losses alone have been estimated at over £250m (14).

3.21 Such losses may well have a particularly strong impact on certain types of people. For example, one detailed survey has shown that, surprisingly, as many as 23% of endowment policies are sold to 16-24 year olds, (even more surprisingly, as many as 22% of term and whole life policies, i.e. protection policies, are apparently sold to this group) (15). Some in this age group will still be in education or training, and others will be in, or looking for, their first employment. It seems predictable, therefore, that, as indicated in the survey referred to in the following paragraph, lapses of policies are particularly high in these young age-groups.

3.22 Despite criticism of the methodology used to derive such persistency findings from company returns to DTI, there was no general industry rejection of the figures or the picture they presented. Indeed, one group of nine companies, the "Watford Group", commissioned another survey to determine the reasons behind such high lapse rates, and what might be done to reduce them. This exercise indicated that:-

- while 31% of lapses were due to product, advice or service problems, some 68% of lapses could be attributed to changes in personal circumstances, leading, for example, to the inability to continue to afford the premiums;

- four areas might be addressed to improve persistency: reviewing the sales process, improving the overall quality of advice, introducing more flexibility into products, and communicating the implications of early surrender more effectively (16).

3.23 LAUTRO are tackling the problem of persistency rates by increased training and more effective supervision of sales. I welcome this. LAUTRO's new training requirements should bring significant improvements, although it will take time for these to emerge. LAUTRO has also been more overtly effective in its own supervisory role, and has imposed fines on many companies for mis-selling, although the impression remains that widespread over-selling remains a significant problem. Last year LAUTRO also launched a study into the structure of commissions. This could bring very useful advances, but any new proposals have yet to emerge.

3.24 Attempts by one specialist financial publication to throw light on persistency rates by gathering statistics from companies have not been very successful, with one survey resulting in only 11 out of 43 companies being willing to disclose persistency rates of their policies. Nevertheless, the survey was valuable in showing the wide variations among companies, with persistency rates after two years ranging from 96% to 64%. It seems possible that some of the companies not responding might have persistency rates they would prefer not to disclose. (17).

3.25 Unfortunately, no authoritative figures exist on persistency rates. A general impression, from the SIB survey, published articles, and from discussions with the secondhand market-makers, is that on average some 30% of policies are surrendered in the first 2/3 years, some 40% are surrendered later, leaving some 30% to reach maturity. But the variations from company to company are very considerable.

3.26 Given such variations among companies, I conclude that prospective policyholders would benefit significantly if persistency rates were disclosed to them before the point of sale. It is for SIB and LAUTRO to consider which persistency rates should be disclosed, but it might be most informative if persistency rates after 2 years were disclosed on regular premium life and pension plans. It would also be useful if companies were to indicate what proportions of such policies in their experiences lasted until maturity.

3.27 Persistency rates should be a good indicator of which companies were taking care to sell products suitable for each consumer and which companies were not. It would be important for consumers to be informed of any companies with low persistency rates, especially if it had low surrender values. In order that prospective policyholders can be so informed, I consider it would be desirable for SIB and LAUTRO to introduce rules requiring disclosure of persistency rates before the point of sale.

TRANSPARENCY THROUGH DISCLOSURE STATEMENTS.

4.1 I should now like to focus on how greater transparency should be introduced. I believe it should be achieved through an improved disclosure statement explained to consumers prior to sale. Such a disclosure statement should be directed principally at showing the projected cash returns on maturity, on surrender or death at various times, and how these amounts are made up. In my view, while further work is needed to settle the details, a disclosure statement should ideally show:-

- the costs of "pure life cover" within the overall product, thereby helping consumers to compare the savings and investment elements with other financial products;

- charges in a form that encourages competition in charging levels, and brings pressure to bear on levels of charges;

- the intended practices on surrender penalties throughout the life of the policy;

- the effects of charges, and surrender penalties, on returns to consumers;

- the projected cash returns, and resulting investment yields to consumers, at maturity, and on surrender at different stages of the policy;

- the effect of variations in the company's return on investment on maturity values and on bonuses generally;

- the sum payable on death, based on the sum assured and any bonus additions.

4.2 A disclosure statement on these lines would provide:

- a basis enabling comparisons to be made of projected cash returns from different life insurance products, and from other financial products; and

- a basis enabling policyholders to observe, through annual statements, the actual progress of their policies against the indications and assumptions made at the start.

4.3 My Office has called on the technical expertise of a firm of consulting actuaries (18) to assist in the preparation of a possible format for a disclosure statement, and this has led to the suggested format that I illustrate on page 28. The requirements for charges to be itemised and explicitly stated could easily be achieved with current practices on unit-linked policies. For with-profits policies, I have been assured that similar itemisation is technically possible. However, a different presentation would be acceptable if it provided the information I have set out above and would be of even more help to investors in assessing prospective cash returns.

4.4 The disclosure statement I have illustrated shows how projected returns to consumers would build up by accumulating premiums paid, less expenses incurred, at particular rates of investment return. The effect of surrender penalties on the sums payable on surrender is also shown. Such an illustration is consistent, I believe, with company practices, and is indicated, for example, in "with-profits" guides. But the development of policies is actually explained to policyholders in a very different way, focusing on bonuses, in part related to the sum assured. This might seem surprising given that life cover is generally a minor aspect of these products. But the disclosure statement I have suggested also illustrates such a bonus-related build-up in relation to sums payable on death.

4.5 As I indicated in my introduction (para 1.7), I should like companies to go further and set out their policies on the allocation of their investment earnings. They should indicate their intended practices on 'smoothing' year to year in relation to both surrender values and bonus additions. They should indicate the extent to which the investment return would be passed on to policyholders, or retained to strengthen reserves, or, in the case of proprietary companies, retained for shareholders. In this latter circumstance, companies should indicate the impact on the investment return assumed for the projection of surrender or maturity values. I should like this aspect to be developed for disclosure. I understand the expression 'bonus philosophy' covers many of these discretionary practices, and I would hope that this could be set out more clearly.

4.6 For such a disclosure statement to be fully effective, it would ideally have to be shown to the client at an early stage, and be client specific. The statement should ideally be given, with explanations, to a policyholder before he completes an application form for a policy. I recognise that the form of disclosure should represent a balance between the needs of a thoughtful investor/purchaser and the costs of providing information, and that it should not unduly inhibit dealings between willing parties. In my judgment, the prospective benefits of a statement along the basis illustrated are likely to outweigh the prospective costs. I assume that most companies will calculate the information needed to provide direct specific information by computer and that once the system has been set up the cost of provision will be slight. Moreover, individuals can ask for some of this information now and some systems for providing it already exist. I believe the key principle on timing is that customers should not make a mental or legal commitment until they have been well informed.

__Different illustrations.__

4.7 On pages 28 and 29, two examples of the disclosure statement that I have suggested are set out for 25 year endowment policies offered by two "hypothetical" companies. The first of these, on page 28, is the same as that already shown on page 8. The expenses of the two companies are assumed to be identical, but not their surrender penalties:-

- the company in the first illustration has only "token" surrender penalties of £24, which might represent an administration charge;

- the company in the second illustration has heavy surrender penalties, ranging to nearly £10,000 in the later years.

4.8 The two illustrations are intended to reflect actual practices, consistent with the surrender/maturity value statistics that I have discussed earlier. As the illustrations show, the differences in the early surrender values are not very large, and the maturity values at year 25 are shown as identical. But in the intermediate years the surrender values are markedly different.

4.9 The illustrations have been drawn up for endowment policies, but they would be adaptable to personal pension plans, with transfer penalties being indicated instead of surrender penalties. The illustrations are also in terms of with-profits policies, but they would apply readily to unit-linked policies.

Comparisons in the financial press.

4.10 There will be many variations in the charging and surrender value calculation practices of companies. This is to be expected in a market such as that for life products, and there is nothing inherently wrong about such variations - indeed they are desirable - provided information about them is clearly set out for consumers. The specialist financial periodicals already make detailed comparisons of projected returns from investments in life policies, and the form of disclosure that I have suggested would provide a ready basis for making further comparisons. Indeed, the preparation of industry-wide averages of projected returns at different stages of policies would enable consumers to check how particular policies compared, perhaps at three principal stages:-

Early	-	when surrender values would be particularly dependent on initial charges and early surrender penalties;
Inter-mediate	-	when differences in surrender values, although reflecting charges, may be significantly influenced by penalties;
Maturity	-	with differences in maturity values largely reflecting charges.

4.11 These comparisons would be useful, because they would emphasize the considerable differences among companies in terms of benefits to consumers. Some companies may feature well at all three stages. Others might present a good picture at one or two stages, and some may feature poorly at all stages.

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4.12 Comparisons of projected cash returns and yields could also readily be made with other financial products. Indeed, specialist financial publications already make comparisons of actual and projected returns on life insurance products with those on unit trusts, investment trusts, PEP unit trusts, unit trust saving schemes, etc. Comparisons with interest-bearing deposit products, such as building society accounts, TESSAs and national savings, could also be made.

4.13 I believe that disclosure in the form I have suggested would bring out differences in performance of companies, and would therefore be a stimulus to effective competition. It would be for SIB and LAUTRO to develop any new disclosure requirements on the lines suggested. My Office will certainly be very willing to assist them in any such work, and I am sure that life companies and other organisations with an interest would also be keen to contribute to the process.

AN ILLUSTRATIVE DISCLOSURE STATEMENT 1

YOUR 25 YEAR WITH PROFIT ENDOWMENT POLICY

Your policy will provide:-

(a) a capital sum on maturity, arising from the investment of your premiums less expenses, or

(b) a smaller capital sum if you surrender before maturity, or

(c) a sum payable on your death equal to the sum assured and bonuses attaching at that time.

SUMS PAYABLE ON MATURITY OR SURRENDER

The table below shows, in turn, how your premiums of £600 each year would accumulate, assuming an investment return of 7.5% p.a., before taking account of expenses, column 1, after expenses (2), and after surrender penalties (3). The annual investment returns you would achieve on maturity, or on surrender at different stages, is shown in column 4.

Number Of Years Premiums Paid	Total Accumulated Premiums Including Investment Return (1)	Total Accumulated Investment Underlying Your Policy After Expenses (2)	Projected Cash Available On Surrender Or Maturity After Penalties (3)	Your Investment Return To Date Of Surrender Or Maturity (4)	Sum Assured And Attaching Bonuses (5)
	£	£	£	% p.a	£
1	640	129	105	-82.3	15,548
2	1,325	748	724	-28.8	16,116
5	3,694	2,876	2,852	-1.4	17,949
10	8,968	7,566	7,542	4.4	21,479
15	16,496	14,179	14,155	5.7	25,705
20	27,257	23,517	23,493	6.2	30,758
24	39,172	33,752	33,728	6.5	35,509
		AT MATURITY			
25	42,746	36,808	36,808	6.5	36,808

If the actual investment return were 5% p.a., the capital sum at maturity would be £11,083 LESS, or, if it were 10% p.a., the capital sum at maturity would be £16,664 MORE.

COST OF LIFE COVER, EXPENSES AND SURRENDER PENALTIES

The cost of life cover, which averages £18 each year, has been taken into account in column 1.

The expenses comprise an initial charge of £450, reflecting the setting up cost, and annual charges of £25, for administration, and 0.25% of the 'Accumulated Investment Underlying Your Policy', for investment management. The effect of these expenses is shown by the difference between columns 1 and 2.

The effect of surrender penalties is shown by the difference between columns 2 and 3. The deduction of £24 represents a charge for administration.

MATURITY SUM PAYABLE - GUARANTEED SUM PLUS BONUSES

The projected sum payable at maturity is equivalent to a guaranteed minimum sum of £15,000, plus bonuses allocated to your policy over the 25 years. With an assumed investment return of 7.5% p.a. the equivalent bonus rate would be 3.7% p.a. compound. If the investment return were 5% p.a. this bonus rate would reduce to 2.2% p.a., and if the investment return were 10% p.a. it would increase to 5.2% p.a..

SUM PAYABLE ON YOUR DEATH

If you were to die during the period of the policy, the amount payable would be £15,000 plus bonuses attaching at that time, as shown in column 5. The bonus rates applicable at various levels of investment return would be as indicated above.

2

AN ILLUSTRATIVE DISCLOSURE STATEMENT

YOUR 25 YEAR WITH PROFIT ENDOWMENT POLICY

Your policy will provide:-

(a) a capital sum on maturity, arising from the investment of your premiums less expenses, or

(b) a smaller capital sum if you surrender before maturity, or

(c) a sum payable on your death equal to the sum assured and bonuses attaching at that time.

SUMS PAYABLE ON MATURITY OR SURRENDER

The table below shows, in turn, how your premiums of £600 each year would accumulate, assuming an investment return of 7.5% p.a., before taking account of expenses, column 1, after expenses (2), and after surrender penalties (3). The annual investment returns you would achieve on maturity, or on surrender at different stages, is shown in column 4.

Number Of Years Premiums Paid	Total Accumulated Premiums Including Investment Return (1)	Total Accumulated Investment Underlying Your Policy After Expenses (2)	Projected Cash Available On Surrender Or Maturity After Penalties (3)	Your Investment Return To Date Of Surrender Or Maturity (4)	Sum Assured And Attaching Bonuses (5)
	£	£	£	% p.a	£
1	640	129	109	-81.7	15,548
2	1,325	748	627	-35.7	16,116
5	3,694	2,876	2,358	-7.7	17,949
10	8,968	7,566	5,977	0.2	21,479
15	16,496	14,179	10,776	2.5	25,703
20	27,257	23,517	17,168	3.5	30,758
24	39,172	33,752	23,829	4.0	35,509
		AT MATURITY			
25	42,746	36,808	36,808	6.5	36,808

If the actual investment return were 5% p.a., the capital sum at maturity would be £11,083 LESS, or, if it were 10% p.a., the capital sum at maturity would be £16,664 MORE.

COST OF LIFE COVER, EXPENSES AND SURRENDER PENALTIES

The cost of life cover, which averages £18 each year, has been taken into account in column 1.

The expenses comprise an initial charge of £450, reflecting the setting up cost, and annual charges of £25, for administration, and 0.25% of the 'Accumulated Investment Underlying Your Policy', for Investment management. The effect of these expenses is shown by the difference between columns 1 and 2.

The effect of surrender penalties is shown by the difference between columns 2 and 3. The penalties rise to £9923 to cover the cost of ....

MATURITY SUM PAYABLE - GUARANTEED SUM PLUS BONUSES

The projected sum payable at maturity is equivalent to a guaranteed minimum sum of £15,000, plus bonuses allocated to your policy over the 25 years. With an assumed investment return of 7.5% p.a. the equivalent bonus rate would be 3.7% p.a. compound. If the investment return were 5% p.a. this bonus rate would reduce to 2.2% p.a., and if the investment return were 10% p.a. it would increase to 5.2% p.a.

SUM PAYABLE ON YOUR DEATH

If you were to die during the period of the policy, the amount payable would be £15,000 plus bonuses attaching at that time, as shown in column 5. The bonus rates applicable at various levels of investment return would be as indicated above.

TRANSPARENCY THROUGH ANNUAL STATEMENTS TO POLICYHOLDERS.

5.1 Taking into account the large investment element in most life insurance products, I believe that it would also be beneficial to consumers if additional information were to be provided in annual statements to policyholders, on the lines of statements which investors in other products are entitled to receive. These statements should give information on actual performance by the company as it affects the policy concerned, in a form that is comparable as far as possible with the information given before the policy was purchased. This means that they should substitute actual returns on investment for standard returns, disclose current surrender values, and, if appropriate, revise estimates of maturity values and sums payable on death.

5.2 The annual statements would help policyholders to observe whether companies were following the practices they had indicated in their original disclosure statements. Companies would not be expected to adhere rigidly to their indications, but significant departures from the practices and performance levels originally indicated would merit explanation to policyholders. This kind of reporting framework would meet the fundamental right of investors to accountability.

5.3 If SIB and LAUTRO consider it to be outside their powers to require such annual statements, I hope that the industry will introduce such statements on a voluntary basis.

THE IMPACT OF GREATER TRANSPARENCY - PUBLICITY AND CONSUMER AWARENESS.

6.1 The greater transparency proposed in the initial disclosure statement should help consumers to understand how life insurance investment works, the penalties of early surrender, the effects of charges and later surrender penalties, and how returns might vary with different investment performances.

6.2 But the full potential of effective competition will be realised only if consumers are aware of how any projected returns compare with the returns on other life insurance products, and on other financial products. The evidence suggests, however, that most life insurance savings and investment products are bought by consumers who do not "shop around".

6.3 Consumers dealing with independent financial advisers ought to benefit from greater transparency through the advice they receive. IFAs account for over 30% of the value of sales, but they tend to deal more with those consumers seeking higher value policies. Perhaps only about a fifth of consumers actually deal with IFAs.

6.4 As far as the majority of consumers are concerned, there is a considerable problem in helping them to receive and understand the messages that greater transparency is intended to bring. Comparative tables of the projected cash returns or yields on different products will be important in this process, if suitably presented and publicised. Specialist publications make such comparisons regularly, but their circulations are relatively small and largely confined to people who work in the financial services industry. In contrast, over 8 million individual life and pensions policies are taken out each year (19).

6.5 I would expect the main messages from the comparative league tables of the specialist financial publications to find their way into the more general media, and particularly into the personal finance columns of the weekend and daily newspapers and magazines. But presumably, even these sources will reach only a small proportion of potential purchasers of life products, and particular information programmes may prove to be desirable.

6.6 Information to be got across to consumers, in addition to the importance of shopping around, would include the importance of recognising the status of advisers, i.e. whether they are independent or tied, the scope for commission bias (for example, in the choice of mortgage financing), and possibly also the availability of differential pricing of a product by different tied agents of the same company.

6.7 There is the further question of whether consumers will have sufficient interest to absorb information about the characteristics of financial products. One recent survey on attitudes to financial matters found that 27% of adult respondents indicated that they were "very interested in financial matters". But 58% responded that they think about finance only when they have to, and a further 14% maintained that they never thought about financial matters (20). Although it is encouraging that 27% of respondents, 31% of men and 25% of women, apparently are very interested in financial matters, it seems to me very desirable that as many people as possible are given the opportunity to improve their decisions on financial matters. The greater transparency I propose should bring out just how much money can be at stake when consumers choose, for example, one life company rather than another, and that alone should have the effect of raising consumer interest.

6.8 My Office intends to hold discussions with industry representatives, financial journalists, consumer organisations and others on how these questions of communication and consumer awareness might best be addressed. In particular, I shall consider whether I can take any action under my own functions, to contribute effectively to an improvement.

SUMMARY AND PROPOSED ACTIONS.

7.1 The purchase of life insurance products or personal pension plans involves a large investment element. Prospective purchasers and holders of these products should be given the same kind of information as other investors. Investors will wish to assess prospective cash receipts from buying a life product, to estimate the rate of return on the payments they will make, and to consider whether or not this is sufficient having regard to the risk involved and the returns available on other investments. This assessment will inevitably be subject to great uncertainty not only because of the uncertainty over future returns in the life company's investment portfolio, but also because of the wide variations in the charges and surrender penalties of companies. However, this does not justify the withholding of information that could reduce the uncertainty, or the presenting of such information in obscure ways. I believe that future regulation, or voluntary action where regulation is not possible, should call for the following to be set out clearly:

(a) <u>the investment context</u>

- the dominant investment element of the product; a consumer should know that for many of these products the cost of life cover represents only a few % of premiums; he would then be able to compare the investment element with other financial products;

- the different possible outcomes from this investment element and from the life cover, i.e. a capital sum on maturity arising from investment of premiums less expenses, or a lower capital sum on surrender also taking into account surrender penalties, or a sum payable on death based on a sum assured plus bonus additions;

- the life company's investment policy, showing broadly the kinds of securities where investments would be made; and the company's "bonus philosophy", setting out its intentions with regard to the smoothing of surrender values and bonuses, and its intended allocation of invest_ent returns to its policyholders;

(b) <u>charges</u>

- the levels of the life company's own charges and their effects on returns, so that high charge companies are put under more competitive pressure;

(c) <u>surrender penalties (or transfer penalties in the case of pension plans)</u>

- the level of surrender penalties at various stages of the policy, bringing out the differences in practices between companies, and in some cases the particularly large differences in returns between surrendered policies and policies held to maturity;

(d) <u>persistency rates</u>

- persistency rates for the company concerned, showing how such rates vary widely among companies and thereby helping assessments of which companies take greatest care to sell suitable policies;

7.2 In particular, I believe that much of the required increase in transparency should be achieved through an initial <u>disclosure statement.</u> This would:-

- indicate the projected cash returns on maturity, on surrender at different stages, and on the death of the policyholder;

- describe the methods of calculating returns on maturity and surrender, using an "own charges" basis, and showing the effects of different rates of return on investments;

- indicate expenses and surrender penalties and their effects on returns, and the costs of life cover;

- show how sums payable on death are made up from the sum assured, and bonus additions;

- be provided early in the sales process.

7.3 I also see the need for the <u>annual statements</u> to policyholders to explain any divergence from the initial disclosure. These would indicate the investment return to date, show how this related to the projected maturity value, report on charges made, indicate the surrender value, taking into account the current surrender penalty, and generally provide information for comparisons with the initially projected cash returns. Such a statement would not only keep the policyholder informed, but also enable him or her to observe the extent to which the original indications of charges and surrender penalties were being followed, or indeed improved upon.

7.4 Getting the messages from such greater transparency across to consumers would present a major challenge, which might be tackled through:-

- comparisons of projected cash performances of life products being made on an industry-wide basis by the specialist financial press; similar comparisons could also be made with other financial products;

- more widespread publication of the results of such comparisons through the press and other media;

- particular information programmes if these are required;

- getting more consumers interested in life insurance and other financial products, through awareness, in particular, of the cash implications of choosing one product rather than another.

Proposed Actions.

7.5 The implementation of the above proposals is, in large part, for others to achieve. The preparation of new retail regulation rules is for SIB and LAUTRO. I therefore encourage those regulatory bodies to consider the introduction of:-

- a requirement for a disclosure statement on the lines I have suggested;

- a rule requiring companies to make persistency rates known to prospective policyholders before the point of sale.

7.6 I have also suggested that:-

- there should be an annual "progress" statement to policyholders;

SIB and LAUTRO will decide whether they have powers to require such annual statements. If they do not, I encourage the industry as a whole to introduce voluntary measures.

7.7 My Office will be ready to help SIB and LAUTRO, and the industry generally, in such work, and I expect others will wish to contribute as well. I will consider whether I can use my functions of providing information and advice to improve consumers' understanding of what, evidently, for many people is an extremely but perhaps unnecessarily complex transaction.

PREPARED STATEMENT OF BRIAN S. BROWN ON BEHALF OF THE AMERICAN SOCIETY OF CLU & CHFC

My name is Brian S. Brown. I am a Chartered Life Underwriter (CLU) and a Chartered Financial Consultant (ChFC). I currently serve as the Immediate Past President of the American Society of CLU & ChFC. I am also member of the Society's Board of Directors and am vice chairperson of the Society's Insurance Illustration Task Force. I have been employed as an agent, manager or home office executive in the life insurance business since 1952.

The American Society is a national association of 35,000 insurance and financial services professionals who have earned or are working toward the Chartered Life Underwriter or Chartered Financial Consultant designation. Since the Society was founded in 1928, it has been our mission to help improve the public's economic security by providing the financial services industry with professional continuing education programs and ethical guidance.

The American Society has been concerned about the use of sales illustrations for several years. In 1986, the Society began to gather information about ways to help consumers better understand the limitations of sales illustrations and to avoid unrealistic expectations about the ability of sales illustrations to predict the future. In 1987 we formed a task force to study the issue and present solutions.

The Task Force concluded that there was a significant lack of consumer understanding about the uses and limitations of life insurance sales illustrations. It was determined that this gap could be closed by improving the education of the insurance field force about the non-guaranteed assumptions upon which illustrations are based. This improved educational process would enable insurance agents to provide better counsel to their clients. To accomplish this goal, we adopted the Insurance Illustration Questionnaire (IQ) in 1992.

The IQ is a set of 25 questions which an agent may submit to an insurance company. The IQ is intended to help educate insurance agents on the non-guaranteed assumptions used by companies to generate life insurance proposals, better known as sales illustrations. A copy of the IQ is appended to this statement.

In less than four months since our February 1993 request, 29 companies representing about one-third of the industry as measured by admitted assets have already published responses. The Society is aware that more responses are being prepared by other carriers.

The Society has begun a multi-tiered educational process to help practitioners understand the IQ's benefits and purposes. We are now conducting a series of classes throughout the U.S. which introduce and explain the IQ to the insurance industry sales force. We are also preparing a videotape and student textbook for a more sophisticated and technical educational course which will be available to the insurance industry field force later this year. These courses will help the student understand the significance of each question and enable him or her to analyze the range of possible answers to the IQ's questions.

We believe that our approach; disclosure and education, is the best way that our organization's members can help consumers avoid unreasonable expectations about the future values of their life insurance policies. Ours is not the only approach nor the only solution. We took part in the work of the National Association of Life Underwriters (NALU) Task Force on Sales Illustrations and we support the recommendations that group made to the National Association of Insurance Commissioners (NAIC).

Before proceeding further, there might be some value in looking at the sales illustration issue with an historical perspective. Life insurance has been illustrated one way or another for prospective purchasers longer than anyone in this room has been alive. Why has this become an area of such *current* concern?

Life insurance is not an easy product to understand. Nevertheless, consumers have a right to know what happens if they live, die or quit. Before we had computers or computerized illustrations, agents laboriously copied out the insurance premium costs per $1,000 of death benefit from their company rate book and multiplied each number by the number of thousands in the death benefit of the proposed purchase. Then came hand calculators and then computers. The task of preparing illustrations became easier, but other factors I will describe introduced new complexities.

Virtually all active practitioners and almost all purchasers of life insurance today came of age and gained their own experience about financial products after World War II. In the 35 years that followed, there were two kinds of products; non-participating policies issued only by stock companies, and participating policies issued by mutual companies and a few stock companies. Almost all companies used a portfolio approach to calculate interest crediting rates in their dividend formulas. Under the portfolio approach, a single interest rate applied regardless of when the policy was issued.

Interest rates and mortality actual experience got steadily better for about 35 years after World War II. Products out-performed illustrations. Illustrations are simply a projection of current mortality, lapse, expenses and interest rates and in those 35 years the future generally turned out to be better than we had expected it to be. In fact, for most of this century, the life insurance industry's financial results have outperformed its illustrations. This fact was not lost on consumers. Anyone familiar with the economic history of this country up to the 1970's and 1980's would conclude that there was a lot of evidence to support the conclusion that dividend projections were conservative.

Agents too came to rely upon that, consistently superior performance. Consumers and agents both learned to believe, that the insurance industry's performance would always be better than its illustrations. Consumers read, and largely ignored, the footnotes on the illustrations which warned that the non-guaranteed elements in illustrations were not, in fact, guaranteed.

Then a great many things changed all at once. Interest rates spiraled up. Interest sensitive products were introduced. Some companies went to the investment generation method of crediting interest. Under the investment generation method, the interest rate reflects the year when the policy was issued. Computers made possible illustrating the concept of the so-called "vanishing premium." Under this concept, the premiums due at some point in the future could instead be paid by the use of non-guaranteed dividends or interest credits. Computers also made it possible for illustrations to be modified to show results if interest rates were higher or lower than the company's current crediting rate. And finally, the high long-term rates of the early eighties were followed by the lower rates we see today.

When interest rates began to decline below the levels assumed in the illustration, the carriers were no longer able to regularly exceed those illustrated non-guaranteed rates of return. It did not seem to matter that the companies were still exceeding the levels of performance they had guaranteed; consumers had forgotten the explanations about the difference between guaranteed performance and illustrated performance.

All this followed years of improved product performance. Many people just didn't understand that illustrations validly based on current experience will perform very differently in an era of dynamic interest rates. Despite cautionary language on the illustration itself, many people believed that "the illustration is the policy."

Company illustration practices changed because of the new environment and products described above. There is now a great deal of diversity in the way companies project the non-guaranteed elements. Therefore, illustrations can't be used to compare the policies of different companies. Illustrations do have an important value for consumers as an educational tool to help them understand their policies. A Society of Actuaries study concludes that illustrations are a good way to explain how a product works but not a good way to compare policies.

Consumers are entitled to an understanding of how products work. But we need to be sure that purchasers understand that the non-guaranteed portions are only what will happen if a complex series of assumptions based on present experience turns out to be correct. For this reason, we will support NALU's proposal to the NAIC.

The IQ is intended primarily for the education of agents, but the Society has not forgotten that consumers need accurate information too. For them, we have created a series of disclosure documents; recommended language to help explain concepts like "vanishing premium payment plans." Copies of these disclosure drafts are appended to this statement.

We also believe that the consumer should seek any service provider, including his or her insurance agent on the basis of knowledge and ethical commitment. We see the role of the American Society of CLU and ChFC to obtain full disclosure for agents and to provide educational programs on the meaning, uses and limitations of sales illustrations.

The following series of questions and answers will help further explain the Society's IQ.

WHY WAS THE IQ DEVELOPED?

The IQ was developed to assist insurance agents obtain the information they need to better understand and evaluate how the non-guaranteed and variable risk elements of a life insurance policy can impact future performance. In today's rapidly changing world, it is critical for agents to understand and be able to explain to their clients how changes in interest rates, investment gains, mortality, persistency and expenses can affect the future performance of a life insurance policy.

ISN'T A SALES ILLUSTRATION BASED ON THE POLICY ITSELF?

Yes. Individual states require that policy illustrations be based on current assumptions. This means that illustrations include more than just the underlying guaranteed policy values. They also include projections of non-guaranteed benefits and values which assume that current assumptions will continue into the future. Thus, an illustration is merely an insurance company's estimate of how an insurance policy might perform over time if a given set of assumptions as to interest rates earned on premium deposits, mortality experience and expense costs actually occurs. Since the potential for future performance to exactly match all current assumptions is low, it is safe to say that the sales illustration will *never* exactly portray the policy's actual performance.

WHERE DO ILLUSTRATIONS COME FROM?

There are a variety of sources for illustrations. They may be prepared by the insurance company in response to an agent's request. These usually contain a disclaimer noting the "figures presented are only illustrations and are not promises or guarantees." Still others are prepared using software created by independent vendors who have incorporated the issuing company's information into their system. Illustrations are also prepared on the insurance agent's computer, in which case it may have no direct relationship to the insurance company. Regardless of how the illustration is prepared, it is still only an estimate of future performance and cannot be any more accurate than the assumptions on which it is based.

DO ILLUSTRATIONS HAVE ANY BENEFIT?

Yes. Even though the numbers cannot predict actual policy performance, they do serve a vital function. Illustrations can be useful in developing the best combination of policy specifications to achieve the insurance buyer's objective. An illustration can show how quickly projected cash values mount, what projected dividends can do to reduce the policy's actual cash cost, and how many years premiums will have to be paid.

In addition, the insurance buyer can learn more about how the policy benefits may vary by reviewing alternate illustrations that project high and low interest rates. Though not exact and not guaranteed, these projections are of value to the insurance buyer because they demonstrate how the life insurance policy works. They also show how various policy features can be used to come up with a range of potential benefits and costs. However, it is important to bear in mind that while illustrations may help in the decision making process, they should not be considered as authoritative in making final buying decisions.

HOW IS THE "IQ" USEFUL TO CLIENTS?

An understanding of where the figures come from and what they actually represent will enable agents to better communicate the risks as well as the benefits of a life insurance contract to their clients. Agents can provide clients with details on the guaranteed and non-guaranteed elements inherent in the policy. This information will help avoid disappointment in years to come. Unrealistic expectations can be avoided when insurance professionals explain that ultimate policy performance is not influenced by a "sales illustration."

Company as well as policy performance is based on the following non-guaranteed risk elements:

- Mortality experience
- Investment performance
- Policy lapse rates
- Expenses

It is impossible to predict in advance what any of these four factors will ultimately be. For this reason, it helps agents to know how they were estimated in the sales illustration. Histories of these four factors are available for comparison through such insurance industry resources as Best's Life Reports and Standard & Poor's Insurance Rating Service. They are often available at public libraries or from insurance companies. It is important to remember that a company's past experience may not be an accurate guide as to what will happen in the future.

HOW DOES THE "IQ" HELP AGENTS GET INFORMATION?

Rather than searching through many sources for difficult to obtain information, the IQ allows agents to review responses from companies that have completed the IQ Questionnaire. The IQ covers such topics as the company's method of crediting earnings on investments to policies. Also, it includes questions on whether the company assumes any changes in mortality experience, and if so, what are the changes. In addition, the IQ asks what methods are used in changing expense charges including investment expenses, taxes and administration.

Since the answers will often contain complicated actuarial information, the American Society has developed an educational component for agents as part of the IQ Program. In addition to Society members, classes will be offered to other members of the financial services industry and allied professionals who can benefit from learning more about how to interpret the IQ Questionnaire.

HOW MANY COMPANIES HAVE RESPONDED TO THE IQ?

In February 1993, the American Society distributed the IQ to 130 of the leading U.S. life insurance companies and asked them to consider publishing an official response. To date, we are pleased to note that twenty-nine companies have already sent us a copy of their published answers. We are advised that other carriers are in the process of completing their responses. Considering the complexity of the process necessary to formulate the responses, we are very pleased with this result. We estimate that the responding companies represent more than one-third of the U.S. insurance companies measured by admitted assets. As agents and their clients become aware of the Illustration Questionnaire and seek the answers to the IQ, the American Society believes more companies will elect to provide responses.

Instructions For Use of Term Insurance Illustration Information

Because of the many product variations, the term illustration information statement requires some modification by the agent. Not all the information will be applicable with every term insurance presentation. Areas that are boxed should be included in the statement only if they apply to the policy(ies) being illustrated. Areas that are shaded require completion by the agent according to the particular product.

With regard to the "Conversion Privileges" section, you may want to insert a final paragraph concerning the types of policies which are (or are not) available for conversion.

In all cases, we recommend that you provide your client(s) with a proposal prepared by or approved by the insurance carrier. We also suggest that the proposal illustrates premiums and values to the expiration date for a pure term policy, or to the maturity date for other types of policies.

Term Insurance Illustration Information

The following explanation is for your information. The language of any insurance contract purchased controls your rights.

Premium Rate Guarantee

The only premiums guaranteed by the contract are those shown under the heading "Guaranteed" (or "Maximum") premium rates. All other premium rates illustrated are based upon the insurance company's currently billed rates which can be changed by the company.

Dividends *(If Applicable)*

This policy is a dividend paying policy. Dividends illustrated are based upon the current dividend scale and can be changed by the company.

Renewability

The policy is guaranteed to be renewable for ____ years (or to age ____), upon timely payment of the premiums, regardless of changes in health or finances.

Re-Entry Provisions *(If Applicable)*

This policy is a re-entry term policy. This means that the company may continue the policy at a lower premium rate than would have been charged otherwise, but only if the following requirements are met:

- You must apply for re-entry during the ____ day period before the ____ anniversary(ies) of the policy.
- You must provide evidence of insurability satisfactory to the company at that time. This may include a physical examination and other underwriting requirements similar to those required in an application for a new life insurance policy.

re-entry provisions
continued

If these requirements are not met, your policy will be continued at the rates being charged by the company at that time, subject to the Guaranteed or Maximum provisions discussed in the "Premium Rate Guarantee" section above.

If the application for re-entry is approved there will will not be a new suicide and contestability period.

The right to apply for re-entry is is not guaranteed. It is your responsibility to initiate the application for re-entry.

Cash Value

This policy generates a guaranteed cash value after the th year. This policy does not have guaranteed cash values.

Suicide and Contestability Periods

Claims will be denied for suicide occurring within years. Likewise, a claim occurring within years can be contested.

A new suicide and contestability period may be imposed only if the company requires new evidence of insurability (such as for reinstatement or a request for a lower rate classification, including a request for re-entry rates).

Conversion Privileges

The policy is convertible for years (or to age). The policy is not convertible. Convertible means that the policyowner has the right to exchange the policy for a permanent insurance policy regardless of changes in health or finances and with no new suicide and contestable periods.

If the policy is converted, the new policy will be issued with the same rate classification as a different rate classification from the term policy. Differences from the current status, if any, should be noted here, e.g. preferred nonsmoker, quantity discount, etc.

Approved by the
American Society of CLU & ChFC Board of Directors
on April 2, 1993.

American Society of CLU & ChFC
A National Organization of Insurance and Financial Service Professionals

Proposed "Vanish" Language (Universal Life)

The illustrated cash premiums are to be paid for _____ years while the insured is living.

If the non-guaranteed interest crediting rate, and mortality and expense charges used in this illustration are continued without change, the policy will provide the death benefit illustrated to age _____ .

If actual policy values are lower than assumed in the illustration (because the interest rate declines and/or mortality or expense charges increase), cash payments may be required for additional years, may be required at a higher level, and/or may have to be resumed at a later date.

For example, if the interest rate used in the illustration is immediately reduced by 200 basis points (2%), and no other assumptions are changed,

> the illustrated cash payments would be required for _____ years before policy values would be sufficient to pay all future mortality and expense charges.
>
> *OR*
>
> the illustrated cash payments made every year would maintain coverage at the initial level only until age _____ .

This method of managing a policy's premium is frequently called "Vanishing Premium" and should not be confused with "Paid-up," which guarantees the continuation of coverage regardless of future interest crediting rates, and mortality and expense charges.

Approved by the American Society of CLU & ChFC Board of Directors on September 10, 1992.

American Society of CLU & ChFC

A National Organization of Insurance and Financial Service Professionals

Proposed "Vanish" Language
(Par Whole Life)

The contract requires payment of premiums for _____ years (i.e. to age _____), while the insured is living.

This illustration assumes that only the first _____ years of premiums are paid in cash. It is assumed that subsequent premiums will be paid by the application of current dividends, or the surrender of dividend additions, or both.

Dividends are not guaranteed. If paid in sufficient amounts, dividends will reduce the number of annual premiums that must be paid in cash. This illustration shows the results using the current dividend scale to reduce the required number of cash premiums.

If actual dividends are lower than assumed in the illustration, cash payments may be required for more years, or may have to be resumed at a later date.

For example, if the interests rate used in the dividend scale is immediately reduced by 200 basis points (2%), and no other assumptions are changed, the illustrated cash payments would be required for _____ years before dividends would be sufficient to pay all future premiums.*

This method of managing policy premiums is frequently called "Vanishing Premium" and should not be confused with "Paid-up" which guarantees the continuation of coverage regardless of future dividends.

*Sometimes the policy includes a combination term/paid-up addition rider that provides so much coverage (relative to the amount of the basic whole life policy), that the full amount of death benefit coverage cannot be maintained even if all illustrated cash premium payments are made. In such an instance, the last phrase in this sentence should be changed to: "the illustrated cash payments made every year would maintain coverage at the initial level only until age _____ ."

Approved by the American Society of CLU & ChFC Board of Directors on September 10, 1992.

American Society of CLU & ChFC

A National Organization of Insurance and Financial Service Professionals

Introduction to the Life Insurance Illustration Questionnaire (IQ)

The Life Insurance Illustration Questionnaire (IQ) is an educational tool; its use by companies or agents is entirely voluntary. Some insurance companies may be unable to provide some information or unwilling to do so if they view that information as proprietary.

The purpose of the IQ is to help the student of life insurance understand the different non-guaranteed performance assumptions which insurance companies use to design and create sales illustrations. It has been developed primarily for non-SEC regulated products. Students should understand that sales illustrations are useful in developing the best combination of policy specifications to achieve the buyer's objective. However, illustrations have little value in predicting actual performance or in comparing products and companies.

Most life insurance products sold today have adjustable pricing. This can be accomplished either as a traditional "participating" product or as a product with "non-guaranteed pricing elements" such as changeable interest crediting rates, mortality charges, expense charges, etc. All adjustable pricing products incorporate some guarantees. However, the sales illustrations are usually designed to present potential benefits and costs under a set of non-guaranteed assumptions more optimistic than the guarantees. The insurance company generally limits its responsibility to the guarantees. So the risks associated with the inability of a product to achieve the higher illustrated benefits, or lower illustrated costs, than those generated by the guarantees are borne by the policyholder. A study of the responses to the IQ should help the student better understand those risks.

Life Insurance Illustration Questionnaire

Educational Information about current company illustration practices should be provided separately where company practices differ. For example, company practices may differ for traditional participating plans, universal life, indeterminate premium term plans and joint life.

This educational information covers the following plan(s):
(Ed. note. At this point, the responding company identifies the products covered by this IQ response.)

I. General

Basic Information

1. Are one or more of the policies participating? Specify:

   If so, does the company employ the contribution principle* with respect to these policies? If not how does it differ?

* The contribution principle calls for the aggregate divisible surplus to be distributed in the same proportion as the policies are considered to have contributed to the divisible surplus.

2. Are one or more of the policies non-participating? Specify. Describe the non-guaranteed elements.

   If so, what is the company's policy and discretion with respect to the determination and redetermination of non-guaranteed pricing elements? Are there any guaranteed pricing elements?

3. Whether participating or non-participating, do the underlying experience factor(s) for any non-guaranteed factor(s) used in the illustration differ from current experience? If so, describe.

4. Whether participating or non-participating, is there a substantial probability that the current illustrative values will change if current experience continues unchanged?

5. Whether participating or non-participating, is it company policy to treat new and existing policyholders of the same class the same or consistently with respect to the underlying factors used in pricing? If not, describe.

II. Mortality

Basic Information

1. Are the mortality rates underlying the illustration lower than actual recent company experience? Define actual recent experience (e.g., company experience for the last 5 years).

2. Does the illustration assume mortality improvements in the future?
   If so, describe.

3. Do the mortality rates or cost of insurance charges include some expense charge?
   If so, describe.

Additional Information

1. Do the underlying mortality rates vary by product (e.g., whole life vs. universal life vs. survivorship life) or policy size? If so, specify. (Provide general description of differences - not the actual rates used).

2. Indicate approximate duration when all mortality rates are the same by attained age.

III. Interest or Crediting Rates

Basic Information

1. Describe the basis of the interest rate used in the dividend scale or credited in the illustration. Include in description whether the rate is gross or net of expenses and/or margins.

   Do the interest rate(s) reflect the earnings on all invested assets? A portion of the assets? New investments over certain number of years? (If so, specify number of years). An index? (If so, specify).

2. Do the company investment earnings rates required to support the interest rate used in the dividend scale or credited in the illustration at any policy duration exceed the company's actual current earnings rate on the investment segment backing that block of policies?

3. Does the interest rate used in the dividend scale or credited in the illustration vary between new and existing policies?

4. Do the interest rates used in the dividend scale or credited in the illustration vary by policy duration?

Additional Information

1. Do the illustrative interest rates vary by product, class or otherwise? If so, specify including general description of variations.

2. Do the illustrative interest rates include capital gains? If so, include general description of capital gain recognition.

IV. Expenses

Basic Information

1. Do the expense charges used in the dividend scale or charged in the illustration reflect actual recent company experience? If so, what is the experience period? If not, describe basis.

2. How are investment expenses and taxes assessed?

3. Are expense charges used in the dividend scale or charged in the illustration consistently determined for new and existing policies?

Additional Information

1. Do the illustrative expense charges vary by product, class or otherwise? If so, specify, including general description of variations.

2. Do the expense charges used in the dividend scale or charged in the illustration vary by duration after the initial expenses are amortized? If so, describe.

3. Are the expense charges used in the dividend scale or charged in the illustration adequate to cover the expenses incurred in sale and administration? If not, how are remaining expenses covered (e.g. charges against interest rate, increased mortality charges)?

V. Persistency

Basic Information

1. If the actual persistency is better than that assumed, would that negatively impact illustrated values?

2. Non-guaranteed persistency bonuses are amounts illustrated as being paid or credited to all policyholders who pay premiums (sometimes of a minimum specified amount or more) for a specified number of years. Does the illustration involve such a bonus?

   a. If so, what is its form (e.g. cash amount, additional interest credit, refund of mortality or loading charges)?

   b. What conditions must be met to pay or credit the bonus?

   c. Is there any limitation on company discretion in deciding whether to pay or credit the bonus?

   d. Does the company set aside any reserve or other liability earmarked for future bonuses?

3. Does the illustration include a guaranteed bonus?

   a. If so, what is its form (e.g. cash amount, additional interest credit, refund of mortality or loading charges)?

   b. What conditions must be met to pay or credit the bonus?

   c. Is there any limitation on company discretion in deciding whether to pay or credit the bonus?

   d. Does the company set aside any reserve or other liability earmarked for future bonuses?

Prepared Statement of Robert M. Nelson on Behalf of the National Association of Life Underwriters

Mr. chairman and members of the Subcommittee, my name is Robert M. Nelson. I am in the insurance business as an agent in Omaha, Nebraska, and serve as the Chairman of The National Association of Life Underwriters Task Force on Sales Illustrations. NALU, founded in 1890, is a federation of 1,000 state and local life underwriter associations throughout the United States and Europe. The 142,000 members of these local associations are sales professionals in life and health insurance and other related financial services.

I'd like to start off by acknowledging that I consider it a special privilege to be able to present an agent's point-of-view on the subject of sales illustrations. For my part, I want to cover the following: first—a brief history of NALU's Task Force on Sales Illustrations and its work to date; next—highlights of the recommendations we have made thus far; finally—a personal comment about the important topic we are discussing.

I might note that a major cause of the current problems with life insurance sales illustrations stems directly from the precipitous downward spiral of interest rates. Illustrations themselves have historically been used successfully over many years, not as predictions of the future, but as guideposts for consumers in making decisions about life insurance. No one can guarantee the future, but almost everyone must make some attempt to estimate future events; otherwise no personal or business plans could ever be fashioned.

Stable Interest Rates: In the 1950's, '60's and '70's with relatively stable interest rates, policy illustrations based on then-current dividends, or similar non-guaranteed values for non-par policies, were generally conservative. Actual dividends or excess interest credited normally exceeded those which had been illustrated.

Sharply Rising Interest Rates: In the early 1980's rapidly rising interest rates changed illustration experience in two ways:

(1) A whole new generation of new money-based policies illustrated results based on a projected continuation of extremely high current rates, while

(2) Traditional portfolio-based products continued to exceed their original projections but appeared to offer lower returns than the new money-based policies.

An unfortunate result of these illustration practices was the inability of traditional policy owners to see how competitive their policies would be over time. This led to the widespread replacement of these policies to the policyowner's detriment.

Sharply Decreasing Rates: With the sharp decrease in interest rates in the 1990's, policyholders have experienced lower dividends and excess interest credits than their original illustrations had indicated. Hence, the current disillusionment.

I hope my testimony will demonstrate that the perplexity of illustrations is not the result of industry or state regulatory failings but rather unfavorable financial pressures that have changed the "ballgame" forever. Use of current rates in gauging future performance is no longer sufficient. These are troubling times and difficult dilemmas must be solved. The insurance industry has acted and is acting responsibly to correct the problem as I hope recounting NALU's contributions will help to show.

Throughout last year, many agents were sensing the public unrest over policy performance and the credibility of sales illustrations. We agents are generally the first to hear of the disappointments, confusion and bitterness of policyholders. Consequently, we may be in a unique position to comment upon the problems associated with the same illustrations that often cause that frustration.

At a meeting late last year, the major field organizations resolved to form a task force to look into the problems of sales illustrations. NALU's Task Force comprises representatives from all the principal life and health insurance field organizations. Those participating include: American Society of CPU and ChFC, Association for Advanced Life Underwriting, Association of Health Insurance Agents, General Agents and Managers Association, Million Dollar Round Table and, of course, The National Association of Life Underwriters itself.

In addition, actuaries from both stock and mutual companies representing the American Academy of Actuaries and the Society of Actuaries serve on the NALU Task Force on Sales Illustrations. We relied heavily on the work already undertaken by the American Society of CLU & ChFC, American Academy of Actuaries and Society of Actuaries Task Force Report. NALU's Task Force agreed on a number of recommendations that were subsequently approved and adopted by the NALU Board of Trustees and are incorporated in this statement.

Of paramount concern to agents is the fact that illustrations in a decreasing interest environment, although accurately reflecting current experience, may not be supportable under current actuarial standards of practice for even a few years into the future.

The NALU Task Force believes that there must be more precise definitions and stricter rules governing the definitions of "supportability" and "current experience." NALU took its concerns to the Actuarial Standards Board (ASB) public hearing on March 3, 1993. We asked the ASB to review its current actuarial practices and help define and strengthen the definitions and rules regarding supportability and current experience of sales illustrations.

In March of this year, NALU testified before the National Association of Insurance Commissioners, because we believe the answers to problems created by illustrations should be solved at the state regulatory level. We said that the NAIC should take the following actions:

1. Require that consumers receive a supportable illustration as defined by the Actuarial Standards Board or a statement, prominently displayed on the illustration, that the current illustration is not supportable. A prerequisite for adopting this recommendation is a usable definition of "supportable."

2. Sensitize policyholders to material changes in the policy as illustrated by requiring a short, simplified sensitivity summary to accompany illustrations. It would contain policy data for a given amount of premium, using both current and lower interest rates. If the illustration is particularly sensitive to changes in non-guaranteed elements other than interest, this fact should also be covered by the summary.

3. Mandate a signed disclosure statement whereby the consumer acknowledges that he or she has read the illustration, understands it, and knows that non-guaranteed elements and dividends are not guaranteed. If an agent does not use an illustration, then the agent would be required to sign a statement attesting that an illustration was not used in the sales process.

4. In order to identify better items that should be regulated as illustrations, precisely define the term "sales illustration," so that agents and companies will understand when regulations apply.

5. Make certain that a description of all policy types and riders integral to the product being illustrated accompanies the illustration.

6. Require that illustrations show the first 20 years, year-by-year, plus years when significant policy changes may occur, such as premium reappearance, and optionally every fifth or tenth year increment to maturity. The figures should be rounded down to the lower hundred dollars. This last statement—about "rounding down"—has apparently not been well received in subsequent discussions. The intent was to "soften" the impression that sales illustrations are "precise." I should note that this was one of the first changes I readily made to my own use of sales illustrations.

7. In the case of vanishing premium illustrations, require, as recommended by the AAA, that:

   —adequate disclosure of the vanishing concept be illustrated or footnoted. The language recently recommended by the American Society of CLU and ChFC is a good example of adequate disclosure in this area. See Exhibit A attached.

8. With respect to illustrations of second-to-die policies, require, as recommended by the American Academy of Actuaries:

   —a statement whether the policy values change at the first death, and if so, how they change; and

   —an illustration displaying the operation of the contract when both insureds are alive, and after the first death.

9. In illustrations of "blended" or "modular" policy/rider combinations, i.e., those policies that allow for blends of term riders, paid up additions' riders, and dividend options to provide an integrated package of benefits, require (again as recommended by the AAA):

   —clear disclosure of the "modular" structure in the illustration;

   —disclosure of the current guaranteed premium for any applicable term coverage (whether provided by riders or dividends); and

—illustration of the annual cost of the total death benefit for all years, based on policy guarantees.

10. Provide (as recommended by the AAA) that sales illustrations should not be used by themselves for comparative policy performance. We then provided the following sample language to expand on "why" sales illustrations by themselves were inadequate for policy comparisons.

    Sales illustrations should not be used by themselves to compare policies. Life insurance policies are complex financial instruments, which generally contain both guaranteed and nonguaranteed elements. A sales illustration may be helpful in understanding how a particular policy performs under specified circumstances. It is not feasible, however, to use sales illustrations alone to determine whether one policy is a better buy than another.

    Today's illustrations are not adequate for comparison purposes because it is generally impossible to obtain illustrations from different companies, or even for different policies of the same company, that are based on sufficiently similar factors to be comparable.

    This results from the fact that there are considerable differences among companies in the bases they use for various non-guaranteed elements and dividends and other pricing elements underlying their sales illustrations, and, at present, there is relatively little dissemination of information regarding these bases.

    Questions involved in selecting an insurance company require knowledge and analysis of assumptions; consideration of financial circumstances of the company; the quality and availability of service of the company and agent, and the individual policy provisions under consideration.

11. Delete the interest-adjusted cost indexes from point-of-sale illustrations and in the NAIC Model Buyer's Guide because their use in the illustration invites "comparison" which we already concluded was an improper use of the illustration. (We acknowledge their value when used with historical policy performance.)

12. Require that if an agent provides the buyer with a self-prepared or third-party vendor software illustration, it must be accompanied by a company-prepared or endorsed illustration.

All of these recommendations are the result of the Task Force's broad experience in the field and its contact with consumers and their reaction to illustrations used in sales situations. Agents certainly have and will continue to have the responsibility to point out and discuss with their clients all relevant disclosures on illustrations.

We believe that the actuarial profession—specifically the ASB, the Society and the Academy of Actuaries—is the best group to develop improved illustration practices for the industry.

We believe that the NAIC is the institution best equipped to develop regulations to guide the industry and protect increases in this area.

* * *

I would also like to respond to some special concerns that have been expressed by you, Mr. Chairman. In your letter to the National Association of Insurance Commissioners dated September 18, 1992, you pointed to a number of specific problems you believe the NAIC should consider in the context of any discussion of life insurance illustrations. We believe the recommendations we have made in this statement for the reform of illustrations will serve to answer many of the special problems of disclosure that you have raised. In addition, we have itemized below what appear to be some of your other major concerns, and have included with each what we believe might be a reasonable and appropriate response.

I. LIFE INSURANCE ILLUSTRATIONS CONTAIN NO CLEAR AND ACCURATE BREAKDOWN OF POLICY-RELATED ADMINISTRATIVE CHARGES AND OTHER EXPENSES, INCLUDING AGENTS' COMMISSIONS THAT CAN RANGE FROM 55 TO 105 PERCENT

Life insurance policies do not provide a breakdown year-by-year of the actual administrative charges and other expenses. Many policies do not specifically itemize such charges and expenses. If there is no direct charge for these expenses, it may even be misleading to the buyer for an insurer to make an attempt to isolate them. Even a policy that does have explicit expense charges may provide for absorption of some of these expenses through conservative margins in other policy elements (higher mortality charges or lower credited interest rates) or through surrender charges.

What is most relevant to the buyer is the disclosure of the guaranteed cash values and the cash values based on the current scale of dividends and non-guaranteed elements. The cash value may be derived from several elements:

(1) the premium that is paid;

(2) the mortality charges that are assessed;

(3) the expense charges that are assessed; and

(4) the interest that is credited.

It is the interaction of these elements that is important to the buyer. To isolate any one element will give the buyer an incomplete or misleading picture of the operation of the life insurance policy. A buyer of an automobile wants to know the overall price of a car and its features and performance; not the price of individual components.

Dividend-paying policies, for example, may have no explicit mortality costs or expense charges. The dividend allocates back to the policyowner his or her share of divisible surplus based on contributions to surplus, or experience that is better than the guarantees. Dividends are not broken down for the policyholder by element, so the true mortality cost, expense charges or interest credits cannot be easily derived. However, the cash values resulting from this annual distribution are clearly displayed in the illustration.

One of the policy expenses mentioned in your letter is agents commissions. Marketing and distribution expenses are factors in all goods and services offered to the American consumer. Commissions are an expense that should be considered in relation to the overall cost of the product to the buyer, as would be done in the case of other services (e.g. real estate sales), rather than as a percentage of the dollar amount of the first installment.

Consider an example of a male, age 45, who purchases a whole life policy with a face amount of $100,000. A typical annual premium for such a policy would be about $2,300. The policy would be the kind that would accumulate cash values and pay dividends over the years. A policy issued at age 45 can be expected to remain in force, on the average, for a period of approximately 12 years, according to the Life Insurance Management and Research Association (LIMRA). During that time the insured would pay, in premiums, a total of $27,600.

A composite of the career agent's contracts of 48 New York and non-New York licensed life insurance companies, also developed by LIMRA, provides for a commission of an average of 53 percent of the first annual premium on a whole life policy, plus an additional 44 percent, spread out over the next nine years. Payment of the renewal commissions would be dependent on the payment by the policyholder of each renewal premium. Thus the agent would typically be paid a total of 97 percent of one annual premium, but over a 10-year period.

The agent will thus earn $1,219 when the policy is sold (53 percent × $2,300); in the aggregate, the agent will receive $2,231 of the $27,600 that the insured will pay in premiums over the 12 years the policy is in force (97 percent × $2,300). The agent will therefore have ultimately received 8.0 percent of the total premium in commission payments, which is certainly consistent with commissions paid in other types of sales transactions.

Not only will the life insurance agent's aggregate compensation be partially deferred over a period of 10 years, but it will also be contingent upon each annual renewal of the policy and the agent's continued employment. And in the event that the whole life policy should remain in force longer than the average of 12 years, the 8.0 percent paid to the agent would be commensurately reduced, so that, for example, should the policy be in force for 20 years, the agent's total compensation would be only 4.8 percent of the aggregate premiums paid.

The commission to be paid to the agent is no more relevant to the life insurance purchasing decision than would be knowledge of the profit margin of the seamstress in the purchase of a dress. The pertinent questions are: "What does the insurance (or the garment) cost?", and "What is the value received?". Commissions are clearly an expense item, just as are other costs of distribution, administration, and policy service functions, such as medical examinations of applicants. Each carrier incorporates these costs into its pricing structure.

The commission an agent receives, if required to be "revealed," is more than likely to confuse the process of selecting the best product, much as would occur if one decided to shop for clothing on the basis of the salaries or sales commissions paid to the sales staff of those stores. The issue of commissions is a red herring. The essential issues for the buyer are, "What do I *need,* what does it *cost* me, and what is its *value?*". Those are perfectly valid questions to pose about any good or service to be acquired.

II. THERE IS NO CLEAR INDICATION OF SURRENDER CHARGES

Imposing surrender charges is one approach to the way in which a carrier can protect itself against termination of the policy too soon to recover its initial costs. If the carrier uses this method, the account value of the policy (the gross cash value before surrender charges) is shown in the illustration along with the surrender value of the policy. The surrender charge is easily determined as the account value minus that year's surrender value. The surrender charge will typically persist for 10 to 20 years, and generally diminishes over time. Once the surrender charge has diminished to zero, the account value and the surrender value are the same. This should be clearly shown in the policy illustration.

A more traditional approach to incorporating the financial protection needed by the carrier in the event of early termination, is to charge all or most of the initial cost of issuing the policy against the cash surrender value of the policy over the first year or two. The surrender value of such a policy will typically be $0 in the first year, and cash values will begin to emerge in the second policy year.

III. THERE IS NO INDICATION WHICH POLICY BENEFITS ARE GUARANTEED

The NAIC models and the majority of states that have adopted solicitation and disclosure rules require that illustrations indicate which policy benefits are guaranteed when non-guaranteed policy elements and dividends are illustrated, and these indications must be made with equal prominence. This has also become a common practice in the industry.

IV. THERE IS NO INDICATION HOW MANY YEARS IT WILL TAKE A REPLACING POLICY TO OFFSET THE LOSSES OF A REPLACED POLICY

Life insurance replacement regulations attempt to deal with problems such as this in two ways: first, the replacing company is required to send a notice of the proposed replacement to the existing insurer to give that insurer the opportunity to provide its policyholder with meaningful comparative information; second, the policyholder is given a written notice to the effect that the wisdom of making a replacement cannot be determined without a careful comparison of all the relevant issues relating to the two policies. The notice urges the policyholder to hear both sides before making a decision.

Perhaps even a better answer can be found in the growing number of companies that now have in-force illustration systems which would demonstrate the value of insurance already in-place.

In this area, Mr. Chairman, your concerns are particularly well-founded. Perhaps more work on the part of the NAIC is called for to regulate policy replacement, especially in light of the knowledge that there is presently one large national life insurance sales force at work that has seemingly dedicated itself to the deplorable mission of indiscriminately replacing every whole life policy in America, without making the kind of disclosure you properly feel is vital.

V. SALARIES AND BENEFITS FOR THE EXECUTIVES NOT DISCLOSED

This information is available from several different sources for all companies doing business in the state of New York, as well as for stock carriers from their 10–K filings with the Securities and Exchange Commission. Variable life policies will reflect this information in the prospectus. In all cases this information is quite as irrelevant as the amount of commission being earned by the selling agent.

There are readily available policy performance histories which can be obtained from agents or from the public library, and this is far more relevant to the buyer than executive compensation would be.

* * *

As a final comment, I want to clarify that I am an agent who entered this business almost 20 years ago. I had then and have today a great sense of pride and professionalism in what I do for my clients. I sincerely believe that significant improvements need to be made in today's sales illustration, as I have indicated above. But that is not a reason to condemn our industry, nor should we pretend our industry should have been immune to change, especially in view of the economic realities of the past few years. But we did not communicate to customers the impact of change as well as we should have, especially the impact of change on the numbers we used in our sales illustrations.

So, our challenge is to learn and to respond. I sincerely believe it is a shared responsibility by all of us—agents, the actuarial profession, company leadership, state regulators and even consumers. The industry's biggest mistake would be to delay, and I hope it will not. Thank you again for the opportunity to present NALU's views on this critical matter.

EXHIBIT A

BOARD OF DIRECTORS APPROVES LANGUAGE FOR VANISH PREMIUMS

[From Society Page/December 1992]

Recognizing the nature of sales illustrations, client perceptions and the need for life insurance practitioners to communicate clearly with their clients on key issues in the sales process, the Board of Directors of the American Society of CLU & ChFC has approved sample disclosure language for use by agents when illustrating vanish premiums in participating whole life and universal life plans.

"The goal of disclosure statements is to provide producers with common, clear language to help explain complex things to clients," according to Frederick Stitt, CLU, a member of the American Society Board of Directors, and chairman of the Society task force that developed the drafts.

"The statements are appropriate for use with all clients where vanish premiums are concerned," Mr. Stitt said. "Society members can simply pick these up and use them. The Society's point of view is that what we have is language that is acceptable. This doesn't mean you have to use it. But if you choose to re-edit it to meet your marketplace, we only suggest that you keep the same elements in the disclosure."

The disclosure drafts were developed earlier this year by a Society task force organized to review the Professional Practice Guideline, which was developed in 1988.

The task force, chaired by Mr. Stitt, has focused on issues related to life insurance sales illustrations, and has also developed the Life Insurance Illustration Questionnaire—an educational tool to help agents understand the elements that drive the illustrations for life insurance products.

American Society President John D. Campbell, CLU, ChFC, is urging all members to familiarize themselves with the disclosure drafts.

"The American Society's goal is to offer members support in two vital areas—education and ethics. These materials have been developed to help practitioners learn more about life insurance products and illustrations, and to ethically and resposibly help clients understand these products," Mr. Campbell said.

"During the upcoming year, we will be giving members more information on this key area of our business. We will also provide information on how to use the IQ in evaluating the life insurance products we represent to our clients." SP

APPROVED VANISH LANGUAGE—UNIVERSAL LIFE

The illustrated cash premiums are to be paid for — years while the insured is living.

If the non-guaranteed interest crediting rate, and mortality and expense charges used in this illustration are continued without change, the policy will provide the death benefit illustrated to age —.

If acrual policy values are lower than assumed in the illustration (because the interest rate declines and/or mortality or expense charges increase), cash payments may be required for additional years, may be required at a higher level, and/or may have to be resumed at a later date.

For example, if the interest rate used in the illustration is immediately reduced by 200 basis points (2 percent), and no other assumptions are changed, the illustrated cash payments would be required for — years before policy values would be sufficient to pay all future mortality and expense charges * * * or: the illustrated cash payments made every year would mainain coverage at the initial level only until age —.

This method of managing a policy's premium is frequently called "Vanishing Premium" and should not be confused with "Paid-up," which guarantees the continuation of coverage regardless of future interest crediting rates, and mortality and expense charges.

APPROVED VANISHING LANGUAGE—PARTICIPATING WHOLE LIFE

The contract requires payment of premiums for — years (i.e., to age —), while the insured is living.

This illustration assumes that only the first — years of premiums are paid in cash. It is assumed that subsequent premiums will be paid by the application of current dividends, of the surrender of dividend additions, or both.

Dividends are not guaranteed. If paid in sufficient amounts, dividends will reduce the number of annual premiums that must be paid in cash. This illustration shows the results of using the current dividend scale to reduce the required number of cash premiums.

If actual dividends are lower than assumed in the illustration, cash payments may be required for more years, or may have to be resumed at a later date.

For example, if the interest rate used in the dividend scale is immediately reduced by 200 basis points (2 percent), and no other assumptions are changed, the illustrated cash payments would be required for — years before dividends would be sufficient to pay all future premiums.

This method of managing policy premiums is frequently called "Vanishing Premium" and should not be confused with "Paid-up" which guarantees the continuation of coverage regardless of future dividends.

Sometimes the policy includes a combination term/paid-up addition rider that provides so much coverage (relative to the amount of the basic whole life policy) that the full amount of death benefit coverage cannot be maintained even if all illustrated cash premium payments are made. In such an instance, the last phrase in this sentence should be changed to: "the illustrated cash payments made every year would maintain coverage at the initial level only until age —."

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