

Late-Night Comedians Be Warned, some Insurance Regulators Are Speaking

The attached document was presented at a May 1, 1994 NAIC meeting attended by approximately 100 industry executives and regulators on the NAIC's on-going work to improve life insurance policy illustrations. While the document is a virtual goldmine of life insurance regulatory incompetence, the following sections contain some extra-special treasured nuggets:

- 1) Section 4 Paragraph F which reads "Rate of Return" means the ratio of interest credited to premium paid. Appendix A (the last page of this document) shows that in the years in which the "interest credited" was reported as \$85, \$120 and \$170 on a policy with a \$1000 annual premium, that the NAIC was proposing that the Rate of Return for those years respectively be listed as 8.5%, 12% and 17%. Let me know when you stop laughing.
- 2) Section 8 entitled "Prohibitions" reads, "The following actions by companies or their agents are prohibited: ...B. Making any representation about the future performance of the policy, including but not limited to potential dividends, rate of return or cash value other than those which are guaranteed by the company...[underline added for emphasis]" In other words, on a participating policy, any discussion of such future performance is verboten. How then, pray tell, is a consumer suppose to understand a participating policy? And, finally,
- 3) Section 5 on Illustration Format Standards contains the following demonstration of the NAIC's extensive real-world knowledge of the sales process with its proposal in Subsection C. 4. It reads, "A statement to be signed and dated by the insurance agent as follows: "I certify that this is the only illustration used in the sale of this life insurance policy and that no representations have been made that are inconsistent with the illustration [underline added for emphasis]." To have assumed and asserted in 1994, following so closely on the industry's widespread sales practices problems of the 1980s and early 90s, that only one life insurance illustration was used in the sale of a policy shows such a shocking ignorance of agents' various illustration and sales practices (i.e. short pay, retirement funding, borrowing for college, etc.) as to have possibly warranted a psychological evaluation for confinement because of such delusional thoughts.

Readers are invited to submit their other favorite priceless nuggets of regulatory incompetence found in the following 10 page NAIC document and/or any other NAIC documents to the blog at Breadwinners' Insurance.

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RULES GOVERNING THE USE OF
ILLUSTRATIONS IN CONNECTION WITH THE
SALE OF LIFE INSURANCE

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Section 1. Purpose

The purpose of this regulation is to provide rules for life insurance policy illustrations based upon policy guarantees and actual past performance compared to an index. The rules provide illustration formats, prescribe standards to be followed when illustrations are used, and require disclosures to be used in connection with illustrations. These rules require illustrations to be understandable by purchasers of life insurance without explanation by an agent or others possessing specialized insurance knowledge.

Section 2. Authority

This regulation is issued based upon the authority granted the Commissioner under [cite appropriate enabling legislation].

*The objective
is to make
illustrations
understandable*

Section 3. Applicability and Scope

- A. This regulation shall apply to all group and individual life insurance policies and certificates marketed with the aid of an illustration, except as otherwise provided in this regulation.
- B. This regulation shall not apply to individual and group annuity contracts, to variable life insurance contracts without guarantees as to future performance, to credit life insurance or to life insurance policies issued in connection with pension and welfare plans.

Section 4. Definitions

- A. "Guaranteed values" means values which the insurer warrants will be available to the insured for withdrawal from the policy.
- B. "Illustration" means a ledger or proposal used in the sale of a life insurance policy which shows in a tabular, graphic or chart format the guaranteed values the policy will generate in the future as well as the actual values generated previously by a particular life insurance policy.
- C. ^{INCREASE} "Interest credited" means the total amount of all increases in policy value (e. g. excess interest or dividend credits) to the policy
- D. "Past performance" means a demonstration of amounts credited to a policy during each calendar year that a policy form has been issued. This shall include both guaranteed and non-guaranteed values.
- E. "Qualified actuary" means an individual who is a member in good standing of the American Academy of Actuaries who has

certified an understanding of illustrations based upon policy guarantees and past performance.

- F. "Rate of return" means the ratio of interest credited to premium paid. This number is shown for illustrative purposes as a basis for comparison against the consumer price index (CPI) for each year shown. This number is an indicator of the growth of the value under the policy and does not take into account the insurance element of the policy.

Section 5. Illustration Format Standards

A policy illustration consisting of a cover page, appropriate tabular, graphic and textual descriptions shall be subject to the following minimum standards:

- A. Each page of an illustration, including any explanatory notes or pages, shall have a page number for each page with a showing on each page of the total number of pages in the illustration (e.g. the fourth page of a seven-page illustration shall be labeled "page 4 of 7 pages").
- B. Each illustration shall be clearly labeled "Life Insurance Illustration," shall identify the insurance company, shall identify the generic type of life insurance, and the company product name, if different. The policy form number shall also be identified.
- C. Each illustration shall have a cover page, which shall be page one of the illustration, which shall contain the following:
- (1) The premium classification upon which the illustration is based, as well as a narrative explanation of this classification and the percentage of insureds covered

by this form that fall into this premium classification.

- (2) The current financial rating of the insurer by all rating agencies that have rated the insurer. The rating agency shall be clearly identified with its rating, accompanied by a statement indicating the number of ratings available from that rating agency as well as the numerical ranking (e.g. 5th out of 7 ratings) of the rating given to the insurer.

Drafting Note: A state may wish to limit or specify the rating agencies that must appear on the cover sheet.

- (3) A statement to be signed and dated by the applicant as follows: "I have received a copy of this illustration of the life insurance policy for which I have applied."

- (4) A statement to be signed and dated by the insurance agent as follows: "I certify that this is the only illustration used in the sale of this life insurance policy and that no representations have been made that are inconsistent with the illustration."

D. Prior to or at the time of delivery, the company shall provide a copy of the illustration which includes a statement signed and dated by an officer of the insurance company as follows: "I certify that this is an appropriate illustration for the policy issued to the applicant and that it accurately describes past performance and values paid by the company on this policy form and complies with the standards established by the Actuarial Standards Board."

Drafting Note: The officer of the insurance company may authorize the use of his facsimile signature but is still responsible for the statements made in the illustration.

Section 6. Certification by the Company; Disclosure

A. At or prior to delivery of a life insurance policy, an insurer shall provide the applicant with a second copy of the illustration provided under Section 5 which is certified by the company as:

- (1) Appropriate for the underwriting class of the applicant and the policy issued;
- (2) Accurately describing the guaranteed values and past performance of the policy; and
- (3) Prepared in compliance with the standards of the Actuarial Standards Board.

B. An officer of the insurance company shall sign and date the certification required under Subsection A.

C. An insurance company may comply with Subsection A by substituting a different illustration than the illustration signed by the applicant under Section 5, but only if:

- (1) The substitution is necessary because the policy issued is in an underwriting class other than that illustrated;
- (2) The substitute illustration complies with Section 5 and is signed and dated by the agent and the applicant as required by Section 5C; and

- (3) The substituted illustration includes on the first page a clear and prominent disclosure that it is a revised illustration and that it should be carefully reviewed prior to acceptance of the policy.

Section 7. Standards for Illustrations

- A. Each illustration shall be based upon past performance and guarantees only.
- B. Each illustration shall show past performance for each ~~calendar~~ year illustrated as follows:
- (1) Information shall be shown in a tabular fashion as demonstrated in Appendix A;
 - (2) For each year the premium ^{planned periodic} paid for the policy shall be shown;
 - (3) For each year the Consumer Price Index shall be shown for each year;
 - (4) For each year, the interest credited and the rate of return if the policy is not surrendered shall be shown; ~~and~~
 - (5) For each year, the interest credited and the rate of return if the policy is surrendered shall be shown.
- C. Illustrations shall show guaranteed performance as follows:
- (1) Agent's name and address;
 - (2) Insured's name;
 - (3) Age and sex of insured;

(4) Underwriting class;

(5) Columns as follows:

(a) Policy years listed annually for years one to twenty (20) and five-year intervals beginning at age sixty (60) and ending at age 100;

(b) Premium for each year sufficient to produce an endowment at age 100 with totals at year ten (10) and year twenty (20) and age sixty-five (65);

(c) Cash accumulation value for each year;

(d) Cash surrender value for each year; and

(e) Death benefit for each year.

Section 8. Prohibitions

The following actions by companies or their agents are prohibited:

A. Representing the policy as anything other than life insurance;

B. Making any representation about the future performance of the policy, including but not limited to potential dividends, rate of return, or cash value other than those which are guaranteed by the company and described in the illustration.

C. Making any representation regarding the past performance of the policy other than the representations contained in the illustration;

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- D. Using a policy illustration which does not comply with the requirements of Section 5 of this rule;
- E. Providing an applicant with an incomplete policy illustration;
- F. Representing in any way that premium payments will not be required for each year of the policy in order to maintain the illustrated death benefit; or
- G. Illustrating any product not identified pursuant to Section 5B.

Section 9. Annual Report

Refer to 255 or 256

The insurance company shall annually provide a report to the insured which compares the illustrations made at the time of sale with the actual results that have occurred since that time. The report must be made no later than thirty (30) days after each anniversary date. It shall contain information similar in format to the original illustration and shall inform the policyholder how to obtain more information on the effect of these changes. Any changes impacting policy values or premium outlay requirements must be explained.

Section 10. Actuarial Standards

Illustrations shall meet standards with regard to measurement of past performance established by the Actuarial Standards Board. Each insurance company shall require a qualified actuary to certify that illustrations used by the company meet these standards. In the event that standards are not developed by the Actuarial Standards Board that are acceptable to the Commissioner, the Commissioner may prescribe alternative standards to be met in connection with illustrations.

Section 11. Separability

The provisions of this regulation are hereby declared to be separable. If any court of law shall find any provision of this regulation unconstitutional, the other provisions shall not be affected.

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Appendix A

ILLUSTRATION OF PAST PERFORMANCE

Whole Life Insurance Policy

Male Age 35
Rating: Preferred

Annual Premium: \$1,000
Death Benefit: \$100,000

End of Calendar Year	Premium Paid	Consumer Price Index	If Policy Not Surrendered		If Policy Surrendered	
			Interest Credited	Rate of Return*	Interest Credited	Rate of Return
1994	\$1,000.00	7.0%	\$15	1.5%	0	0%
1993	\$1,000.00	6.2%	\$85	8.5%	0	0%
1992	\$1,000	7.1%	\$90	9.6%	0	0%
1991	\$1,000	5.8%	\$120	12%	\$10	1%
1990	\$1,000	6.0%	\$170	17%	\$25	2.5%

etc.

* The rate of return is a percentage equal to the ratio of interest credited [dividends paid] to the policy for the period shown to the total premium paid. [This number is shown for illustrative purposes as a basis for comparison against the Consumer Price Index (CPI) for each year shown. This number is an indicator of the growth of the value under the policy and does not take into account the insurance element provided by the policy.]