
To: Hon. T. F. Gilroy Daly
Insurance Commissioner
State of Connecticut

From: Paul J. Mason
Chief Counsel, Securities
American Council of Life Insurance
Washington, D. C.

Re: Proposed Changes to NAIC Model Variable Life Insurance Regulation

Date: November 29, 1976

This is in further reference to our November 22 meeting at which we provided you with comments regarding Richard Hemmings' report dated September 9, 1976 concerning proposed changes to the NAIC Model Variable Life Insurance Regulation submitted by the American Council of Life Insurance.

It was understood that we would furnish you with a summary of our reaction to the September 9 document, which summary supplements our "Explanation of Recommended Changes to NAIC Model Variable Life Insurance Regulation" dated April 30, 1976 and forwarded to the (C4) Subcommittee on May 3, 1976. We anticipate that the enclosed summary will be discussed at the meeting of the (C4) Subcommittee on Variable Life and Variable Annuities scheduled for December 6. Bruce Nickerson and I will be available at the (C4) Subcommittee meeting to answer any questions you may have.

We very much appreciated the opportunity of discussing this subject with you in Hartford and hope that the enclosed material will be beneficial.

ACLI Reaction to NAIC Staff Report
on Proposed VLI Regulation Amendments

At our meeting in Commissioner Daly's office on November 22, it was agreed that the American Council of Life Insurance (ACLI) would transmit to the NAIC Central Office and to Commissioner Daly a summary version of our reaction to Richard Hemmings' September 9, 1976 memorandum entitled "Recommendations on the Industry Proposed Changes of

the NAIC Model Variable Life Insurance Regulation." Again, as stated at the November 22 meeting, these comments do not substitute for our earlier proposal entitled "Recommended Changes to NAIC Model Variable Life Insurance Regulation" dated April 30 and submitted to the NAIC (C4) Subcommittee by the ACLI on May 3, 1976. Our complete submission is obviously more detailed and also covers several items which are not separately touched upon here.

The item numbers below correspond to the item numbers of the NAIC memorandum of September 9, 1976.

Changes in Investment Policy (Item 2)

The ACLI's narrative explanation of its proposed change may have been somewhat ambiguous since Mr. Hemmings' "Summary of Recommendations" reflects that we were recommending an elimination of the "substantial similarity" test. Actually, we were recommending the addition of an alternative test, namely one of "consistent safeguards" and we continue to urge that this alternative be adopted.

We believe this additional test to be most workable and useful. Without such an alternative approach, companies domiciled in, for example, New York, Michigan and Colorado (which do not have a public hearing requirement for changing investment policy) could not readily operate in states which adopt the model regulation in its present form. Similarly, there are quite a number of states which have already approved variable life insurance policy forms without a regulation, relying solely upon statute and the overall powers of the Commissioner. Companies domiciled in such states might not pass the "substantial similarity" test of a state which adopted the presently existing model regulation.

Filings (Item 3)

It would seem appropriate, particularly if our recommendation immediately above is adopted, for the Commissioner to receive a statement from the insurer describing its actual procedures for changing investment policy.

Use of Sales Materials (Item 4)

A unique procedure for review of advertising of variable life insurance policies should not be required. The NAIC model regulation on advertising specifically covers the variable life insurance product. Therefore, variable life insurance should not be singled out for additional treatment.

Also, we note that the VLI Regulation's optional requirement for prior filing of variable life advertising material renders the possibility of a national campaign, particularly one using network television, an extremely difficult undertaking. This is not a requirement for fixed benefit insurance, and singling out the variable life insurance product makes it appear less like traditional life insurance.

Mandatory Policy Benefit and Design Requirements (Item 5)

Mr. Hemmings' analysis deals separately with (a) the lifetime coverage requirement; (b) the minimum multiples; (c) limitations on policy design, generally; and (d) an increase in nonforfeiture benefits in the event premiums exceed a certain level.

As to items (a) and (b), we believe, as stated in our earlier submission, that the existing requirements unduly restrict an insurer's ability to develop and market useful variable life insurance products.

As to items (c) and (d), ACLI's position is contained in an earlier submission.

Policy Reinstatement (Item 6)

The ACLI's narrative explanation of this proposed change was not clear in explaining the need for this change. The reinstatement provision in the present model regulation makes no reference to incidental insurance benefits. The ACLI proposal is intended to correct this drafting oversight in a manner which would be consistent with the reinstatement requirements for fixed benefit life insurance and would avoid unequal treatment of different VLI policyholders.

If a fixed benefit life insurance policy includes an incidental insurance benefit for which an extra premium is charged, then the statutory charge for reinstating this benefit after lapse is the amount of the overdue premiums for the benefit plus interest. The ACLI proposal would provide precisely the same charge if the benefit had been included in a VLI policy. If the ACLI proposal is not accepted, then insurers would be required under some circumstances to reinstate incidental insurance benefits at a lower charge, or even for free. We are convinced that this anomalous result was not intended, and urge that our recommendation be accepted.

18 Month Exchange Privilege (Item 7)

The NAIC and the insurance industry are in full agreement that the mathematical basis of exchange specified in the current provision produces unfair and erroneous results. No insurance department should permit, much less require, a VLI policy to include a guarantee for exchange on that basis. Even though an NAIC review of this ACLI proposal has not yet been completed, we urge that the current provision not be retained.

At least, the ACLI proposal is a workable alternative. The immediate problem is not to find the best permanent solution, but to avoid the harm that would result if the present language were not changed. If our proposal is adopted now, this damage will be avoided, while the NAIC would in no way be precluded from adopting any further revision which might be indicated upon completion of its actuarial review.

Deferred Payment of Death Benefits (Item 8)

We believe that this suggested change is an appropriate technical revision regardless of whether SEC regulation is involved. The ACLI recommendation would limit the six month deferment right to fixed benefits, and in that respect would conform more closely to the NAIC Model Variable Contract Law, which makes inapplicable to VLI certain provisions of the insurance law which do not fit variable life insurance. The six month deferment clause is part of the nonforfeiture provision of the insurance law. The model law, at Explanatory Note to Section 5, makes "inapplicable any provisions of the Insurance Law requiring . . . nonforfeiture provisions," and, at Section 5, states that a variable life insurance contract "shall contain . . . nonforfeiture provisions appropriate to such contract."

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

The proposed change, of course, retains the insurer's right to defer payment of variable benefits in the case of a stock market emergency, since such an emergency would prevent the determination of the amounts to be paid.

Settlement Options -- Fixed Basis Only (Item 9)

We have no comment beyond that already expressed in our earlier submissions.

Charges Against the Separate Account (Item 11)

ACLI's comments are contained in our earlier presentation.

Standards of Conduct; Conflicts of Interest (Item 12)

It would be preferable to rest upon the traditional regulation already afforded by the insurance laws of the various states and make the deletions we have earlier recommended.

Investment Advisory Services to a Separate Account (Item 13)

Same comment as immediately above.

Information Furnished to Applicants (Item 15)

We recommend the elimination of the requirement for disclosure of commissions. Although this is presently required under SEC regulations, it is not a state insurance law requirement for fixed benefit products.

Foreign Companies (Item 17)

The provision we are recommending (see our earlier submission) would afford insurance commissioners extremely useful discretionary powers. It is identical to the provision found in the NAIC Model Variable Annuity Regulation.

In those instances where a domiciliary state's laws or regulations are not precisely in line with those of a state which has adopted the model regulation, our proposed new Article X would permit the Commissioner to find that there is necessary compliance with the laws of his state so long as the domiciliary provides protection to policyholders and the public "substantially equal" to those of the model regulation.

This is not an unusual type of insurance provision and it is doubtful that insurance departments would be overwhelmed with requests for exemptions.

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