****

ATTACHMENT ONE-A

Questions & Answers
Life Illustrations Model Regulation
as of Dec. 17, 1996

Introduction:

In December 1995 the Life Insurance Illustrations Model Regulation was adopted by the NAIC. Since then a number of questions have arisen regarding its application and interpretation. For 1996 the Life Disclosure Working Group was charged to provide guidance in interpreting provisions of the model regulation. This charge is being met through the completion of this Questions and Answers document.

This document is not an official pronouncement of the NAIC but rather an unofficial statement of the working group alone that is offered as assistance to any state that chooses to use it. It is not intended to expand the content of the model regulation but gives some insight into the intent of the original drafters of the model regulation and provides interpretive guidance regarding certain of its provisions.

The working group will provide amended and expanded versions of this document from time to time as additional questions are identified and answered.

Section numbers in the questions and answers refer to the NAIC model regulation.

Section 1. Purpose

1.1 How does the life illustration model regulation affect the inclusion of the table of values in the individual's policy?

The model regulation does not apply to the information contained in the actual policy.

Section 3. Applicability and Scope

3.1 We sell a policy that is a combination of life insurance with a flexible premium annuity rider. The life policy is modified whole life with all guaranteed values. The annuity rider has a guaranteed interest rate, but also an interest sensitive element. It would appear that neither of these elements would presently come under the illustrations regulation, but since this policy is always sold with both elements present, the complete policy could be construed as an interest sensitive policy. Should we illustrate such a product to comply with the NAIC model? Should the life policy and annuity rider be illustrated separately or as one combined product?

If the insurer wishes to illustrate the nonguaranteed elements of the policy being sold with the annuity rider, the life policy and annuity rider must be illustrated as one combined product.

3.2 If a traditional (nonparticipating) product has an annuity rider (fixed premium) attached and the annuity rider has excess (non-guaranteed) interest credited, is it subject to the regulation?

Yes, if it is illustrated, the product with the rider is combined under the requirements of the regulation.

3.3 Will benefits provided by membership in a fraternal have to be included in the illustration?

The fraternal insurer *may* refer to benefits of fraternal membership in the illustration as long as they meet the requirements of Section 6B and are part of the policy. There is no provision saying an insurer *must* illustrate particular benefits.

3.4 If a life policy is sold in conjunction with a mutual fund (rather than an annuity) which is not part of the policy but is billed on the same statement can these two elements be combined in a single illustration?

The working group was asked this question during model development and all agreed that the mutual fund is not insurance and has no place on a basic life insurance illustration. According to Section 6B, the policy being illustrated cannot be represented as anything other than a life insurance policy. A supplemental illustration may show other assets as long as the requirements for a supplemental illustration are met.

Section 4. Definitions

4.1 Are there exceptions to the requirement that the disciplined current scale be "reasonably based" on actual recent historical experience?

Yes. To gain an adequate understanding of what the disciplined current scale is, a thorough reading of both the regulation and standard of practice is necessary. One example of where the disciplined current scale may not be based on actual recent historical experience is where a change in practice has occurred. Section 5.4 of the Actuarial Standard of Practice describes the way in which the disciplined current scale may be modified to reflect changes in practice which have not yet had time to result in actual changes in experience.

4.2 Suppose your current credited interest rate is 6.5%. If an agent submits an illustration using 6% (or any lower rate), is a "revised illustration" necessary?

Section 4G defines "illustrated scale" as a scale of non-guaranteed elements that is "not more favorable to the policy owner" than the lesser of the disciplined current scale or the currently payable scale. Assuming all of the requirements of the model regulation are met, use of an interest rate lower than 6.5% is permissible.

4.3 Are cost disclosures "illustrations" or "basic illustrations"? Do state cost disclosure regulations still apply?

The possibility for overlap with existing NAIC models and state regulations was discussed by the working group and the recommendations of the group are contained in a report attached to the March 1996 minutes. A letter was sent to each commissioner from the working group chair recommending that an illustration could take the place of a required policy summary. If a state chooses not to change such a rule, a policy summary and an illustration meeting the requirements of the illustrations regulation could both be required.

4.4 Is a presentation or depiction that shows only guaranteed elements an illustration?

"Illustration" means a presentation or depiction that includes non-guaranteed elements. A presentation or depiction that shows only guaranteed elements is not an illustration, and therefore the model is not applicable in such instances.

4.5 What does the phrase "over a period of years" mean in the context of the definition of an illustration?

The phrase "over a period of years" refers to any presentation or depiction of a non-guaranteed element beyond the later of (a) the first policy anniversary and (b) one year from the end of the report period in the most recent annual report.

4.6 Is a depiction of a single, projected non-guaranteed value an illustration? For example, one number showing what the cash value would be in 15 years assuming the current dividends continue to be paid and are allowed to accumulate at 6% interest.

Yes, in order to arrive at that "one" number, an entire series of non-guaranteed amounts is implicitly included. This scenario would be included in the phrase "over a period of years."

4.7 According to the regulation's definition, which of the following are "illustrations?"

a. A rate book page for an indeterminate-premium term plan, with both guaranteed and current premiums.

b. A universal life brochure that talks about non-guaranteed elements (interest and mortality), but does not show any numbers.

c. Company-developed agent training material on a participating whole life plan that discusses dividend options, guaranteed cash values, etc., and shows some hypothetical projections.

d. An advertisement for a universal plan that shows the current interest rate.

e. A short print-out of numbers for a universal case that is generated through company-provided software, and is clearly labeled for agent use only, not for use with a client, and is used by an agent in his office to compare and contrast his own company's plans, so he can arrive at the best strategy before seeing the client.

f. A company announcement on a new dividend scale that discusses the changes to be implemented in the various elements.

The working group's minutes reflect an intent to interpret the term "illustration" broadly. The following answers assume the material might be shown to the prospect.

a. A rate book page would be considered an illustration if it showed non-guaranteed elements beyond policy year one.

b. A brochure describing non-guaranteed elements without any actual examples would not be a "ledger or proposal showing non-guaranteed elements."

c. Agent training materials would be illustrations if the agent used them in the sales process. If they were restricted to the training process, they would not.

d. An advertisement showing current interest rates would not be an illustration because it does not constitute a display over a period of years. However, the regulation requires the agent to certify that he has made no statements inconsistent with the illustration, so use in the sales process of an advertisement showing numbers in excess of what can be shown in an illustration would not be permitted. The agent would also need to be careful to clearly represent that this was the current rate and not to imply that the current interest rate would apply into the future.

e. A print-out of numbers used by an agent in his office to compare and contrast his own company's plans that is not shown to the client is not an illustration.

f. A company announcement to existing policyholders might rise to the level of an in-force illustration if it depicted future dividends that are not guaranteed. It would not be an illustration if it dealt only with declared dividends that are guaranteed.

4.8 We have a product book used to educate our sales force. We want to illustrate what happens to the death benefits and paid-up additions, if any, under the various dividend options. We plan to show 20 years worth of data as an example. Is this an illustration falling under the regulation? What if we stamp the word "SAMPLE" across the page?

These are agent training materials and would be illustrations if the agent used them in the sales process. If they were restricted to the training process, they would not.

4.9 If showing a chart or graph in a basic illustration, which values have to be shown: guaranteed, midpoint or current?

If any nonguaranteed elements are shown, the guarantees must also be shown.

4.10 Section 3 indicates that the model is applicable to group life policies and certificates, however Section 4H indicates that an illustration by definition contains "non-guaranteed elements" over "a period of years." Now if a regular old garden variety group term life plan is sold and an "illustration" (using the term loosely here) is provided to the employer in the course of that sale indicating covered lives, volume and monthly premium, is that an "illustration" in the terms of the regulation? It covers one year (not years), and the rate is the rate—no non-guaranteed elements.

This is not an "illustration" and is not covered by the regulation.

4.11 Is a handwritten worksheet considered an illustration?

Since it is a "depiction" (Section 4H of the model), it is not excluded from the definition of "illustration" merely by being a handwritten worksheet.

4.12 Is marketing on the Internet considered an illustration? We need a clear definition of what an illustration is.

Since marketing on the Internet involves a "presentation or depiction" (Section 4H of the model), information so communicated is not excluded from the definition of "illustration" merely because it is sent via the Internet.

4.13 Suppose a life insurance policy provides long-term care benefits in the following manner: a) long-term care payments are 2% of the death benefit for each month the insured is institutionalized; b) the death benefit is reduced in an amount equal to the long-term care benefit paid; and c) the nonforfeiture benefits are reduced proportionately to the reduction in the death benefit. Does the disciplined current scale underlying the illustration have to incorporate long-term care experience that is "recent, determinable, and credible" if it affects non-guaranteed elements? Do the guaranteed values that are shown have to be adjusted to reflect the amount of long-term care benefits that may be paid?

In the above example, utilization of the long-term care benefit represents one experience component that will affect the accumulated cash flows. Therefore, long-term care morbidity should be one assumption underlying the disciplined current scale. One reasonable approach in the construction of the numeric summary and tabular detail in the basic illustration would be to assume that the policyholder for whom the illustration is being prepared will not utilize the long-term care benefit. If that approach is taken, a supplemental illustration could show how policy values will be reduced if long-term care benefits are utilized.

4.14 Can agents write down guaranteed values only for a customer on an illustrated policy as long as they get a compliant illustration before or at the time of policy delivery? Can an illustration show guaranteed values only for a policy that has non-guaranteed elements described in the policy form?

Showing guaranteed elements only, as that term is defined in the model, does not constitute an "illustration." Providing a compliant illustration at the time of policy delivery would be required if the policy form is one designated to be used with an illustration.

4.15 Would a sales brochure showing values in a chart or graph be considered an illustration?

Yes, if it contains nonguaranteed elements over a period of years, it would be an illustration and all of the model requirements would have to be met.

Section 5. Policies to be Illustrated

5.1 Does a policy form that the company discloses is to be marketed without an illustration need to pass the actuarial test?

The model regulation requires no actuarial tests for such policy forms, except for in-force illustrations.

5.2 Is group term life included in the provisions of Section 5C and 5D?

When discussing the applicability of the model to term life, the drafters went through the entire model and identified provisions that would not apply to term life. No such designation is included in Section 5C and 5D.

5.3 It seems that a typical group term life plan would be defined as "non-term group life" under Section 4L of the regulation. In a typical plan, the employer selects the benefits and levels, pays the premium, and the group is issued on approval of the underwriters (group underwriting?). It seems odd to call this "non-term group life." If that is the case, then Section 5D would indicate that "quotations" should be provided and "illustrations" on request. The wording seems to obviously be directed at more typical examples of "non-term group life," such as group universal—obviously a whole different ball game.

The definition is aimed at non-term types of group plans and was not intended to imply that group term life was included. The minutes of the Nov. 8, 1995, conference call make clear that the drafters changed the language from "universal life" to "non-term group life" so it would include group traditional whole life. However, even if the definition in Section 4L includes what most would regard as group term products, this does not create a problem. As pointed out in Answer 5.1, an insurer may choose never to use an illustration; nothing in Section 5A compels them to do so. Instead, if a policy form uses an illustration, then Section 5D functions as a liberalization of the regulation, permitting deferral of the delivery of the basic illustration until the certificate is delivered.

5.4 In order to be classified as "non-term group life" does a plan of coverage need to meet all 3 of the conditions in Section 4L?

Yes.

5.5 Does a basic illustration need to be provided at delivery to enrollees for non-term group life for all permanent insurance? It would seem that more than the minimum premium necessary to provide pure death benefit protection would be involved for all permanent insurance.

Some of the interested parties commenting on the draft evidently sell products where the insured can choose to contribute only the amount of premium necessary to provide pure death benefit protection on a non-term product. This provision was put in at their suggestion.

5.6 If a traditional (nonparticipating) product has a rider attached with non-guaranteed elements, is it subject to the regulation because of the non-guaranteed premiums of the rider?

If the presentation includes a product with non-guaranteed elements, an illustration is required unless the insurer has chosen to not use illustrations with the product, even if one or more of the products included in the presentation are fully guaranteed and not normally subject to the regulation.

5.7 In a payroll deduction case in which the coverage is marketed to the individual employees, can a generic set of rate illustrations for sample ages and weekly premium amounts be used for illustrative sales purposes at the point of sale, followed up with a personalized illustration complying with the regulation at policy delivery?

Section 5D allows use of quotations in group marketing, followed by a personalized illustration at policy delivery if the non-term group life policy meets the three criteria of Section 4L. Since a basic illustration will be provided to those who enroll for more than the minimum premium necessary to provide pure death benefit protection, the quotation should contain information that a personalized illustration will be provided to those who enroll. If meetings are held with individuals after a group presentation, a personalized illustration will be presented at that time, or a signed statement obtained that no illustration was used, in compliance with Section 9B.

5.8 Are payroll deduction sales of small (but more than $10,000) universal life policies, sold via employer sponsored meetings, considered sales to individual group members (because they sign an individual application) or are they considered group sales and therefore exempt from this regulation?

Group sales are not exempt from the regulation, but rather follow the requirements of Sections 5C and 5D.

5.9 What are the illustration requirements when a policy is purchased by the trustees of a qualified pension or profit-sharing plan where the trustees are the owner and premium payer and the insured selected the insurance coverage?

If the policy is not being marketed to the individual, the provisions of Section 5C apply. The illustration may be either an individual or composite illustration representative of the coverage on the lives of group members. If illustrations are presented to the individual insureds in order to select the insurable coverage, the illustrations must comply with the model.

5.10 Section 9B(1) states that, if no illustration is used in the sale or if the policy is applied for other than as illustrated, the producer shall certify to that effect on a form. On the same form, the applicant must acknowledge that no illustration was used. Does this apply to forms for which no illustration is used, as certified by the company?

No.

Section 6. General Rules and Prohibitions

6.1 Under the generic name requirement, the regulation refers to "flex premium benefit life." Is "universal life" acceptable as a generic name?

Presumably, states that have permitted use of "universal life" as a short title will continue to permit its use.

6.2 Are new policies that come into existence as a result of term conversions or the exercise of a guaranteed purchase option subject to the regulation? Note that these policies are not marketed in the same way that most policies are.

There is no specific exclusion for term conversions, etc., in the model regulation. Assuming that the new policy is one that has been identified as marketed with illustrations, it would seem evident that an illustration would be expected by a regulator.

6.3 How will agent or broker produced illustrations comparing several companies' premiums side-by-side be impacted by this new model?

Any effort to sell a particular policy would require the agent or broker to provide the illustration required by the model regulation.

6.4 Section 6A(4) requires that the illustration contain the underwriting or rating classification upon which the illustration is based. Does this refer to smoker, nonsmoker, standard, preferred? Or is other information required if the insured is rated? For example, does the amount of the rating have to be shown or would it be sufficient to use a statement to the effect that an additional rating charge is included?

The designation required by Section 6A(4) must be in sufficient detail to identify the payment schedule and any other elements dependent on classification.

Section 7. Standards for Basic Illustrations

7.1 Does the law really define the format (i.e., sequence of text, etc.)? It appears that the numeric summary must follow the narrative summary and that the signature blocks must appear with the summary, but nowhere does it say that the summary must immediately follow the narrative. My feeling is that a summary or a summation is a cursory review of the detail. Therefore can the signature block appear last?

The model says the signatures must appear on the same page as the numeric summary. The model is perhaps not as clear as it should be that the elements listed in Section 7 are to come in that order. The working group report from June 1995 makes it quite clear that was the intent of the drafters. The regulators expressed concern over the idea that a tabular display might end up early in the illustration. The sample illustrations prepared for the working group all used the same order as described in the regulation.

7.2 Can an applicant be given more than one basic illustration pertaining to one policy form during a single sales presentation?

So long as each illustration complies with the requirements of the regulation, there is no provision of the regulation that would prohibit this practice. Other than for guaranteed values there are no floors on illustrated scales, so it is possible to create many illustrated scales that meet the requirements of the regulation. The use of multiple illustrations could be helpful in demonstrating the impact of various interest rate scenarios. Also, in cases where the applicant has characteristics that make unclear the appropriate underwriting classification, multiple illustrations could be helpful in illustrating the impact on policy values of each of the classifications.

7.3 Can a faxed copy of the illustration be presented to the applicant or policy owner?

Yes. Nothing in the regulation requires an originally printed illustration.

7.4 Will other numbering systems suffice for § 7A(2) or is that a standard rather than an example?

The numbering "four of seven" in the model is an example rather than a standard. The intent of the working group was clearly to alert the applicant that he had not received all the pages. Any similar system that achieves that goal is suitable.

7.5 If a company is illustrating the effect of loans on policy values, what do they illustrate in the "guaranteed" column if the contract does not specify a maximum interest rate?

If the contract does not explicitly specify a maximum interest rate, then the maximum rate of interest that could be charged under state and federal law would have to be utilized in illustrating guaranteed values.

7.6 Do graphs, charts and concepts have to be included in the pagination?

Section 7A(2) of the model regulation says that each page, including any explanatory notes or pages, shall be numbered and show its relationship to the total number of pages in the illustration. Graphs, charts and concepts only have to be included in the pagination of the basic illustration if they are part of the basic illustration. In many cases they will be part of a separate, complying supplemental illustration, and thus need not be included in the pagination of the basic illustration.

7.7 Occasionally prospects request the illustration of policy values that are not system supported. May these values be displayed using a spreadsheet application? Is it permissible if the printout of the spreadsheet (without text, definitions, continuous pagination, etc.) is attached to a basic illustration of the same policy form?

Assuming the spreadsheet meets the requirement that it not be inconsistent with a basic illustration, it could be attached to the basic illustration as a supplemental illustration.

7.8 What is the term of the contract referenced in Section 7B(2) for a contract without a maturity date?

The working group has not addressed this issue. It would seem reasonable to use the limiting age underlying the valuation table or to use age 100, consistent with the tabular detail specified in Section 7E(1).

7.9 Sec. 7B(2) requires that the illustrations show the premium outlay that must be paid to guarantee coverage for the term of the contract, subject to the maximum premiums allowable to qualify as life insurance under the Internal Revenue Code. Suppose the guideline level premium under the IRC is $1,000 per year; the illustration assumes a monthly mode; the premium required to guarantee coverage is $1,100 paid annually or $100 paid monthly. Which of these three numbers do we show?

Section 7B(2) does not preclude the illustrating of premiums that exceed the guideline premiums in Section 7702 of the IRC. Rather, it merely compels the insurer to at least show the lesser of a) the premium outlay required to guarantee coverage and b) the maximum premium allowable to qualify as a life insurance policy under the applicable provisions of the IRC. Thus, in the cited example, if the insurer does not want to illustrate premium payments over $1,000 per year, this is permissible. However, if the insurer wants to illustrate the payment of $1,200 during each policy year, paid by $100 monthly premiums, this is permissible also. Assuming that the $1,200 premium is illustrated in the numeric summary, the insurer would be required to disclose in the narrative summary that $1,000 is the maximum premium qualifying premium under the IRC. In this circumstance, the insurer would need to clearly disclose that the $1,200 premium violated the guideline premium test.

7.10 If the guideline level premium will not provide coverage to the end of the term of the contract, does the illustration have to display the annual term charges allowed by § 7702 or can the illustration explain that the coverage will terminate?

See Question 7.9. Either may be illustrated as long as the insurer discloses the effect of what is illustrated.

7.11 Section 3 of the illustration regulation lists the exceptions to the regulation. Riders are not listed as an exception. Section 7B(3) states that a basic illustration shall include a brief description of any policy features, riders or options, guaranteed or non-guaranteed, shown in the basic illustration and the impact they may have on the benefits and values of the policy. Does this mean that riders that pay dividends, such as a 10-year level term rider, are exempt from the disciplined scale requirements and from the self-support and lapse-support tests? What about a product like flexible whole life that has a rider made up of a combination of one-year term and paid-up whole life?

No non-guaranteed element, whether provided through the base policy or rider, is exempt from the self-support and lapse-support tests.

7.12 Can the description of supplementary benefits and riders be in footnotes or must they all be included in the text of the narrative summary?

Section 7B(3) says the narrative summary shall include a brief description of any policy features, riders or options, guaranteed or non-guaranteed, shown in the basic illustration. Section 1 articulates the goal of eliminating footnotes as much as possible.

7.13 If an agent illustrates at issue a change in benefit, such as a face amount decrease after five years, does the company have to automatically honor this change when this change date occurs, or can the company wait for the policyholder to request the change at that future date?

The inclusion of a future benefit reduction in an illustration does not, by itself, *obligate* or authorize the insurer to implement the benefit reduction. The language contained in the policy itself will control the insurer's practice. Section 7B(3) of the model regulation requires that the insurer include a description of any future benefit reduction (and the policyholder's options with respect to the changes) if it affects any information (e.g., numeric summary, tabular detail) contained in the illustration.

7.14 If the basic illustration includes a depiction of paid-up additions on paid-up additions, settlement options, etc., do they all have to be factored into the illustrated scale at "50%"?

The numeric summary required by Section 7C says that *all* values shown in the illustration must be calculated on three different bases, one of which is dividends at 50% of those contained in the illustrated scale.

7.15 Are illustrated reductions going to be defined or explained—can a straight average of current and guaranteed be used, or must components (like mortality, interest, rider charges, expenses) be averaged?

In the case of participating policies, the dividends in the reduced scale are to be one half of the corresponding annual dividends in the illustrated scale. In the case of policies with non-guaranteed elements of other types, each experience factor (interest rate, mortality rate, etc.) is to be the average of the corresponding factor underlying the illustrated scale and the guaranteed factor.

7.16 Section 7C(1)(c) refers to numeric summary guaranteed values, illustrated values and 50% basis. The last one's "average" values are not exactly arithmetic mean value, are they? If not, would you please elaborate how these values can be determined? The calculated values may not be exactly average of guaranteed and illustrated values.

Section 7C(1)(c)(ii) and (iii) uses the word "average" but does not give an example of how the calculation is to be performed. The result expected by the working group would be based on a policy credited and charged at rates that lie one-half the way between guaranteed and illustrated charges and credits.

7.17 Can the numeric summary be restricted to annual premium mode only or must it use the same mode as in the tabular detail?

Section 7C(1) says the numeric summary shall include the premium outlay. Section 7E(1)(a) says the tabular detail shall show the premium outlay and mode the applicant *plans to pay*. The numeric summary and the tabular detail should be consistent with each other.

7.18 For a new policy form relative to which a company argues it sells no similar forms, how does the regulator determine what a realistic currently payable scale is?

There is no precise answer possible for this question. However, if the company's other policies utilize disciplined current scales that are generally greater than the corresponding currently payable scales, the regulator should question the company as to why it is realistic to expect that this policy form will be different.

7.19 With the requirement that all non-guaranteed elements be described in the contract, will policies illustrated with "persistency bonuses" need to be refiled to include a description of these bonuses?

Section 7E(3) says that non-guaranteed elements may be shown (in the illustration) if they have been described in the contract. Therefore, a company wishing to include a persistency bonus in its illustration would need to include a description in the policy.

7.20 Does not Section 7E(2) need some more words to clearly express its intent?

The meaning of Section 7E(2) is clear, even if the wording is somewhat awkward. The guaranteed policy values should be those that will be provided if the contract premium is paid.

7.21 Must the tabular detail be shown at the premium mode that is expected to be paid, or can annualized premium be used? This would obviate having to calculate interpolated net single premiums for some riders.

Section 7E(1)(a) says the illustration shall include the premium outlay and mode the applicant plans to pay.

7.22 If a non-guaranteed element is not shown in the contract, it cannot be illustrated. If it is the company's practice to pay a persistency bonus, may it be illustrated as long as a zero is shown in the guaranteed column?

The phrasing of the question leaves the impression that the company does not plan to include a description of its persistency bonus in the contract. If that is the situation, Section 7E(3) says the persistency bonus cannot be shown in the illustration. Showing a zero in the guaranteed column is not adequate compliance with 7E(3).

7.23 If the expected premium outlay but not the contract premium on a traditional policy is to change at some point after the 10th policy year, does that need to be shown in the tabular display, or will it suffice to just show every fifth year ending at 100, etc.?

Section 7E(1) of the model regulation indicates that the tabular detail will need to be shown (except for term insurance beyond the 20th year) for any year in which the premium outlay is to change. Note that Section 7E(1) refers to when the premium outlay *and* contract premium change, but it was clearly the working group's intent to show the year when *either* changes.

7.24 Suppose a prospect asks a sales person to illustrate a universal life policy where the applicant plans to pay an annual premium of $2,400 until his retirement at age 62, after which he plans to reduce his annual premium to $100. If a conforming illustration is delivered with the policy at issue must the illustration show the planned premium reduction at age 62? The same situation might arise where a rate change is anticipated, for example a commercial pilot who will retire at age 55. Must the conforming illustration show the planned rate change?

Yes. See Answer 7.23 above.

7.25 Are there any special provisions regarding terminal dividends?

Section 7E(3) of the model regulation contains the following statement: "In the case of an illustration for a policy on which the insurer intends to credit terminal dividends, they may be shown if the insurer's current practice is to pay terminal dividends."

7.26 Does Subsection 7C(1) say that we have to illustrate premiums in the numeric summary for policy years 5, 10, 20 and at age 70? Are these cumulative premiums or can we just state the annualized premium in the top right-hand corner labeled as such?

The premium amount must be shown clearly on this page. The cumulative premium is not required.

7.27 In the tabular detail, if an applicant selects monthly mode, do we have to illustrate 12 months of data for each policy year or would illustrating the annualized (i.e., monthly rate times 12) premium suffice?

The annual amount can be illustrated, however the accumulation values must be calculated on the basis of payments received monthly.

7.28 Can we bold print the current assumption values and not the guaranteed values on a compliant illustration? Can we bold print a line (i.e., age 70 values)?

Section 6B(2) prohibits using the non-guaranteed elements in a manner that could mislead. Printing a line for one year would not raise the same concern as bolding non-guaranteed values.

7.29 Can we refer to the non-guaranteed values as "projected values" or similar term, or must we use the term "non-guaranteed values"? Are there any specific limitations on the terms we can use?

The terms used should be the consistent with those used in the policy and should be defined in the narrative summary.

7.30 If the policy expires at death, even if that occurs beyond age 100, may the tabular detail be illustrated only to age 100?

The tabular detail is only required to age 100.

7.31 Is the numeric summary intended to contain just three columns for each basis: contract premium (or outlay) death benefit, and cash value? Or is it intended to show additional columns such as cash value of additions, face value of additions, cash value of additions surrendered, etc. If so, must it show the same columns as on the tabular report?

The intent is that the numeric summary should be a brief view of key elements. The language of Section 7C does not specifically prohibit more than the three columns, but it was intended to provide an overview which could easily be lost by the use of many columns.

7.32 For indeterminate premium term products, what should the contract premiums be under the guaranteed assumptions? Indeterminate premium term, by its nature, has different contract premiums under illustrated, guaranteed and midpoint bases. This would dictate that the premium shown in the different bases must differ even though our interpretation of the regulation is that we should show the same premium under all three bases. Is it acceptable to show three different contract premiums?

The basic illustration should follow the terms of the policy or rider. An indeterminate premium term contract has a scale of maximum premiums that are guaranteed at issue and contained in the policy or rider form. The non-guaranteed element is a premium discount that results in a scale of current premiums that are lower than the guaranteed maximum premiums.

The premiums shown in the numeric summary and the tabular detail should follow the terms of the policy or rider. Some indeterminate premium term products provide that, whenever the scale of current premiums increases, the automatic option is that the death benefit will decrease and the premium paid will remain level. In that instance, the premium illustrated is constant for all three bases (guaranteed, non-guaranteed and midpoint) and the death benefit will vary to match the premium. Other indeterminate premium term products require that, whenever the scale of current premiums increases, the automatic option is that the premium must be increased to maintain the death benefit. In this situation, the premiums will vary for each of the three bases (guaranteed, non-guaranteed and midpoint) while the death benefit is held constant.

An indeterminate premium term contract can be differentiated from a flexible premium contract through the presence of an explicit scale of guaranteed maximum premiums contained in the indeterminate policy or rider, payment of which will assure that the indeterminate policy remains in force and maintains the level of death benefit. It is the insurance company, not the policyholder, that determines the premium that must be paid to maintain the benefit in force under the indeterminate premium contract. If the policyholder has the contractual right to pay a policy or rider premium that is greater, or lesser than the premium determined by the insurance company, it is only appropriate to illustrate one premium pattern for all three bases in the numeric summary and tabular detail. It should be remembered that Section 7B(2) requires that "for a policy that does not require payment of a specific contract premium, the illustration shall show the premium outlay that must be paid to guarantee coverage for the term of the contract" in the narrative summary.

Section 8. Standards for Supplemental Illustrations

8.1 Assuming most common variations on a policy form (i.e., larger premium payments, different death benefits or riders) may be shown in supplemental illustrations, are there any variations that may be so great or extreme or unusual as to require use of *another basic illustration? For example, if a basic illustration is for a non-smoking female, can you illustrate the same policy form for her smoking husband as a supplemental illustration?*

The intent of the drafters was that the supplemental illustration would show special features and variations applicable to the basic policy being illustrated. It was never contemplated that it would be used in this fashion. Since the contract premium or the premium outlay is required to be the same as that in the basic illustration, this scenario is unlikely in any event.

8.2 In some cases multiple supplemental illustrations are prepared and shown to a client to help him evaluate different scenarios. Must each of these be accompanied by a basic illustration, and if so, does each need to be signed and submitted with the application?

Generally one basic illustration can accompany several supplemental illustrations. The contract premium or premium outlay underlying the supplemental illustration must be equal to the premium outlay shown in the basic illustration. Other variations may not require another basic illustration as long as other requirements of Section 8 were met. The basic illustration matching the policy applied for would be signed and submitted with the application.

Section 9. Delivery of Illustrations and Record Retention

9.1 If a person desires a flexible premium policy and is shown an illustration with a planned premium of $600/month, but at application changes to $500 per month, is the illustration not "as applied for"?

The policy would have been issued "as applied for" and not as illustrated and under Section 9B a new illustration would be required at the time of policy delivery.

9.2 When does a difference in money illustrated and money received become a reason for a revised illustration to be sent?

If the amount of the § 1035 exchange varies from the illustrated amount to the extent that it affects the terms of the contract, then a new illustration should be provided.

9.3 Is an agent's signature required on revised illustrations sent from the home office?

Section 7D(2) of the model regulation says that the statement must be signed and dated "by the insurance producer or other authorized representative of the insurer." Section 9A(2) says the revised illustration shall conform to the requirements of the model regulation, shall be labeled "Revised Illustration," and shall be signed and dated by the applicant and producer or other authorized representative of the insurer. The intent of the provision in 9C allowing illustrations to be mailed to the policyowner from the company was not to require a producer or representative signature because it is not being provided as part of a sales presentation. However, if the mailing results from a sales presentation made by telephone or otherwise by an employee of the company, that person should sign as the producer or representative.

9.4 If an insurer employs no agents or other commission-compensated employees and never makes in-person sales, and delivers all documents, including sale packets with multiple illustrations, by mail, would it follow the provisions of Section 9C?

Section 9C is designed to address direct marketing where the basic illustration is mailed from the insurer. The conforming illustration and request for signature may be included with the policy delivered by mail.

9.5 The signature requirement refers to the producer or other authorized representative of the insurer. Do we have a choice of whom this person should be, e.g., the agent as opposed to the general agent?

Yes, however the person is certifying that he or she has explained that any non-guaranteed elements illustrated are subject to change. That must be done by the person in contact with the applicant and in a position to knowingly certify.

9.6 Must the copies in the company's policy owner file be paper copies or is it satisfactory to have the capability to regenerate an exact duplicate of the illustration used in the sale? Can only the signature page be retained, or the signature be imaged into the computer illustration?

The purpose of the signature page in the file is to assure a market conduct examiner that the standards in the regulation have been followed. In order for the examiner to be assured by a computer-generated duplicate of the illustration used in the sale and/or a computer imaged signature, the company's system must be reliable enough to convince the examiner that the technology used by the company will freeze the illustration at the time of solicitation so that it would not be possible to change it before or after placing it in the applicant's electronic file. The technology used might be hardware that scans in the actual illustration used and the applicant's signature and preserves it, or a program that stores the parameters to allow the recreation of the illustration used.

9.7 If the insurer can show § 9C due diligence, must it still retain the signed illustration page?

The Section 9C due diligence requirement applies only when the illustration is mailed out from the insurer's office rather than provided by the agent. If no signed page is returned, the due diligence standards are sufficient.

9.8 We intend to keep the original signed illustrations on file at the head office. What would happen if we misplace or lose these? Will a photocopy or a carbon copy be sufficient? Do we have to go back to the insured and get original signatures? What if the agent has left the company by this time?

The regulation says the signed basic illustration should be retained in the file. A market conduct examiner would undoubtedly need to hear a good reason why the illustration had been "lost." Even a signature obtained years later will not be very persuasive in showing the individual did not hear any representations not consistent with the illustrations shown. A photocopy or a carbon copy should suffice as would an electronic image of the illustration.

9.9 Does § 9D require an insurer to keep a signed certification from the original sale and a subsequently delivered basic illustration and a revised basic illustration if issued other than as applied for?

Yes, the plain language of the subsection does make that requirement. When discussing this requirement, there was mention made by the working group that this would be useful to point out a pattern of agents illustrating policies not as issued.

9.10 "Other than applied for" may mean that the beneficiary or address changes. It may mean in a § 1035 exchange that the exact amount of the proceeds to be applied from another policy is not known until weeks or even months after the policy is issued. Do these situations require a revised illustration?

Changes that do not affect plan values or benefits do not require a revised illustration, although they may necessitate changes in the administrative records of the insurance company. "Other than as applied for" would come into play when the insurance company will not issue the policy on the basis applied for, such as when it is determined that a worse rating class is necessary. If the policy is issued on a basis different than illustrated and that difference would affect the premiums, benefits or values, a revised illustration would be required. Since the final amount of a § 1035 exchange will almost never be known until after the policy is actually issued and will not generally affect the premiums, benefits and values of the policy, a revised illustration will generally not be necessary.

9.11 Usually it is not known if a proposed insured is in a preferred class until after the application is submitted and the underwriting process is complete. If the initial illustration was done at the standard class, but the final determination is preferred, must the policy be re-illustrated? Keep in mind that the preferred illustration will always show values that are more beneficial to the insured.

Yes, the illustration must conform to the policy issued.

9.12 For Section 9B(1), is it permissible to show an illustration conforming to the model requirements on a computer screen, and obtain the signature at policy delivery?

Where a computer screen illustration conforming to the regulation is used and no hard copy is furnished at the time of application, an acknowledgment, signed by the applicant and agent, should be obtained and submitted with the application, conforming to the following requirements:

1. The personal and policy information on which the computer screen illustration was based shall be itemized in accordance with Section 6A, and

2. An acknowledgment consistent with the provisions of Section 9B(1) shall be obtained so that the applicant is aware that a copy of an illustration conforming to the policy as issued will be provided to him or her no later than at the time of policy delivery. One copy of the signed acknowledgment will be left with the applicant and one copy will be submitted with the application. Following is a sample acknowledgment:

Sample Certification

I certify that I displayed a computer screen illustration for ____________________ that complies with state requirements and for which no hard copy was furnished. The illustration was based on the following personal and policy information:

1. Gender	Male_______ Female_______
2. Age	____________________
3. Underwriting or Rating Class	____________________
4. Type of Policy	____________________
5. Initial Death Benefit	$____________________
6. Dividend Option	____________________

____
AGENT
DATE:____________________

I acknowledge that I viewed a computer screen illustration based on the information as stated above. No hard copy of the illustration was furnished. I understand that an illustration conforming to the policy as issued will be provided to me no later than at the time the policy is delivered.

____
APPLICANT
DATE:____________________

An illustration conforming to the requirements of the model must be prepared and personally delivered by the agent at or prior to delivery of the policy.

Section 10. Annual Report; Notice to Policy Owners

10.1 If a person buys a policy in a state that has not adopted the regulation, then moves to a state that has, which state's regulations govern in-force illustrations?

General contract law would require you to use the law of the state where the contract was made. However, the laws of the particular states in question should be researched in order to determine whether this rule applies.

10.2 If a policyholder requests an in-force illustration of a policy form not sold with an illustration and the company agrees to provide one on request of the policyholder, must the illustration comply with the regulation?

A policy form designated as one to be sold without an illustration is not subject to the requirement to offer an in-force illustration, but if an insurer does choose to provide an in-force illustration, it must meet the requirements of Section 10C.

Section 11. Annual Certifications

11.1 Can consultants be hired to perform the "illustration actuary" function?

The model regulation does not require the illustration actuary to be an employee of the insurer.

11.2 Is it acceptable for a holding company to allocate expenses disproportionately among its subsidiaries so as to make the illustrations of certain subsidiaries more favorable?

No. In addition, it would be a violation of Section 5A(1)(c) of the NAIC Model Holding Company System Regulatory Act to allocate expenses in this manner.

11.3 Can an insurance company that is the part of the same holding group as a bank negotiate an artificially high interest rate on a deposit with the bank in order to make the illustrations more attractive?

Section 5A(1)(a) of the Model Holding Company System Regulatory Act prohibits transactions within a holding company system which are not "fair and reasonable."

11.4 Must (a) each illustrated value for the specific demographic/premium paying/benefit combination for each insured who receives an illustration meet the definition of self-supporting and non lapse-supported, or (b) can the insurance company certify that the self-supporting and lapse supported tests are met looking at accumulated cash flows in the aggregate across the assumed distribution of ages, premium-paying patterns, etc.?

Provision (b) is the correct answer. The regulation speaks to certifying of the policy form, and generally certification must be done at the policy form level.

11.5 Does the allocation of assets among policies for purposes of illustration certification have to be the same as the allocation of assets for statutory cash flow testing? Does the allocation of expenses for purposes of illustration certification have to be the same as the allocation of expenses done for statutory financial reporting?

There may be valid reasons for differences between allocations on a statutory and illustration basis. However, as much consistency as possible should be maintained between the two, and the illustration actuary should be prepared to explain any differences.

11.6 If the illustration actuary changes his or her opinion as to what constitutes recent historical experience prior to the deadline for the next annual certification, does the actuary have to change the disciplined current scale?

If recent historical experience has deteriorated (e.g., expenses have increased, investment yields have diminished), then the illustration actuary should conduct studies to determine if the disciplined current scale is still consistent with recent historical experience. Otherwise, an insurer may be in violation of Section 6B(2) (prohibition of using or describing non-guaranteed elements in a manner that is misleading or has the capacity to mislead).

11.7 Is there relief for any unusual expense items when it comes to determining expense assumptions? What if there is a one-time expense in 1996, such as purchases of new administration software? Does that have to be reflected in 1997 illustrations?

Section 5.3.3.e.1. of the Actuarial Standard of Practice states, "Nonrecurring costs, such as systems development costs, may be spread over a reasonable number of years (e.g., system lifetime) in determining the allocable expenses for a particular year."

11.8 Can the method of determining the expense assumption, fully allocated, generally recognized expense table (GRET) or marginal, vary by product? Regardless of the method, can the unit expense vary by product?

A single method of determining the minimum assumed expenses (i.e., fully allocated, GRET or marginal) must be chosen by the insurer for all policy forms. Variations in the expense allocation formula by product may occur when using fully allocated or marginal expenses. Two sources of variation, as indicated in Section 5.3.3.e of the Actuarial Standard of Practice may be the average policy size and volume of sales for a particular policy block. When using the GRET, expenses will simply be calculated by applying the specified factors.

11.9 Will the different costs of various levels of underwriting (guaranteed issue, simplified issue, nonmed, paramed, etc.) be recognized within the expense structure?

Presumably, differing costs of various levels of underwriting can be reflected in a company's own fully allocated or marginally allocated expense assumptions.

11.10 In the individual life product line, may you choose only one of the expense methods for that line regardless of the product (term vs. universal life vs. par universal life, etc.)?

Section 4K(1) of the model regulation says "the insurer may choose to designate each year the method of determining assumed expenses *for all policy forms* . . ." In addition, Section 5.3.3.e. of the Actuarial Standard of Practice indicates that the same expense method—fully allocated, marginally allocated, or generally recognized study—must be used for all policy forms during the certification year.

11.11 Is it appropriate to exclude the cost of complying with the illustration regulation in setting the (allocated) expense levels?

The cost of complying with the illustration regulation should be allocated in a manner consistent with the method of allocating other expenses.

11.12 If the illustration is based on zero-profit (minimum), why must income tax be included?

Section 5.3.3.C. of the Actuarial Standard of Practice says the cash flows used in carrying out the self-supporting test should include cash flows arising from all applicable taxes. All income taxes, except the additional tax associated with the differential earnings rate, should be recognized in accordance with their impact by duration in the self-supporting test. However, to the extent that the underlying assumptions would result in no income tax liability being incurred, then clearly the disciplined current scale would not reflect any expense for income taxes.

11.13 What if no company or industry experience exists for a certain experience factor—i.e., level of antiselection, effectiveness on select and ultimate term products—what does the actuary do?

Section 5.3.3 of the Actuarial Standard of Practice says that when no experience of the given company or under similar classes of business in that company or other companies is available, "other sources" may be used.

11.14 For interest and mortality assumptions for the disciplined current scale, is there any guidance on what is considered credible and what is the definition of recent?

Section 5.3.3.a. and b. of the Actuarial Standard of Practice contains guidance on "recent." For guidance on "credible," Actuarial Standard of Practice No. 23, "Data Quality," might be consulted.

11.15 How does an illustration actuary demonstrate that the required tests have been met?

Section 6.3. of the Actuarial Standard of Practice gives sufficient guidance.

11.16 Suppose a block of business is sold from one company to another. Would the company purchasing the business immediately have to apply its own standards to the illustrations, or would there be a transition period during which they could continue to rely on the prior company's certification, disciplined current scale, and illustrated scale?

Before the company purchasing the business can issue illustrations, it will have to file a certification with the commissioner. This is necessary because there is no assurance that the recent historical experience for the prior company will be applicable to the new company.

11.17 When an actuary certifies that an illustrated scale is in compliance with the regulation, is that actuary certifying as to all illustrated scales since the last certification, illustrated scales currently being used, or something else?

The actuary is certifying to all illustrated scales in use at the time of the certification as well as all illustrated scales used since the previous certification.

11.18 Must an insurer file Section 11 certifications both before the effective date of the regulation and later on the date the insurer elects under Subsection G?

Perhaps the language of Section 11D is not as clear as it should be. The intent of the Life Disclosure Working Group was clear. All policy forms, whether existing on the effective date of the regulation or developed later, should not be illustrated until after a certification has been filed with the commissioner. The answer to the question being asked is "yes" and a technical amendment will be proposed to the model to delete the word "new" in Section 11D(1)(b). Then there will be no question that an insurer will file a certification when the regulation becomes effective, and again on the date it chooses, which might be a week or a month or a year later.

11.19 Will the actuarial certification be subject to review as part of the regular state examination process?

Yes, probably as part of the market conduct examination.

11.20 The Actuarial Standard of Practice is directed at compliance with the NAIC model. What kind of standard would be applied if some state adopts a regulation significantly different from the model?

Actuarial Standard of Practice Section 1.2, "Scope," says: "Actuaries involved in the preparation of illustrations subject to a regulation that differs materially from the model may consider the guidance in this standard to the extent that it is applicable and appropriate." There is no actuarial guidance for any provisions contained in a particular state's law or regulation that are not also part of the model.

11.21 When one policy form is sold through two different distribution channels, does the illustration actuary need to prepare two illustrations and certifications to reflect the differing distribution channels, or can one illustration and certification be prepared that reflects an average of the two?

If the customer will receive the same treatment regardless of the distribution channel, i.e., same non-guaranteed elements, then only one illustration is necessary (other than the obvious changes to the identification of the producer of the illustration, etc.) In conducting the self support test and lapse support test, the illustration actuary would develop assumptions taking both distribution systems into account and could test the single scale separately for each system or could test using assumptions that combined the experience of the distribution channels.

If the non-guaranteed elements will be different depending on the distribution channel used, the situation is different. Even though the regulation and standard of practice require testing for compliance on a policy form basis, assuming a mix of policies consistent with actual experience, the regulation prohibits an insurer from using or describing "non-guaranteed elements in a manner that is misleading or has the capacity to mislead" (Section 6B(2)). Combining policies that are anticipated to credit significantly different non-guaranteed elements would clearly have "the capacity to mislead." Therefore, the illustrations should be distinct for each distribution channel and they should be considered separately in the self support and lapse support tests.

11.22 If one group universal life policy form is utilized to write business where some of the non-guaranteed elements reflect group-specific experience, does the illustration actuary have to tailor-make the illustration and certification for each group, or can the illustration reflect some sort of averaging of all the groups insured under the policy form?

See answer 11.21 above.

11.23 Under fully allocated expenses, does each policy form have to receive some allocation of general overhead expenses, such as rent, furniture and equipment expense, and the president's compensation?

Yes. According to the Actuarial Standard of Practice, overhead expenses must be fully allocated using a sound method of expense allocation. There are many sound methods for allocating overhead, but professional judgment needs to be used to ensure that the method used is not merely a subterfuge to effectively avoid the full expense allocation requirement. For example, some have argued that the company could create a policy form for which it does not intend to use illustrations, and allocate all indirect expenses to that form. This would effectively allow the company to use marginal expenses while stating in its certifications that it is using fully allocated expenses, or a company could argue that it is allocating all of its indirect expenses to non-life lines, and accomplish the same thing. The illustration actuary should have sound business reasons for the allocation methods used so that the expense allocations that result do not generate sales illustrations that will mislead purchasers.

11.24 *If benefits under riders with only guaranteed elements are illustrated, should those benefits be incorporated into the self-support and lapse-support tests applied to the underlying policy?*

Yes. To argue otherwise would promote "gaming" in the division of policy benefits between the underlying policy and the rider.

Section 14. Effective Date

14.1 Will permanent group life plans in force before the effective date of the regulation be subject to the regulation?

The regulation applies to any sale that occurs on or after the effective date. If a group plan includes sales to new employees, those sales would be covered by the regulation.

****