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ADVERTISING

APA Adoption Life Insurance Illustrations

Commissioner Elton Bomer has amended 28 TAC §§ 21.114, to conform with the Life Insurance Illustration Rule summarized in this section under the heading, LIFE INSURANCE. The change provides that if dividends are illustrated, the illustration must conform to the requirements of the newly adopted life insurance illustration rule (28 TAC §§ 21.2201-21.2214).

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Further information: 512 463-6327*

LIFE INSURANCE

APA Adoption Life Insurance Illustrations

Commissioner Elton Bomer has adopted new 28 TAC §§ 21.2201- 21.2214, concerning the use of illustrations in the sale of life insurance. The rules apply to all group and individual life policies and certificates except for variable life, annuities, credit life and life policies with no illustrated death benefits exceeding \$10,000 on any one individual. The rules will apply to such policies sold on or after July 1, 2000.

The new sections incorporate nearly all of the NAIC Life Insurance Illustration Model Regulation but also contain provisions unique to Texas.

The stated goals of the rules are to assure that illustrations do not mislead life insurance buyers and to make illustrations more easily understood. Insurers are expected to define terms in language understood by a typical person within the segment of the public to which an illustration is directed.

The rules apply an actuarial test called the "Disciplined Current Scale" to limit the projection of non-guaranteed elements to those that are based on actual, recent and verifiable experience. The purpose of this test is to minimize or eliminate manipulation of assumptions underlying the illustration of non-guaranteed values.

Definitions

The most significant definitions include:

Contract premium, meaning the gross premium required to be paid under a fixed premium policy, including the premium for a rider for which benefits are shown in the illustration.

Non-guaranteed elements, defined as the premiums, benefits, values, credits or charges under a life insurance policy that are not guaranteed or not determined at issue.

Currently payable scale, meaning a scale of non-guaranteed elements in effect for a policy form as of the illustration date or declared to become effective within 95 days of the illustration date.

Disciplined current scale, which means a scale of non-guaranteed elements that constitutes a limit on an insurance company's currently used illustrations. The scale must be reasonably based on actual recent historical experience, as certified annually by an illustration actuary designated by the insurer. Standards of the Actuarial Standards Board may be relied upon for guidance if they are:

- Consistent with all provisions of the rule.
- Limit a disciplined current scale to reflect only actions that already have been taken or events that already have occurred.
- Do not permit a disciplined current scale to include projected trends of improvements in experience or any assumed improvements in experience beyond the illustration date.
- Do not permit assumed expenses to be less than minimum assumed expenses.

Illustrated scale, which means a scale of non-guaranteed elements currently being illustrated that is not more favorable to the policy owner than the lesser of:

- 1) the disciplined current scale or
- 2) the currently payable scale.

Illustration, defined as a presentation or depiction used in the solicitation or sale of a life insurance policy that includes non-guaranteed elements of the policy over a period of years and includes but is not limited to:

- A basic illustration, which is one showing both guaranteed and non-guaranteed elements.
- A supplemental illustration furnished in addition to a basic illustration. It must meet basic requirements of the rule and may be presented in a format different from the basic illustration. It may depict only a scale of non-guaranteed elements that is permitted in a basic illustration.
- An in-force illustration, which is one furnished at any time after the policy has been in force for one year or longer.

Policies to Be Illustrated

Life insurers must notify TDI whether a policy form is to be marketed with an illustration. This requirement will apply both to policies actively marketed on the rule's effective date and those filed later. If a policy form is identified as marketed without an illustration, a company may not use an illustration before the first policy anniversary. If illustrations are used, a basic illustration conforming to the rule must be provided. The rule makes certain exceptions for group policies.

General Requirements and Prohibitions

Guaranteed death benefits and values available upon surrender, if any, for the illustrated premium must be shown and clearly labeled as guaranteed.

An illustration may not base non-guaranteed elements on a scale more favorable to the policy owner than the insurer's illustrated scale at any duration. These elements must be clearly labeled as non-guaranteed.

Any illustration depicting non-guaranteed elements over a period of years must include a conspicuous disclaimer that:

- Identifies benefits and values that are not guaranteed.
- Identifies the assumptions on which the illustration is based.
- Discloses that the assumptions for the years shown are likely to change and, in fact, are subject to change by the insurer.

- States that actual results may be more or less favorable.
- Either generally identifies the factors that may affect future policy performance, such as death claims, investment earnings and overhead costs, or refers to the narrative
- that identifies these factors.

An acceptable disclaimer might say: "The values shown in the current and mid-point columns are not guaranteed and assume that our current scale for interest credited, cost of insurance and expense charges will remain unchanged for the years shown. This is not likely to occur, and actual results may be more or less favorable. Future credits for interest and deductions for mortality and expenses can vary at the company's discretion, depending upon factors such as death claims, investment earnings and overhead costs."

Any illustration that indicates a consumer might use non-guaranteed values to pay premiums or other policy charges must disclose clearly that, depending on actual results, a policy owner might need to continue or resume premium payments to keep a policy in force.

Insurers are explicitly prohibited from representing a policy as anything other than life insurance.

Illustrations may not depict policy performance as more favorable to the policy owner than that produced by the insurance company's illustrated scale.

The interest rate used to determine illustrated non-guaranteed elements cannot exceed the smaller of

- 1) the earned interest rate underlying the disciplined current scale or
- 2) the interest rate for the currently payable scale.

An illustration may not depict a persistency bonus, a specified additional amount or a specified reduction in mortality costs or expenses in a specified policy year (after the first year) unless it:

- Represents an express obligation of the insurance company in the contract or policy and
- Meets lapse-support and self-supporting tests required by the rules.

"Concept" Illustrations

A basic or supplemental illustration or both may depict a "concept," such as vanishing premium or an income stream. If the concept is shown in a basic illustration, an extended numeric summary must be used. If not shown in a basic illustration, a concept may be shown in an extended numeric summary appended to the basic or in a supplemental illustration.

Supplemental illustrations may depict a concept in one of four ways:

- A single illustration that calculates values based on both the illustrated scale and on an alternative scale contained in the rules.
- A single illustration that calculates values based on the illustrated scale, provided an extended numeric summary is attached that calculates values based on both the illustrated scale and one of the alternative scales.
- Two illustrations, one that calculates values based on the illustrated scale and another that calculates values based on one of the alternative scales.
- Until January 1, 2001, a disclosure document explaining in narrative form that

- 1) the depiction of policy values to pay premiums does not mean that premium requirements are canceled, for-given or waived; that the operation of any plan to pay premiums with policy values depends upon non-guarantee factors remaining unchanged, which may or may not occur; and/ or
- 2) the use of policy cash flows for other purposes depends upon non-guaranteed factors remaining unchanged, which may or may not occur.

When a disclosure document is used to illustrate a concept, it must briefly describe the non-guaranteed factors affecting the use of policy values to pay premiums or to generate cash flows. It also must contain a hypothetical example for issue age 50 showing the im-pact on the concept of reducing the current non-guaranteed factors by 25 percent and 50 percent.

Alternative scales that may be used until January 1, 2001, include

- 1) mid-point and guaranteed scales,
- 2) the dividend component of the illustrated scale reduced by 50 percent or
- 3) the dividend and/ or credited component of the illustrated scale reduced by 50 percent of the interest component of the illustrated scale in excess of policy guarantees.

Standards for Basic Illustrations

Basic illustrations (aside from the coverage page) must begin with a narrative summary that includes a brief description of the policy (including a statement that it is a life insurance policy) and a brief description of the premium to be paid. Narrative summaries also must briefly describe policy features, riders or options – guaranteed or non-guaranteed– and their potential impact on policy benefits and values. A basic illustration also must include the disclaimer, outlined above, concerning non-guaranteed values and benefits.

A basic illustration for an individual life policy must include a "numeric summary" showing premiums, death benefits and values at policy years 5, 10 and 20 and at age 70. The summaries must be presented on three bases:

- 1) policy guarantees,
- 2) insurer's illustrated scale and
- 3) insurer's illustrated scale with non-guaranteed elements reduced as follows:
 - Dividends at 50 percent of the di-vidends contained in the illustrated scale.
 - Non-guaranteed credited interest at rates that are the average of the guaranteed rates and the rates contained in the illustrated scale.
 - All non-guaranteed charges, including but not limited to term insurance charges, mortality charges and expense charges, at rates that are the average of the guaranteed rates and the rates contained in the illustrated scale.

A certification, signed by both agent and customer, that a copy of the illustration has been provided to the customer must be included on the same page as the numeric summary.

Finally, a basic illustration must provide the following "tabular detail" for policy years 1- 10 and for every fifth policy year thereafter until age 100, policy maturity or final expiration and (except for term insurance beyond the 20th year) for any year in which the pre-mium is to change:

- The premium outlay and mode the applicant plans to pay and the contract premium, as applicable.

- The corresponding guaranteed death benefit, as provided in the policy.
- The corresponding guaranteed value available upon surrender, as provided in the policy.

Standards for Supplemental Illustrations

Insurers may provide supplemental illustrations if:

- They are attached to, accompanied by or preceded by a basic illustration that complies with the rule.
- The non-guaranteed elements shown are not more favorable to the policy owner than the corresponding elements based on the scale used in the basic illustration.
- They conform to the General Rules and Prohibitions section of the rule.
- The premium underlying the supplemental illustration is equal to the premium shown in the basic illustration.

Annual Report;

Notice to Policy Owners

When illustrations are used after the rule's effective date, insurers will be required to give policy owners an annual report on the status of their policies. The required information for various contract types will include:

Universal Life

Policy value at the end of the previous report period and the end of the current report period.

Total amounts credited or debited to the policy value identified by type (for example, interest, mortality, expense and riders).

Death benefit for each covered life.

Net cash surrender value.

Amount of outstanding loans, if any.

When applicable, a notice warning that the policy's cash surrender value is insufficient to maintain insurance in force until the end of the next reporting period.

Other Life Policies

Current death benefit.

Annual contract premium.

Current cash surrender value.

Current dividend.

Application of current dividend.

Amount of outstanding loans, if any.

Policies Without Non-Forfeiture Values

TDI will require annual reports for these policies only when the insurer has made changes to non-guaranteed policy elements.

Annual Certification

Each insurer will be required to appoint one or more illustration actuaries. Their duties will include certifying that the disciplined current scale used in illustrations conforms to the Actuarial Standard of Practice for Compliance with the NAIC Model Regulation on Life

Insurance Illustrations issued by the Actuarial Standards Board and that the illustrated scales used in insurer-authorized illustrations meet the requirements of the Texas rule.

The rule sets out requirements for such actuaries.

Other Rules

The life illustration rule does not supersede TDI's existing advertising rules, codified as 28 TAC Chapter 21, subchapters A and B.

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