NATIONAL COUNCIL OF INSURANCE LEGISLATORS
LIFE INSURANCE AND FINANCIAL PLANNING COMMITTEE
ATLANTA, GEORGIA
MARCH 3, 2018
DRAFT MINUTES

The National Council of Insurance Legislators (NCOIL) Life Insurance and Financial Planning Committee met at The Whitley Hotel in Atlanta, Georgia on Saturday, March 3, 2018 at 8:45 a.m.

Representative Deborah Ferguson of Arkansas, Chair of the Committee, presided.

Other members of the Committees present were:

Sen. Jason Rapert, AR	Rep. Justin Hill, MO
Asm. Ken Cooley, CA	Rep. Joe Hoppe, MN
Rep. Richard Smith, GA	Rep. George Keiser, ND
Rep. Matt Lehman, IN	Sen. Jerry Klein, ND
Rep. Steve Riggs, KY	Asm. Andrew Garbarino, NY
Rep. Bart Rowland, KY	Sen. Bob Hackett, OH

Other legislators present were:

Rep. Paul Mosley, AZ	Sen. Neil Breslin, NY
Rep. Bryon Short, DE	Rep. Michael Henne, OH
Rep. Darlene Taylor, GA	Rep. Glen Mulready, OK
Sen. Tom Middleton, MD	Rep. Tom Oliverson, TX
Sen. Ed Buttrey, MT	

Also in attendance were:

Commissioner Tom Considine, NCOL CEO
Paul Penna, Executive Director, NCOIL Support Services, LLC
Will Melofchik, Legislative Director, NCOIL Support Services, LLC

MINUTES

Upon a motion made and seconded the Committee unanimously approved the minutes of its November 16, 2017 meeting in Phoenix, Arizona.

DISCUSSION ON REQUIRING NOTIFICATION BEFORE ADVERSE CHANGES IN LIFE INSURANCE PREMIUMS AND ANNUITY POLICIES

Darwin Bayston, President and CEO of the Life Insurance Settlement Association (LISA) stated that LISA is in support of NCOIL developing a cost of insurance (COI) Model Act. As of 2015, there were 142 million policies on individuals totaling $12.3 trillion in face value. For people aged over 65, that figure is 42 million policies and $2.5 trillion in face value. Consumers place a massive amount of trust in the life insurance industry to provide them resources against the risk of premature death and the financial losses that would occur. They have also placed a great deal of trust in being treated fairly and knowing what to expect. Since 2015 there have been a growing number of COI increases that have been random and excessive. LISA urges that this issue be given strong consideration by the Committee.

Michael Brohawn of ITM TwentyFirst stated that life insurance trusts are used for estate planning purposes. The average policy is 15 to 20 years old, and the trustee has a fiduciary responsibility to maximize the value of the policy for the beneficiary. Mr. Brohawn then discussed a couple of troubling trust owned life insurance (TOLI) cases, the first being an 89-year-old husband and wife who had $15.5 million in survivorship universal life policies (issued in 1995). In 2016, they experienced a 99% increase in COI. Overnight, the annual carrying costs went from $400,000 per year to $981,707. In that example, after paying premiums for 21 years, from age 90 to 100, the trust would pay approximately $1.30 for every dollar of pure death benefit.

In the second case, there was $8.775 million in a single life universal life policy taken out on an 82-year-old woman in September of 2003. She put in $3,945,791 in contributions designed to carry the policy to age 98, at which point the expected outlay would be $197,000 to get to 100 years of age. Instead, she is now 96 years old and the current cash value of the policy is $600,000 and they cannot get illustrations from the carrier showing the current assumptions, only guaranteed assumptions. But by reverse-engineering the policy, Mr. Brohawn and his colleagues know that it will cost about $80,000 per month for the policy going forward. The options then are to surrender the policy for $600,000; pay the policy to maturity (with a guaranteed cost of $12 million); or change the policy to a "reduced paid up" option which would arrive at a death benefit of $747,000. Notably, when the carrier sent out its notice of the COI increase, that last option was not offered to the consumer. The end result is that 14 years ago, $4 million was put into a policy and they received $747,000 in death benefits. And it is important to note, that result occurred with a fiduciary trustee managing the policy with the help of experts – it could have been much worse.

Mr. Brohawn noted that he frequently hears from his colleagues who have been in the life insurance industry for a long time and they are saying they have never seen such behavior by carriers. In some instances, there are COI increases as much as 200%. In many instances, policyholders are simply surrendering their policies because they don't know what else to do.

Steven Sklaver, an attorney at Susman Godfrey, L.L.P., first stated that his presentation is handcuffed due to a lot of the evidence in the litigation he is involved in being under a protective order. Mr. Sklaver first discussed the practice of "shock lapsing" which is a term for when a carrier raises rates purposefully to induce customers to not pay their premiums so that the carrier will benefit in the universal life industry. Shock lapsing can be designed in certain ways. Typically, the healthy policyholders will lapse because the sicker policyholders are unable to get new coverage, so rates will need to be raised even higher – that is called "anti-selective lapse." Mr. Sklaver noted that the big selling point in universal life is the guaranteed interest. Because interest rates dropped, carriers lowered that guarantee, and when they hit the minimum mark, they eviscerate the benefits of that guarantee by raising rates, thereby rendering the guarantee meaningless.

Mr. Sklaver then discussed the litigation surrounding the Aetna/Voya COI increases. Aetna issued policies in the 1980s and the contract at issue stated that "the monthly COI rates may be adjusted by Aetna from time to time. Adjustments will be on a class basis and will be based on Aetna's estimates for future cost factors, such as mortality, investment income, expenses and the length of time policies stay in force." It is important to focus on the terms "class basis" and "Aetna." In 1998, Aetna sold a block of policies, engaging in a 100% indemnity reinsurance contract with Lincoln. That means that Aetna has no costs since they are now borne by Lincoln. When Lincoln tried to increase rates, the New York Department of Financial Services (NY DFS) requested to see Aetna's experiences, who replied with Lincoln's experiences. Additionally, it was discovered that Aetna had merged all cohorts as the class for purposes of their rate increase request. The NY DFS stated that such practices violated New York law which led to Aetna withdrawing their rate increase request in New York, but they did implement it in the other 49 States. Mr. Sklaver stated that raises another issue because if the contract states that COI adjustments will be on a "class basis" – how can a COI adjustment take place in only 49 States. Mr. Sklaver stated that New York's diligence in adopting the regulations is paying off because carriers are not seeking COI increases in New York. It is best to be proactive on issues like these rather than litigating them because you never know how a judge will decide certain issues.

Mr. Sklaver then discussed a COI increase implemented by AXA on certain universal life policies before the NY DFS Regulations were adopted. The COI increase was implemented only on a subset of those policies – policyholders aged 70 and above; at least $1 million in face value; issued between 2004 and 2007. The NY DFS stated that COI increases were unobjectionable but the AXA COI contract language states that "changes in…cost of insurance deductions…will be on a basis that is equitable to all policyholders of a given class, and will be determined based on reasonable assumptions as to…mortality [and] investment income." It was later discovered in litigation that AXA's average-expected ratios of issue age 70+ and with more than $1 million in face value show lighter mortality than face amounts less than $1 million, yet policies with less than $1 million in face value were not hit with the COI increase. Mr. Sklaver stated that they are drawing a circle around that subset of policies probably because they are life settlement owned policies and they are trying to punish life settlement investors. The carriers don't like customers paying their bills on time. Mr. Sklaver referenced a document from AXA in 2013 where they were studying non-individually owned life insurance (NIOL). They were studying who owns their product because they want to see who is minimally funded in order to induce them to lapse.

Mr. Sklaver further noted that with AXA, the policies in questions were sold between 2004 and 2007 but there are documents from 2006 that indicate AXA was already planning to implement COI increases on the policies in order to induce shock lapsing – but illustrations must reflect the insurer's current best estimates. Mr. Sklaver closed by stating that all of these examples show the value of diligent regulatory and legislative oversight. Such oversight is much more valuable and effective then leaving it up to attorneys to try and persuade judges about specific contract language.

Kate Kiernan of the American Council of Life Insurers (ACLI) read from a prepared statement due to the pending litigation on these issues. Ms. Kiernan stated that the issues before the Committee today are being driven by sophisticated institutional investors who hold large quantities of large face amount life insurance policies. Those investors base their yield projections based on paying low minimum premiums which have over the course of time increased, hurting their profit margins. Ironically, protecting or enhancing profit margins is the same accusation that they are leveling against life insurers in litigation. As a matter of fact, at a LISA conference this week, there was a session on COI increases. The session was presented as a panel to discuss the trends and patterns that indicate a likelihood of a COI increase in carrier's existing books of business and its relationship to longevity risk from an investor's perspective. Included in the investor's techniques that they discussed was fine tuning carrier specific and product specific risks, including machine learning applications - applying data-analytics to large books of business to figure out which blocks might have a COI increase. In response to these issues being raised by investors, last year the NY DFS promulgated Regulation 210. Having been recently adopted, the full impact of the regulation is not yet known and the first filings to the department under the Regulation are due in April. What we do know is that the Regulation is highly technical, complex, and has caused voluminous implementation problems for companies and countless conversations between the insurance companies, trade associations and the NY DFS for guidance on exactly what they are looking for.

Ms. Kiernan stated that ACLI believes extending Regulation 210 to a Model Law is unnecessary and definitely premature at this time. Policies designed to be in force until the death of the insured have non-forfeiture value to ensure that policyholders get fair value for the premiums they have paid. This principle allows the consumer to discontinue the policy if they do not believe that the COI increase is warranted. For instance, a consumer may surrender the value amount to purchase a new policy. Similarly, if the institutional investors are not happy about the rate increases, they can surrender the policies for the cash values that have accumulated. However, they have invested more into the policies than the average consumer has. The non-forfeiture values aren't based on what they paid for the polices to the consumers, but rather what the consumer paid for the policies to the insurance company - so the equitable surrender value to the consumer does not feel equitable to the settlement companies. That, however, is not the fault of the insurer. Basically, the settlement companies paid more than the policy was worth hoping that the difference between the future premiums paid and the death benefit they will receive will completely pay them back for their initial investment and also generate a profit. However, they will always generate a deficit if they surrender the policy before death. The average consumer does not have this dynamic since they always receive a fair value for the premiums paid to date. The bottom line is that insurers should not have to pay the bad bets made by the settlement companies and investors.

Regulation 210 has fatal flaws sometimes seen in a hastily developed regulatory response. First, it is too complicated – compliance has so far been an expensive nightmare for companies. The Regulation requires that companies inform the NY DFS about changes to non-guaranteed cost factors in an extremely complex way. ACLI believes that any regulatory response to COI increases should be more simplified and emphasize policyholder notice and information so that they can make informed decisions. Regulation 210 should not be a Model since its emphasis is on actuarial disclosures and rate regulation and not on policyholder information and protection from policy breakdown. The objective of Regulation 210 is ideal and noble, but its mechanism is flawed and impractical. The potential impact of Regulation 210 on the market must also be considered. If Regulation 210 discourages justifiable premium increases such that the industry bears all of the cost of a low interest rate environment and deteriorating mortality, the result could be an industry product portfolio consisting mainly of participating whole life and guaranteed cost whole life and term as in the 1960s where cost factors are guaranteed but policies are much more expensive than today, and the market is much smaller – that is not beneficial to consumers. In summary, ACLI believes that no action should be taken on Regulation 210 until the current litigation is resolved, and any regulatory or legislative response should be focused on notice and not actuarial assumptions that are not understandable.

Rep. Deborah Ferguson (AR), Chair of the Committee, asked Mr. Brohawn if there is a way for the consumer when looking at the illustration to adequately assess whether the assumptions are true. Mr. Brohawn stated that with regard to the interest rate assumption, most policies that had the COI increases were current assumption universal life policies and the interest rates when the policies were taken out were probably not the interest rates that were paid because the interest rates have dropped. Second, with COI, there is typically a guaranteed column on the illustration but nothing that is going to tell the consumer whether or not the costs of insurance are going to increase. In the contract there is a contractually guaranteed rate that shows the highest rate they can take the COI to but nothing in the illustration. Mr. Brohawn stated that the illustrations are confusing. Rep. Ferguson asked how long the non-guaranteed elements in a policy are guaranteed for. Mr. Brohawn stated typically a year.

Rep. George Keiser (ND) responded to Mr. Sklaver's remarks and stated that it does not seem to be a viable argument that the carriers are violating their contracts when implementing COI increases on a "class basis" in only 49 of 50 States. Mr. Sklaver stated that in the Voya case, Voya voluntarily withdrew the COI increase in NY despite their contract stating that COI increases must be on a "class basis" – that term was defined by the carrier when the contracts were written. Rep. Keiser stated that term was defined prior to the NY DFS Regulations being drafted. Mr. Sklaver stated that the carrier cannot shape a contract term like a ball of clay over time to do what fits its needs.

Sen. Bob Hackett (OH) stated that the original illustration, especially when done with a trust company, is not the important illustration – it is the in-force illustration that you get year after year. Sen. Hackett asked if the examples given earlier were the first COI increases they had seen and whether or not they saw it coming particularly since interest rates were decreasing. Mr. Brohawn stated that if you purchase a life insurance policy the COI will increase every year as you age. However, there is a current COI that is built into the policy illustration that has increased over and above what was expected. So, as an example, if you go in and look at a policy, the COI at age 80 might be $1,000 and at age 81 might be $1,050, but now, overnight, the COI went from $1,050 to $1,500. To say that policyholders should have known that their COI was going to increase is true, but not overnight to such a large extent. Sen. Hackett stated that his point is that every year you get the in-force illustration which shows the COI increases going forward. Mr. Brohawn stated that what's happening here is that the COI increases are as large as 50% and they are being implemented overnight. Sen. Hackett stated that the new in-force illustration will then show that increase and those going forward. Mr. Brohawn replied yes and compared it to a mortgage on a house. If the mortgagor is paying 4.5% interest the can get their amortization table but if one day the bank calls and says the rate has increased to 8%, the amortization table has changed dramatically overnight.

Sen. Hackett then asked how Model language in this area would be applied throughout the country. Ms. Kiernan stated that no Model is necessary. Mr. Sklaver stated that he sees the issue no differently than any other statute or regulation applied throughout the States – there are standard non-discrimination clauses applied nationwide. Mr. Sklaver also noted that there is no approval process for COI increases. There is a notification process and then it is up to the Insurance Commissioner to investigate if they so choose.

Asm. Andrew Garbarino (NY) asked if the policyholders know that the rate increases can occur. Mr. Brohawn stated that he can't say what happens at the sales table, but that most people remember the good things about a transaction and not the bad things. The reality is that most people do not understand life insurance. As far as whether someone thinks or knows something will change in a policy: first, no one should be selling based off an illustration, and a consumer should know better than that; second, from a contract perspective, carriers should not be able to change contractual terms. Mr. Sklaver stated that insurers do not argue that they have unfettered discretion to raise rates – they are bound by contracts. This is all about ensuring that rate increases are done in the right way.

Rep. Glen Mulready (OK) asked the panel to clarify: carriers can raise rates at any time, they just must have the data to support the increases; no regulatory permission is required. Mr. Sklaver stated that in most states, regulatory approval for rate increases in life insurance is not required.

Rep. Joe Hoppe (MN), Vice Chair of the Committee, stated that he believes this is a case of two sophisticated industries involved in litigation and this is not the proper time for NCOIL to consider Model legislation. Rep. Hoppe made a Motion for the Committee to wait and see how the litigation plays out and to maybe discuss these issues at a later date. Sen. James Seward (NY) seconded the Motion. The Committee agreed without objection by way of a voice vote.

THE DOL FIDUCIARY RULE – NOT ALL QUIET ON THE STATE FRONT

Ray Farmer, Director of the South Carolina Department of Insurance, provided the Committee with an update on the NAIC Suitability in Annuity Transactions Model Regulation (Model). The Annuity Suitability Working Group (Working Group) was formed by the NAIC in recognition of a growing consensus for an updated and consistent standard for providing personalized investment advice to consumers. In April of 2016, the DOL completed regulations broadening its definition of fiduciary investment advice under ERISA and the IRC. Those regulations expand the scope of who is considered a fiduciary to ERISA retirement plans and IRA's which will include a broader set of insurance agents, brokers and insurers.

The first phase of implementation of the DOL Fiduciary Rule was set to be applicable in April 2017, but the Trump Administration issued a Presidential Memorandum ordering the DOL to reevaluate the Rule. As a result, implementation has been pushed back. At the same time, the SEC has been developing its own fiduciary standards as well. Accordingly, the NAIC decided to update its Model to consider potential improvements. The NAIC believes it is important to have a consistent and compatible standard for all entities and individuals with jurisdiction in this area. The NAIC has been encouraged with its interactions with the DOL, SEC and others. The Working Group released a draft of revisions to the Model this past November. Comments were received in January and the Working Group plans to meet later this month with the goal of having revisions to the Model being completed by the NAIC Summer Meeting, and to have the NAIC Life Insurance and Annuities Committee consider the Model by the NAIC Fall Meeting.

Bruce Ferguson of ACLI stated that there were important lessons learned from the DOL Rule, namely that it was the wrong rule implemented by the wrong regulator. From the outset, it was clear that what they were proposing did not make sense from a market perspective. Even though the Rule is only partially implemented, there has already been a detrimental impact to low and median income savers. The movement towards fee-based arrangements has pushed a lot of individuals out of the market which is not a good thing especially since many are underprepared for retirement. It should not matter to consumers whether they are dealing with an insurance producer, investment advisor, broker dealer, or financial planner – there should be a common standard of care that individuals with whom they are dealing with are acting in their best interests. That will require a coordinated effort among many entities, most importantly state legislators.

Wes Bissett of the Independent Insurance Agents and Brokers of America (IIABA) stated that NCOIL has been an impactful voice in this area, particularly due to Arkansas Sen. Jason Rapert's Resolution opposing the DOL Fiduciary Rule. Among other things, that Resolution noted that the Rule is an example of excessive government regulation that hurts average consumers. Instead of supporting the Rule's repeal, some regulators have stated that the best-interest fiduciary standard should be extended to products within the clear jurisdiction of state regulators and to products that don't even have an investment component. The most notable element of the revisions to the NAIC Model is that it would establish a fiduciary best interest standard that would apply to any form of annuity. Such a standard is ambiguous and creates uncertainty which could lead to litigation. It also would impose costs on agents without providing any clear benefit to consumers.

Mr. Bissett stated that the revisions to the Suitability Model also place some odd restrictions on compensation – a producer would be prohibited from receiving more than reasonable compensation when making a recommendation – that is very vague and will probably end up with officials far removed from the process such as regulators and judges determining what is reasonable. Further, it is unclear why the NAIC would want to harmonize its Model with the DOL Rule particularly since that Rule is not in full effect and is likely to be altered.

Sen. Rapert asked Dir. Farmer if the NAIC is essentially taking up the cause that the DOL Rule is seeking to further. Dir. Farmer stated that the Working Group's activities are a work in progress and nothing is set in stone. Sen. Rapert requested that the NCOIL Resolution opposing the DOL Rule be re-distributed to all NCOIL member legislators in order to clarify NCOIL's position as the NAIC works on this issue.

Mr. Ferguson thanked Sen. Rapert for his leadership on this issue and stated that NAIC is doing the wise-thing by looking to improve its Model in order to make it a workable rule without the onerous impacts of the DOL Rule.

Dir. Farmer closed by stating this is another example of the benefits of having a continued and open dialogue between NCOIL and NAIC.

ADJOURNMENT

There being no further business, the Committee adjourned at 10:00 a.m.