STATE OF MINNESOTA
DEPARTMENT OF COMMERCE

In the Matter of the Proposed
Rules Governing
Universal Life Insurance

STATEMENT OF NEED
AND REASONABLENESS
OF PROPOSED RULES

STATEMENT OF NEED AND AUTHORITY

The proposed rules set forth the requirements and conditions under which insurers may issue universal life insurance policies in the State of Minnesota. The proposed rules follow a model rule for regulation of universal life insurance policies adopted by the National Association of Insurance Commissioners (NAIC) in December, 1983. The rules are proposed by the Commerce Commissioner of Minnesota to implement the provisions of Minnesota Statutes § 61A.03.

The proposed rules establish guidelines for the review and approval of universal life insurance policy forms by the Commerce Commissioner. These guidelines include mandatory policy provisions and disclosure requirements protective of the purchasers of universal life insurance policies.

The proposed rules are also necessary to permit meaningful application of the standard valuation law, Minnesota Statutes § 61A.25, to universal life insurance policies. Under the standard valuation law, modified valuation net premiums are defined as uniform percentages of policy premiums. In universal life insurance policies, although the policyholder may pay premiums in a fixed amount and on a regular basis, the policyholder is not required to do so. Also, the standard valuation law, in specifying the expense allowance to be used in the computation of the policy reserves ("Commissioners Reserve Valuation Method" or "CRVM Reserves"), requires a divisor which is defined as "an annuity of one per annum payable on the first and each subsequent anniversary on which a premium falls due". Since no premiums ever fall due under the terms of universal life insurance policies, the annuity factor is always zero. The proposed rules resolve these problems in applying the standard valuation law to the computation of policy reserves for the universal life insurance policies.

Finally, the proposed rules are necessary to permit Minnesota domiciled - insurers to properly compute their universal life insurance policy reserve deductions for Federal Income Tax purposes.

The Commerce Department considers the proposed rules necessary and reasonable in order to establish standards concerning:

(a.) the establishment and maintenance of reserve liabilities,

(b.) minimum cash surrender values and minimum paid-up nonforfeiture values,

(c.) mandatory policy provisions,

(d.) reports to be used in connection with any advertising, solicitation, negotiation, or procurement of the product,

(e.) annual reports which keep the policyowner advised of the status of the policy, and

(f.) specifications for required filings with, and reports for the Commissioner regarding sales, issuance, and administration of these policies.

FACTS ESTABLISHING REASONABLENESS

The purpose of these rules is to supplement existing regulation of traditional life insurance policies to regulate the development and issuance of universal life insurance policies. The proposed rules reasonably comply with the specifications and requirements of Minnesota Statutes § 45.023.

Part 2747.0005 Definitions.

Subpart 1. Definitions. This subpart defines terms applicable to universal life insurance policies, and clarifies their usage in the rules.

Subpart 2. Case Surrender Value. This subpart indicates that cash surrender value means the net cash surrender value of the policy plus any amounts outstanding as policy loans.

Subpart 3. Commissioner. This subpart defines "Commissioner" to mean the Commissioner of the Department of Commerce of Minnesota.

Subpart 4. Fixed Premium Universal Life Insurance Policy. This subpart defines a fixed premium universal life insurance policy as a policy that is not a flexible premium universal life insurance policy.

Subpart 5. Flexible Premium Universal Life Insurance Policy. This subpart defines a flexible premium universal life insurance policy as a policy where the owner may vary either the timing of one or more premium payments or the amount of insurance or both.

Subpart 6. Interest-Indexed Universal Life Insurance Policy. This subpart defines an interest-indexed universal life insurance policy as any universal life insurance policy where interest credits are linked to an external referent (index).

Subpart 7. Net Cash Surrender Value. This subpart defines net cash surrender value as the maximum amount payable to the policyowner if he/she were to surrender his/her policy.

Subpart 8. Policy Value. This subpart defines the policy value as the amount to which separately identified interest credits, mortality charges, expenses, or other charges are made under the universal life insurance policy.

Subpart 9. Universal Life Insurance Policy. This subpart defines a universal life insurance policy as any individual life insurance policy which has separately identified interest credits (other than dividend accumulations, premium deposit funds, or other supplementary accounts), mortality charges, and expense charges, as a part of the policy. A universal life insurance policy may also contain other credits or charges such as cost of benefits provided by rider.

Part 2747.0010 Scope.

The scope of the proposed rules encompasses the requirements for all individual universal life insurance policies except those policies defined under 4 MCAR S 1.9402(0). The proposed rules establish standards for issuance and sale of individual universal life insurance policies.

Part 2747.0015 Valuation.

Subpart 1. Requirements. This subpart contains definitions for the CRVM Reserves for both fixed and flexible premium universal life insurance policies. These definitions are necessary to limit the application of the proposed rules to appropriate policies.

Under the current standard valuation law and without the proposed rules, there might be an interpretation that the universal life insurance policies have no "right" to an expense allowance in the determination of the CRVM Reserves.

The proposed rules provide for a reasonable expense allowance in the computation of CRVM Reserves. This expense allowance will vary in proportion to the ratio of the policy value to the guaranteed maturity fund. In effect, the higher the level of premium payments on the policy, the larger the expense allowance. This is consistent with the standard valuation law, Minnesota Statutes § 61A.25, as it relates to fixed premium traditional policies.

Subpart 2. Alternative Minimum Reserves. This subpart provides for an alternative minimum reserve calculated by a method consistent with the current standard valuation law for traditional policies. The subpart recognizes the flexibility of the universal life insurance policy by using the guaranteed maturity premium in the calculation of the reserves.

Part 2747.0020 Nonforfeiture.

Subpart 1. Minimum Cash Surrender Values For Flexible Premium Universal Life Insurance Policies. This subpart states that the minimum cash surrender values for flexible premium universal life insurance policies will be determined separately for the basic policy and for any benefits and riders for which premiums are paid separately.

The minimum cash values for flexible premium universal life insurance policies are premiums paid, minus allowable expense charges, accumulated at interest. An additional expense charge, often referred to as a surrender charge, may be deducted from the accumulated premiums.

Allowable expense charges include charges for mortality, charges against the premiums, when paid, and charges against the accumulated premiums. Charges against the paid premiums include a percentage of each premium, while charges against the accumulated premiums include a monthly flat amount per policy or a monthly amount per thousand of insurance. Other allowable expense charges include service charges originating from a policyholders' request for special services, such as furnishing an illustration of future benefits or processing a partial withdrawal.

Expense charges against the paid or accumulated premiums will not be limited if the charge in the first year is not larger than the average annual charge assessed in policy years two through twenty. Practically, this means that these charges will be allowed without limit if they are essentially level for each policy year. If, however, the charge is greater in the first year than the average renewal charge, the excess of the first year charge over the renewal charge is subject to limitation. This limitation is equal to the amount of the initial expense allowance applicable to a traditional fixed premium endowment policy, see Minnesota Statutes § 61A.25.

The limit of the surrender charge is referred to in the rules as the "unamortized unused initial expense allowance". Breaking this into its components, "initial expense allowance" is the same initial expense allowance mentioned previously. The "unused" portion is the difference between the initial expense allowance and the excess of first year expense charges over the average renewal charges. The unused initial expense allowance is reduced each policy year by actuarial factors. What remains is called the "unamortized" amount and is available to be used as a surrender charge.

Increases in face amount are treated similarly to new issues, with an additional expense allowance (based on the amount of the increase and the insured's attained age) available for expenses.

Subpart 2. Minimum Cash Surrender Values For Fixed Premium Universal Life Policies. This subpart states that the minimum cash surrender values for fixed premium universal life insurance policies will be determined separately for the basic policy and for any benefits and riders for which premiums are paid separately. The minimum cash values for fixed premium universal life insurance policies are calculated in a more traditional manner than cash values for flexible premium universal life insurance policies. For fixed premium policies, the present value of future adjusted premiums (as described in Minnesota Statutes § 61A.25) are subtracted from the present value of future guaranteed benefits.

Future guaranteed benefits are determined by projecting the policy value using all guarantees in the policy. Projected policy values are then used to determine future death benefits and/or endowment benefits, if applicable.

Present values are calculated according to actuarial formulas, using interest and mortality rates established by law.

In addition to the present value of future adjusted premiums, the present value of premiums pertaining to guarantees or policy changes made after issue may also be deducted from the present value of future benefits.

Subpart 3. Minimum Paid-up Nonforfeiture Benefits. This subpart states that if the universal life insurance policy offers paid-up nonforfeiture benefits (known as reduced paid-up insurance), the present value of such benefits must be greater or equal to the current cash surrender value.

For flexible premium universal life insurance policies, present values are determined using the interest and mortality rates guaranteed in the policy. For fixed premium universal life insurance policies, present values are determined according to interest and mortality rates established by law. The insurer may offer other nonforfeiture benefits, such as extended term insurance, upon request. The alternative benefit must be actuarially equivalent to the paid-up benefit.

Part 2747.0025 Mandatory Policy Provisions.

Subpart 1. Periodic Disclosure to Policyowner. This subpart requires that the policy contain a provision stating that the policyowner be sent, at least annually, a report of the current status of the policy, at no cost to the policyowner. This report must be current to within three months of the date of mailing. Specific requirements for the annual report are discussed in Part 2747.0035.

Subpart 2. Illustrative Reports. This subpart requires that the policy contain a provision stating that upon a policyowners' request, an illustrative report will be provided. Minimum requirements for the report are contained in Part 2747.0030. The insurer may charge the policyowner a reasonable fee for the report.

Subpart 3. Policy Guarantees. This subpart states that the policy must reflect minimum interest credits and maximum mortality and expense charges. Nonguaranteed credits and charges may not be included in the policy.

Subpart 4. Calculation of Cash Surrender Values. This subpart explains what is included in the calculation of cash surrender values.

Subpart 5. Changes in Basic Coverage. If the policy allows the policyowner to change the basic coverage, any limitation on the amount or timing of the change must be stated in the policy. Also, if the policyowner has the right to increase coverage, the policy must state whether or not a new period of contestability or suicide is applicable for the additional amount of coverage.

Subpart 6. Grace Period and Lapse. This subpart states that the policy must provide for written notice to be sent to the policyowners' last known address at least 30 days prior to termination of coverage. The policy must contain a grace period of at least 30 days after the policy lapses. Unless the policy states otherwise, the policy will lapse on the day on which the net cash surrender value first equals zero.

Subpart 7. Misstatement of Age or Sex. This subpart states the procedure to use if a question arises over the amount of death benefit which should be paid if the insured misstates his or her age or sex. The death benefit will be the amount that would be purchased by the most recent mortality charge at the correct age or sex. The Commissioner may approve other methods.

Subpart 8. Maturity Date. This subpart states that if a policy provides for a maturity date, end date, or similar date, then the policy must also contain a statement in close proximity to that date which states that it is possible that coverage may not continue to the maturity date even if scheduled premiums are paid in a timely manner, if this is the case.

Part 2747.0030 Disclosure Requirements.

Subpart 1. Disclosure Requirements. This subpart states the disclosure requirements in connection with any advertising, solicitation, negotiation, or procurement of a universal life insurance policy. The purpose of this subpart is to protect the policyholder by requiring adequate disclosure of required information during all phases of the solicitation process. Thus, the rule requires disclosure in all advertising, solicitation, negotiation and procurement of universal life policies.

Part 2747.0035 Periodic Disclosure to Policyowner.

Subpart 1. Requirements. The purpose of this subpart is to make certain the policyholder is kept informed of his or her policies values on a regular basis. This information will permit the policyowner to measure the performance of their policies and may serve as a reminder to review their insurance plan and make any desired changes. The subpart sets forth the minimum requirements for periodic reports to owners of universal life insurance policies. Reports must be furnished at least annually and must be mailed within three months following the close of the reporting period.

Part 2747.0040 Interest-Indexed Universal Life Insurance Policies.

Subpart 1. Initial Filing Requirements. This subpart sets the filing requirements for the filing of interest-indexed universal life insurance policies. These additional filing standards pertain to the interest-index feature and provide the information necessary to permit the Commerce Commissioner to review and approve or disapprove these policy forms.

Subpart 2. Additional Filing Requirements. This subpart requires insurers whose interest-indexed universal life insurance policies have been approved for sale by the Commissioner under Subpart 1 to keep the Commissioner informed of any proposed material changes in the insurers investment strategy or method of determining interest credits. This will permit the Commissioner the opportunity to review these proposed material changes prior to implementation. This will protect the purchaser of these policies by preventing insurers from unilaterally making changes which the Commissioner would not approve if considering the proposed changes as an initial filing under Subpart 1. In addition, whether or not material changes are made, all insurers must annually advise the Commissioner of the amount and type of assets backing these policies.

Subpart 3. Statement of Actuarial Opinion for Interest-Indexed Universal Life Insurance Policies. This subpart sets forth the minimum specifications for the actuarial opinion which must be furnished annually to the Commerce Commissioner by insurers whose interest-indexed universal life insurance policies have been approved under Subpart 1.

SMALL BUSINESS CONSIDERATIONS

Minnesota Statutes § 14.115 requires that the impact of proposed rules on small businesses be considered in the development of those rules. Specifically, the statute, at subdivision 2, requires that less stringent compliance standards and reporting requirements for small businesses be considered. The statute also requires that methods designed to reduce the impact of the rules on small businesses be incorporated into the rules if they are feasible and consistent with the statutory objectives associated with the rules.

Despite the lack of comments, the Department considered whether the provisions of the rules might be modified to accommodate the interests of small businesses.

Each of the methods described at Minnesota Statutes § 14.115, subdivision 2 (a) - (e) was considered in proposing the rules. The provisions contained in the proposed rules are thought to have no effect on small businesses.

PROPOSED LANGUAGE

Minn. Rule pt. 2747.0025, subp. 7

If there is a misstatement of age or sex in the policy, the proceeds payable shall be adjusted by the difference between the monthly deductions deducted, and the monthly deductions which should have been deducted, accumulated at the interest rates that were credited to the cash value from the date of issue of the policy; or the amount of the death benefit which would be purchased by the most recent mortality charge at the correct age or sex.