STATE OF MINNESOTA
DEPARTMENT OF COMMERCE

IN THE MATTER OF THE PROPOSED RULES REGARDING THE INTEREST RATE DISCLOSURE REQUIREMENETS FOR CERTAIN LIFE INSURANCE PRODUCTS	)	STATEMENT OF NEED AND REASONABLENESS

STATEMENT OF AUTHORITY

Minnesota Statutes Section 45.025, (sometimes referred to as the "Interest Rate Disclosure Law") prohibits any person from advertising the interest rate of an investment product unless certain disclosure requirements are met. Specifically Minnesota Statute Section 45.025, subdivision 2 requires disclosure at the effective net annual yield which is defined as: "The effective annual yield, based on a hypothetical $1,000 investment, minus any annual fee or similar regular periodic charges." Subdivision 6 of Minnesota Statutes Section 45.025 gives the Commissioner of Commerce, hereinafter the Commissioner, authority by rule or order to waive or defer implementation of the provisions of subdivision 2 to 5 of the Interest Rate Disclosure Law with regard to persons who are regulated by the Securities and Exchange Commission or other regulatory agencies. Additional rulemaking authority provided in Minnesota Statutes Section 45.023 authorizes the Commissioner to "adopt, amend, suspend, or repeal rules ... whenever necessary or proper in discharging the Commissioner's official responsibilities."

The Commissioner finds the proposed rules to be necessary and appropriate in the public interest and consistent with the purposes fairly intended by the policies and provisions of chapters 45, 60A, and 72A.

HISTORY

The Commissioner has met on numerous occasions with insurance company and agent representatives who have requested assistance in interpreting the Interest Rate Disclosure Law as it applies to life insurance products. These representatives have stated that the statutory format for disclosing the effective net annual yield found in Minnesota Statute Section 45.025, subdivision 2 is not an effective or relevant disclosure for life insurance policies. As a result of the meetings between the Department of Commerce, hereinafter the Department, and the life insurance industry, two disclosure sheets have been designed to provide consumers with meaningful interest rate disclosure in a uniform and understandable form. The Department and the industry representatives considered a series of proposals and a number of drafts of the disclosure sheets before agreeing on the two forms which appear in proposed Minnesota Rules Part 2790.1750. The proposed rule containing these disclosure sheets was developed through meetings and discussions with all interested groups and responds to the concerns raised by the various parties to the extent compatable with the legislative intent of Minnesota Statute Section 45.025.

FACTS ESTABLISHING NEED AND REASONABLESS

Rule Part 2790.1750

The proposed rule is intended to provide a method of meeting the disclosure requirements of Minnesota Statute Section 45.025 which is both commercially reasonable and meaningful to the life insurance consumer. The Commissioner has found that it is necessary to promulgate a rule providing a separate format for compliance with the statute for life insurance products because these products are so different in design from other interest sensitive products. Life insurance policies are designed for long term investment. They combine a non-interest generating insurance product with an investment product which does generate interest. Thus the bare statutory requirement of disclosing net effective annual yield fails to provide complete disclosure.

Before drafting the disclosure forms, the Department reviewed the complaints which have been received regarding the marketing of life insurance products. Specifically, marketing techniques have resulted in consumer complaints in three basic areas:

(1) Misrepresentation as to the nature of the policy being sold: the agent fails to adequately disclose that the policy contains a life insurance component and should be purchased only for long-term investment purposes;

(2) Misrepresentation as to the amount of interest income that will be generated by the life insurance policy, and

(3) Misleading or inadequate information about withdrawal penalties and surrender charges.

The proposed rule is intended to provide the general disclosure required by the statute and to address these specific marketing complaints.

Subpart 1 of the proposed rule makes it clear that the rule applies only in the rather narrow situation where an agent or company is presenting a life insurance policy illustration which is based upon the prospective purchaser's age and sex and does not provide a comparison with another policy.

Subpart 2 of the proposed rule waives the provision under Minnesota Statute Section 45.025 requiring disclosure of the effective net annual yield with respect to those life insurance illustrations described in 2790.1750, subp. 1, if before the payment of any portion of the purchase price for the policy, the applicant receives a disclosure sheet in the form prescribed by the Commissioner. The Commissioner finds that the information contained in the disclosure sheet will assist consumers in evaluating the interest potential of the policy to a greater extent than the mere disclosure of the effective net annual yield. To insure compliance with the delivery requirement under subpart 2, both the agent and the applicant will be required to sign and date the disclosure sheet. In addition, a copy of the disclosure sheet must be left with the applicant.

Subpart 3 of the proposed rule sets forth the format of the fact sheet to be used in connection with the offer and sale of universal life products. No alternative form of disclosure will be permitted without the prior approval of the Commissioner.

Section I of the fact sheet is intended to clearly identify the policy being offered as a life insurance policy. Consequently, the consumer will be informed that a portion of his or her first year contribution will be used to pay for the death benefit and administrative costs of the policy, and therefore, will not generate interest. Complaints filed with the Department have indicated that marketing of universal life insurance products often emphasizes the investment aspects of such policies, and fails to disclose the insurance aspects and the costs associated with that insurance.

Section II of the fact sheet provides the name and address of the insurance company offering the policy, the death benefit, whether the advertised interest rate is guaranteed and, if so, the period of time for which it is guaranteed. Complaints to the Department indicate that consumers have discovered after they purchased a life insurance policy that the guaranteed rate is significantly lower than the advertised rate. This section shows the life insurance aspects of the policy.

Section III of the disclosure sheet describes what a purchaser can expect to earn on the policy at the end of the first year. The Commissioner believes that a purchaser is entitled to know in exact figures what the value of his or her investment will be at the end of the first year, so that he or she can compare that insurance product to other types of investment products. Section III separately lists the first year's premium, the amount of the premium which will be allocated to death benefits and expenses, as required by subdivision 2 of the statute, the balance upon which interest will be calculated, the interest income at the advertised rate and the policy value at the end of the first year. By itemizing the dollars which will be allocated to death benefits and expenses, and deducting this from the first year's premium, the purchaser will be able to see the balance upon which interest will be calculated and thus, will be fully able to calculate the net effective annual yield of the product. Finally, Section IV of the disclosure sheet notifies the purchaser that the policy should be purchased only for long term planning and that there may be significant surrender charges or early withdrawal penalties. This section will set forth the surrender charges assessed if the policy is surrenderd at the end of the first year pursuant to subdivision 2 of the statute and the amount which will be received if the policy is surrendered at the end of the first year. Furthermore it requires disclosure of the number of years that the surrender charge will be imposed. The Commissioner hopes that, given this information, the purchaser will see that the policy is a long term financial vehicle and will be able to evaluate the policy in connection with his or her long term financial planning needs.

Subpart IV of the rule sets forth the contents of the disclosure sheet for life insurance products other than universal life. The second form is necessary for those products, generally participating life insurance policies, which are "bundled" products. These policies do not have separately identifiable mortality and expense charges or interest credits. Therefore, the language of the first form, with its references to death benefits and expense allocations, is clearly inapplicable to the bundled product.

Section I of the fact sheet again sets forth the type of investment product which is being sold.

Section II gives the name and address of the insurance copany. It also discloses to the applicant whether the premium is a single or annual one, the amount of the death benefit at the end of the first year and whether or not that death benefit will vary with the dividend credited or other non-guaranteed payment. This portion of the fact sheet provides disclosure of the life insurance components of the policy and is intended to make it clear to the consumer that he or she is purchasing an insurance policy.

Section III of this fact sheet tells the applicant that the policy should be purchased for long term planning. It discloses to the applicant the amount of the first year premium, the guaranteed cash value at the end of the first year, the dividend or other non-guaranteed payment at the end of the first year and the amount the applicant will receive if the policy is surrendered at the end of the first year. Again, disclosure of these items show the investment nature of the product and provide the same information as simple disclosure of the net effective annual yield would provide.

Rule Part 2790.1751

The intent of this rule is to waive the provision of Minnesota Statute Section 45.025, subdivision 2 and 5 with regard to the persons regulated by the SEC and other regulatory bodies. Specific authority for this appears at Minnesota Statute 45.025, subdivision 6.

Subpart 1 of this rule defines the term "Code" as the United States Internal Revenue Code of 1986, as amended through December 31, 1987.

Subpart 2a provides that Subdivisions 2 and 5 of Minnesota Statutes Section 45.025 do not apply to group annuity contracts or policies issued to an employer or trustee to fund an employee pension or retirement plan which is described in sections 401, 403, 408(C), or 457(B) of the Code or to an employer described in section 501(c)(3) of the Code to fund a pension or retirement plan.

The field of pension and retirement funds is occupied by ERISA and subject to the regulation of the United States Department of Labor. Because there is regulation by another agency and because these employers and trustees purchasing these contracts and policies are sophisticated individuals, the Commissioner is exercising his statutory power to waive the provisions of Subdivisions 2 and 5 of the Interest Rate Disclosure Law.

Subpart 2b of the rule waive the application of Subdivisions 2 and 5 of Minnesota Statute Section 45.025 for group life insurance or group health insurance contracts or policies issued to employers, associations of employees or trustees to provide life, health or disability benefits under a employee benefit plan if the plan has assets of at least $1,000,000. This waiver is necessary and proper in view of the regulatory authority exercised by the federal government over many of these plans through ERISA. The Commissioner finds that the purchaser of these contracts (plans which have assets of at least $1,000,000) are not unlike the institutional buyers or accredited investors under various securities statutes and therefore, do not require the same protections as the average consumer.

The purpose of the above rules in their entirety is to give the life insurance applicant the information necessary to make an informed decision. The rules merely require a complete disclosure of the facts relevant to the formation of a thoughtful financial decision.

SMALL BUSINESS CONSIDERATIONS

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

In drafting the proposed rule, the Department considered whether the provisions of the rule might be modified to accommodate the interests of small businesses. Consideration was given to possible ways in which the requirements might be relaxed for small businesses or amended to reduce any burden on small businesses. Comments regarding the proposed rules were solicited from small business, specifically insurance agencies, through several issues of the <u>Commerce Contact</u>. The Commissioner has spoken to numerous groups of agents about the rule. The rule was also discussed at the 1988 Insurance Road Shows which thousands of agents attended. Members of the audience were given a chance to ask questions and make comments during these Road Shows. Further Rhoda Toles, the Director of the Minnesota Association of Life Underwriters, a group largely composed of agents, was a participant in the meetings between the Department and the industry. The Commissioner concludes that compliance would not unduly burden small business.

Each of the methods described at Minnesota Statutes Section 14.115, subdivision 2(a) - 3 was considered in proposing the rule. The provisions contained in the proposed rule are believed to be necessary to achieve the legislative purposes.