Comments of the Center for Economic Justice

To the NAIC Life Insurance and Annuity (A) Committee

Regarding Proposed 2020 Charges

October 31, 2019

The Center for Economic Justice writes to recommend the following changes to the proposed 2020 charges for the A Committee:

1. The Life Insurance and Annuities (A) Committee will:
   A. Monitor the activities of the Life Actuarial (A) Task Force.

2. The Accelerated Underwriting (A) Working Group will:
   A. Consider the use of external data and data analytics in accelerated life underwriting, including consideration of the ongoing work of the Life Actuarial (A) Task Force on the issue and, if appropriate, drafting guidance for the states.

3. The Life Insurance and Annuity Illustrations (A) Working Group will review the NAIC Life Insurance Disclosure, Life Insurance Illustration, Annuity Disclosure and Advertisement of Life Insurance and Annuity models and develop the key content and principles for illustrating the operation of the insurance or contract, including, but not limited to:
   A. Ensure consistency between the Life Insurance Disclosure and Life Insurance Illustration models and advise if the models should be combined;
   B. Ensure consistency between the Life Insurance Illustration and Annuity Disclosure Model for approaches to illustration of indexed products;
   C. Develop key content and principles for illustrations to improve consumer protection and consumer comprehension of products, including but not limited to exploring recommendations for disclosure for IUL from the IUL subgroup/LATF; and
   D. Identify major consumer protection concerns with life insurance and annuity advertising;

4. The Annuity Suitability (A) Working Group will:
   A. Review and revise, as necessary, the Suitability in Annuity Transactions Model Regulation (#275).
   B. Consider how to promote greater uniformity across NAIC-member jurisdictions.
4.5. The Life Insurance Policy Overview Illustration Issues (A) Working Group will:
   A. Develop a policy overview document to replace the policy summary in the Life Insurance Disclosure Model Regulation to provide a comparative shopping tool for consumers that briefly identifies the key features of the life insurance product, including consideration of design, format and methods of delivery to and access by consumers consistent with the purposes of the model regulation. Explore how the narrative summary required by Section 7B of the Life Insurance Illustrations Model Regulation (#582) and the policy summary required by Section 5A(2) of the Life Insurance Disclosure Model Regulation (#580) can be enhanced to promote consumer readability and understandability of these life insurance policy summaries, including how they are designed, formatted and accessed by consumers.

5.6. The Life Insurance Online Guide (A) Working Group will:
   A. Develop an online resource on life insurance, including the evaluation of existing content on the NAIC website, to be published digitally for the benefit of the public.

6.7. The Retirement Security (A) Working Group will:
Explore ways to promote retirement security consistent with the NAIC’s continuing “Retirement Security Initiative.”

Discussion and Rationale

The A Committee currently has four work streams related to life insurance and annuity disclosures and illustrations (not including the proposed new disclosures for the Annuity Suitability Model Regulation in the Annuity Suitability Working Group). These important work streams are not coordinating on key concepts and principles. The purpose of the proposed revised charges is to better describe the work of the current Life Illustrations working group and, more importantly, to address the dire situation with the current state of life insurance and annuity illustration disclosures for consumers.

CEJ recommends that the current Life Illustrations Working Group be renamed to more accurately reflect the decisions of the A Committee regarding the work product of this working group – a work product that is unrelated to illustrations. We provide background and detailed discussion regarding this proposed charge following the discussion of the need for the proposed charge to review illustrations more broadly.

New Life Insurance and Annuity Illustration Working Group

CEJ also recommends – and cannot stress enough the urgency of – a working group to address the sorry state of life insurance and annuity illustrations and the related harm to consumers. One of the three legs of the NAIC Retirement Security Initiative is consumer education. Yet, current NAIC model regulations regarding life insurance and annuity illustrations and advertising permit – and in some cases, require – misleading, confusing and/or deceptive information be provided to consumers in the form of illustrations.
While the work of the current LIIWG is excellent – the summary overview of key product features could help consumers – the working group is not addressing any of the problems with illustrations. Similarly, the Annuity Disclosure and IUL groups are tweaking models that are fundamentally flawed and which take diametrically-opposed approaches to illustrations. While both working groups recognize the larger problems and issues with illustrations, each working group has a very narrow charge that prevents response to the larger problems or coordination with one another.

One major problem is that the approaches to illustrations for life insurance and annuities – particularly for indexed products – are radically inconsistent even for products that operate in a similar fashion. Annuity illustrations requirements don't cap crediting rates, so insurers turn to bespoke indexes created by investment banks by data-mining historical experience to falsely present potential future earnings. But, the annuity illustration at least requires a best and worst ten year scenario in an effort to get at sequence of return risk. And for FIAs, the use of bespoke indices has created huge conflicts of interest because the providers of the indexes (investment banks) may also be providing the hedging programs to the insurer licensing the index.

In contrast, IUL illustrations cap the crediting rate, so indexes other than the S&P are rare, but AG 49 has encouraged the type of products that game the provisions of AG 49. AG 49 was created to stop the use of unrealistic crediting rates that produced unrealistic accumulation values. But, insurers turned to new product features – multipliers and bonuses – with the result that despite lower crediting rates and significantly higher expenses, accumulation values have increased in comparison to pre-AG 49 products. The insurers have taken a product that purports to eliminate downside risk and added that very downside risk with asset charges.

In addition to the use of multipliers and bonuses in IUL products, IUL illustrations also differ from indexed annuity illustrations because of the absence in the IUL illustration requirements of any disclosure of sequence of return risk. IUL illustrations show monotonic returns every year – with the result that loans, which can be illustrated at a lower cost than the crediting rate, are illustrated as cash withdrawals that cost the policyholder nothing. One result of IUL product designs and illustrations is that a significant portion – perhaps the majority – of IUL sales is premium-financed.

The discussions at the IUL subgroup regarding revisions to AG49 also support the creation of the proposed Life Insurance and Annuity Illustration Working Group. The subgroup solicited comments from interested parties for suggestions how to address the problems with current IUL illustrations. Industry stakeholders largely agreed that the current AG49 was not stopping unrealistic illustrations and, importantly, was not providing consumers with critical information regarding risk and return of products promising higher accumulation in exchange for additional fees. Industry comments asked the IUL subgroup to add new disclosures.  

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1 For example, Lincoln Financial Group, National Life Group, Pacific Life and Transamerica jointly recommended requiring a mandatory breakout of charges on illustrations and requiring consumers receive clear and concise information on: (1) the potential impact on accumulated values of index volatility; and (2) downside risks of the product, including any multiplier. Securian Financial wrote “Securian Financial believes in transparency for the consumer and the advisor; without transparency, there cannot be understanding. Today, the way the industry
The state of illustrations today is far worse than in 2015 (see discussion below) and the NAIC models create diametrically-opposed approaches for illustration of indexed life insurance and indexed annuities despite the fact that the indexed products have more similarities than differences for purposes of illustration.

Our proposed charges will – appropriately – end the work of the Annuity Disclosure Working Group. The working group has been worked very diligently to address one issue regarding annuity illustrations – illustrating products tied to indexes in existence for less than ten years. As noted above, this concept represents a contradiction to the AG 49 approach for IUL which seeks to stop the use of data-mined indexes to produce inflated and unrealistic future projections based on cherry-picked historical experience. The issue of how long an index must be in existence before it can be used for illustrations is a key issue that needs to be considered as part of a holistic look at illustrations for both life and annuity indexed products.

Finally, advances in understanding of consumer biases regarding financial services products and of design of consumer disclosures to empower consumers requires a thorough review of the current illustration regime. In support of this last point, we attach a very recent joint report by the financial service regulators in Australia and the Netherlands,

Life Insurance Policy Overview Working Group

The history of the Life Insurance Illustrations Working is relevant for understanding both why the current LIIWG needs a new name and better charge and why a new Life Insurance and Annuity Illustration Working Group with a broad charge is needed. The current LIIWG was created in 2015 to address concerns with illustrations, but the charge was limited to avoid a broader look at problems with illustrations. The minutes of November 2015 Life Insurance and Annuities (A) Committee state:

Commissioner Gerhart explained that the American Academy of Actuaries (Academy) wrote a letter suggesting expansion of the Working Group’s charge to include a review of the Life Insurance Buyer’s Guide (Buyer’s Guide). He said the American Council of Life Insurers (ACLI) followed up with a letter stating that it did not oppose the addition, but pointed out that the Committee itself already has an existing charge to revise the Buyer’s Guide, and the addition of this task to the Working Group might slow down its ability to accomplish the current charge.

Birny Birnbaum (Center for Economic Justice—CEJ) said that although Model #582 may be uniformly adopted by the states, that does not mean it translates into uniform illustrations provided to consumers. He said one reason for this is that Model #582 is out-of-date and does not reflect new product designs. It also does not reflect consumers’ use of technology to access information. Mr. Birnbaum also reminded the Committee of the illustration issues that resulted in the development of Actuarial Guideline XLIX—The Application of the Life Insurance Illustrations Model Regulation to Policies with Index-illustrates some product designs lacks the necessary transparency for consumers and advisors to understand how the product performs and the associated risks.” Securian proposed a number of new, additional disclosures to accompany the illustration.
Based Interest (AG 49) and broader issues with illustrations. He also expressed support for the Committee revising the *Life Insurance Buyer’s Guide*.

Mr. Regalbuto expressed support for opening Model #582 to look at issues related to AG 49. Mr. Robleto asked if appointing a new working group to look at the narrative summary provision in Model #582 and the policy summary provision in Model #580 addressed the Committee’s commitment to level the playing field among insurers. Commissioner McPeak said addressing that issue is still in progress.

The new working group did solicit and review examples of then-current narrative summaries and policy summaries in 2016. The examples submitted by the ACLI showed wildly different formats, lengths and content of the documents across insurers and even across the same category of products. The industry practice was shown to be a document that combined the requirements of the policy summary and narrative summary of the two models without distinction – industry was unable to identify a specific policy summary document.

The working group decided that the best approach would be to create a new, simpler document – called the Policy Overview – to replace the policy summary to fulfill the charge of the working group. The working group presented this approach to the parent Life (A) Committee at the August 27, 2016 Committee meeting and received the Committee’s support.

Although the working group has not completed its charge, significant progress and key insights have been made. First, the policy summary (of the disclosure model) and the narrative summary (of the illustrations model) serve different purposes. The policy summary (to be replaced by the policy overview) describes key features of the life insurance product. The narrative summary explains the illustration.

Second, the life insurance disclosure model includes a “mini-illustration” for products not marketed with an illustration. The model states,

“The insurer shall provide a policy summary to prospective purchasers where the insurer has identified the policy form as one that will not be marketed with an illustration. The policy summary shall show guarantees only. It shall consist of a separate document with all required information set out in a manner that does not minimize or render any portion of the summary obscure.”

The working group recognized that this portion of the policy summary should be split out from the key feature portion of the policy summary into two documents – the new policy overview and a statement of guaranteed premium and benefits.

Third, based on the recognition of the interaction between the illustrations and the disclosure model, the group affirmed that that the policy overview would be provided with all life insurance products, whether marketed with an illustration or not – a decision consistent with the purpose of the disclosures model whose application is not limited to products not marketed with an illustration.
Fourth, the timing of delivery of the policy summary (now overview) and buyer’s guide in the disclosure model is inconsistent with the purpose of the model. The purpose of the model is

To require insurers to deliver to purchasers of life insurance information that will improve the buyer’s ability to select the most appropriate plan of life insurance for the buyer’s needs and improve the buyer’s understanding of the basic features of the policy that has been purchased or is under consideration.

Yet, the delivery of the policy overview – now designed to provide a brief summary of the key features of the product – and the buyer’s guide is not required prior to the purchase in the model. Consequently, key information designed to help a consumer shop for life insurance is not delivered until after the policy has been purchased. While there may have been some justification for this approach when the policy summary included information available only after the policy was issued or in a period in which document delivery was only by paper, those reasons are no longer valid and clearly undermine the purpose of the model and the disclosures.

While the Life Illustrations Working Group has been diligent, despite repeated efforts by the ACLI to derail the working group with false claims of “exceeding the working group’s charges,” two key issues limit the working group’s efforts and need to be resolved. The first issue is the timing of delivery of the policy overview and the buyer’s guide. Industry is adamant that there should be no change from the current requirement that permits delivery only after the policy is purchased. If this delivery provision remains, the purpose of the model, the policy overview and the buyer’s guide are undermined. Second, the disclosures model and the illustrations model are intimately related because certain disclosures are required if a product is not marketed with an illustration, certain disclosures are required if a product is marketed with an illustration and certain disclosures are required regardless of whether the product is marketed with an illustration. Consequently, there is a need to take a holistic look at the two models for consistency and efficiency and we suggest that this be one of the charges for the proposed new Life Insurance and Annuity Illustration Working Group.

Thank you for your consideration.
Key Findings from “Disclosure: Why it shouldn’t be the default”

Prepared by the Dutch Authority for the Financial Markets and the Australia Securities and Investments Commission:

Financial services disclosure has traditionally been assumed to inform us (as consumers), help us make ‘good’ financial decisions, and drive competition.

This report focuses on the real-world context in which disclosure operates. It shows that, and explains why, disclosure and warnings can be less effective than expected, or even ineffective, in influencing consumer behaviour. In some instances it shows that disclosure and warnings can backfire, contributing to consumer harm.

The report is a joint publication by the Australian Securities and Investments Commission (ASIC) and the Dutch Authority for Financial Markets (AFM). Both of these regulators have, over a number of years, identified limitations to disclosure in their respective retail financial services markets. Although the Australian and the Dutch financial markets and regulatory regimes differ, there is also much common ground.

Case studies in disclosure limitations
The report explores the limits of disclosure, using case studies from ASIC, the AFM and other relevant sources as evidence. These case studies are drawn from the full range of financial products and services in different financial markets, and include all forms of disclosure.

As the case studies are specific to products and contexts, the findings from each are not generalisable. However, together they show how overloaded the expectations on disclosure and consumers can be; and why firms providing mandatory information does not necessarily result in ‘informed consumers’ and often does not correlate with good consumer outcomes. Disclosure is necessary, but not sufficient.

Why? Because:
Disclosure does not solve the complexity in financial services markets
Disclosure cannot solve complexity that is inherent in products and processes. Simplifying disclosure, for example, does not reduce the underlying complexity in financial products and services. Nor does it ease the contextual and emotional dimensions of financial decision making, both at the point of purchase and over time.
Disclosure must compete for consumer attention
We are constantly saturated with competing attempts to capture our attention and influence our decisions. Many firms have the commercial opportunity and means to effectively attract, distract and influence us; but regulators, and the disclosures they mandate, generally do not. Firms can also work around or undermine disclosure requirements that, once set, are generally slow to change.
One size does not fit all – the effects of disclosure are different from person to person and situation to situation
Like other forms of regulation, mandated disclosure requirements are often ‘one size fits all’ interventions – yet people and contexts differ and shift. It is hard to predict the individual and context-specific differences in how we will behave, make decisions, and engage with and process information.

In the real world, disclosure can backfire in unexpected ways
At worst, disclosure creates unintended detrimental outcomes for some consumers – in effect contributing to consumer harm (e.g. by increasing rather than decreasing trust in conflicted advisers, and decreasing rather than increasing credit card repayments).

Ongoing monitoring of disclosure is needed because of these unexpected effects.

A warning about warnings
There is emerging evidence from financial services regulators about the limitations of the effectiveness of warnings that firms have to display about the risks and features of certain products and services. There is, for instance, some evidence of the effectiveness of warnings on our understanding of the risks associated with products, and in encouraging us to avoid unsuitable or harmful products.

Warnings are not a cure-all for problems in financial