

PROJECT HISTORY - 2007

MILITARY SALES PRACTICES MODEL REGULATION (#568)

1. Description of the Project, Issues Addressed, etc.

During the NAIC 2006 Winter National Meeting the, NAIC membership appointed a new Military Sales (EX) Working Group to assist state insurance regulators in achieving applicable directives set forth in the Military Personnel Financial Services Protection Act.

2. Name of Group Responsible for Drafting the Model and States Participating

Military Sales (EX) Working Group. The states of Georgia and Texas co-chaired the working group. The following states participated on the working group: Florida, Illinois, Iowa, Massachusetts, New York, North Carolina, North Dakota, Oklahoma and Virginia.

3. Project Authorized by What Charge and Date First Given to the Group

The working group was formed in December of 2006, through the NAIC's adoption of a resolution establishing the Military Sales (EX) Working Group. This resolution stated the following: "...the primary purpose of the new working group is to assist the organization in achieving those applicable directives set forth in the Military Personnel Financial Services Protection Act; and, furthermore, the new working group will coordinate with the Market Analysis Working Group regarding any further multi-state settlements against companies engaged in inappropriate sales practices specifically targeted to members of the Armed Forces."

4. A General Description of the Drafting Process (e.g., drafted by a subgroup, interested parties, the full group, etc). Include any parties outside the members that participated

The Military Sales (EX) Working Group drafted the model regulation and solicited input from all interested parties. In addition to the working group members, the following states submitted comments on the model regulation: New Hampshire, Ohio, Pennsylvania and Virginia.

The working group worked very closely with the Department of Defense throughout the development of the model regulation. This coordination included a face-to-face meeting on March 5, 2007, between Commissioners John Oxendine (GA) and Roger Sevigny (NH) with Deputy Undersecretary of Defense Leslye Arsht and Colonel Michael Pachuta, Director of Moral, Welfare and Recreation Policy. The Department of Defense (DoD) submitted written comments on the model regulation on March 14, 2007.

The following interested parties submitted comments on the model regulation: (1) American Council of Life Insurers, (2) American Fidelity Life Insurance Company, (3) Financial Consulting, LLC, (4) Government Personnel Mutual Life Insurance Company, (5) Insurance Marketplace Standards Association, (6) Military Benefit Association, (7) National Association of Insurance & Financial Advisors, (8) Navy Mutual, (9) Prudential Insurance Company, (10) ReedSmith on behalf of Military Benefit Association, (11) State Farm Insurance Company, (12) Sonnenschein Nath & Rosenthal on behalf of Trans World Assurance and American Fidelity Life Insurance Company, (13) Trans World Assurance Company, and (14) United Services Automobile Association.

5. A General Description of the Due Process (e.g., exposure periods, public hearings, or any other means by which widespread input from industry, consumers and legislators was solicited)

The drafting process followed the following timeline with an opportunity for all interested parties to comment:

The first draft of the model regulation dated February 2, 2007, was circulated for public comment on February 5, 2007. The working group received comments on the draft until February 13, 2007. The working group received comments from the following parties: (1) State of New Hampshire, (2) State of Pennsylvania, (3) American Council of Life Insurers, (4) National Association of Insurance & Financial Advisors, (5) American Fidelity Life Insurance Company, (6) Government Personnel Mutual Life Insurance Company, (7) Insurance Marketplace Standards Association, (8) Prudential Insurance Company, (9) State Farm Insurance Company, (10) Trans World Assurance Company and (11) United Services Automobile Association. The working group reviewed these comments and made numerous revisions to the model regulation.

The working group circulated a revised draft of the model regulation for public comment on March 29, 2007, in conjunction with the submission of the NAIC's report to Congress. The working group received comments on this draft until April 12, 2007. The working group received comments from the following parties: (1) State of Ohio, (2) State of Virginia, (3) American Council of Life Insurers, (4) National Association of Insurance & Financial Advisors, (5) Financial Consulting, LLC, (6) Government Personnel Mutual Life Insurance Company, (7) Military Benefit Association, (8) Navy Mutual, (9) ReedSmith on behalf of Military Benefit Association, (10) Sonnenschein Nath & Rosenthal on behalf of Trans World Assurance and American Fidelity Life Insurance Company. The working group reviewed these comments and made numerous revisions to the model regulation.

The working group circulated a revised draft and held a conference call on April 19, 2007, with all interested parties.

Based upon the review of the comments and dialogue with all interested parties, the working group circulated a revised draft for comment on May 11, 2007. The working group received comments on the draft until May 18, 2007. The working group received comments from the following parties: (1) State of Washington and (2) American Council of Life Insurers.

The working group held an open call with all interested parties on May 24, 2007 and made several revisions to the model act based upon the most recent comments submitted by the ACLI. The working group adopted the model act during this call.

6. A Discussion of the Significant Issues (items of some controversy raised during the due process and the group's response)

Scope of the Model Regulation

Although Congress out of concerns for federalism or McCarran-Ferguson, or both, limited its Section 9 mandate in the Act to the development of standards to protect service members from "dishonest and predatory insurance sales practices" occurring on military installations, the Model is not so constrained. The Working Group found that many of the more egregious practices were not confined to military reservations but occurred off base as well. For example, the misuse and manipulation of the allotment system, which abrogated important rights guaranteed to certain service members, including the right to a cooling-off period and counseling, frequently occurred off base. Also, as installation commanders began to strictly enforce DoD on-base solicitation rules that prohibited solicitation in barracks or without an appointment, much of the actual sales activity moved off base, frequently to agents' offices. Young trainees were invited off base through various inducements, including "pizza parties." During these events, life insurance applications were frequently solicited. The DoD fully supports extending the scope of the Model Regulation to capture these and other prohibited practices occurring off base.

Section 6 of the model regulation addresses practices declared to be false, misleading, deceptive or unfair on a military installation while Section 7 of the model regulation addresses practices declared to be false, misleading, deceptive or unfair regardless of location.

Active Duty - Applicability to Reservist/National Guard Members

The Working Group found that most of the unlawful practices uncovered in the GAO Report to Congress and during the states' multi-state investigations (some of which are ongoing) occurred while service members were on active duty. Reservists and National Guard Members are covered by the model regulation if they are on full-time duty in the active military service. The model does not cover members of the reserve component who are performing active duty or active duty for training under military calls or orders specifying periods of less than 31 calendar days. Thus, the Model would not cover solicitation or sales during weekend drills or "summer camp."

Suitability Standards

Some interested parties argued the suitability standards create a ban on certain classes of products and that the model regulation should focus instead on bad characteristics that might be associated with certain products. These parties indicated that military service members should be provided the same opportunity to purchase term insurance when they are younger just as people who are not members of the military are provided this opportunity.

On the other hand, the DoD in their comments to the first exposure draft questioned the wisdom of limiting a showing of suitability for the sale of combination products to those in pay grades E-4 or below and stated that it is "imperative" that this standard be applied to all pay grades sold these products. The Working Group disagreed. With the exception of combination products, offering inducements to attend off base sales presentations and giving certain tax advice, the Model Regulation

applies to all service members regardless of pay grade or rank. The Working Group's decision to limit combination product suitability to those in pay grades E-1 through E-4 was based on several considerations.

First, a careful review of the substantial documentation developed by state and federal authorities confirming abuses in the sale of life insurance to the military reveals that the victims of this abuse are overwhelmingly concentrated in the enlisted pay grades of E-4 and below. Investigations bore out that the E-1 to E-4 cohort was targeted by a very small group of insurers and their agents because, as a group, they are the most vulnerable and receptive to the deceptive sales pitches and questionable products proffered their way. They are vulnerable because they are young, financially inexperienced and, more often than not, recently separated from the security and comfort of civilian society. They are receptive because, in this new and unfamiliar environment in which they find themselves, loyalty and respect for authority are constant themes of their training and discipline. This deference and respect for authority were easily misappropriated by agents who were often retired military personnel and whose introduction and presence were far too frequently arranged and vouchsafed by their immediate superiors.

Second, the need for insurance in addition to the substantial coverage already provided to this group by the federal government is highly questionable. Service members in pay grades E-4 and below typically are young and unmarried with few financial obligations. Those in higher pay grades, on the other hand, are more likely to have a need for additional life insurance and, given their age and experience, are better prepared to make an informed decision regarding the need for additional insurance.

7. Any Other Important Information (e.g., amending an accreditation standard).

Federal Law Considerations

Responding to 30 years of documented abuse regarding the sale of life insurance to members of the military by a very small segment of the industry, Congress passed and President Bush signed on September 29, 2006, the *Military Personnel Financial Services Protection Act*, Congress found it imperative that members of the United States Armed Forces be shielded from "abusive and misleading sales practices" and protected from certain life insurance products that are "improperly marketed as investment products, providing minimal death benefits in exchange for excessive premiums that are front-loaded in the first few years, making them entirely inappropriate for most military personnel."

To address these concerns, Congress required that the "States collectively work with the Secretary of Defense to ensure implementation of appropriate standards to protect members of the Armed Forces from dishonest and predatory insurance sales practices while on a military installation," and that each state report to Congress by September 29, 2007, on the progress made regarding its adoption of the standards collectively developed. To insure that service members are offered only "first rate financial products" Congress also called on the NAIC in coordination with the Secretary to report to it on "ways of improving the quality of and sale of life insurance products by creating standards for products specifically designed to meet the particular needs of members of the Armed Forces, regardless of the sales location."

The Military Sales Practices Model Regulation was developed to meet these dual Congressional mandates. It makes actionable certain acts and practices which until now have not been declared to be false, misleading, deceptive or unfair under state trade practices statutes. Many of the practices identified incorporate DoD solicitation rules. For example, the Model Regulation, tracking DoD regulations, makes it a deceptive trade practice to solicit in barracks, day rooms and other restricted areas.

The Model Regulation also addresses Congressional concerns regarding suitability and product standards. In this regard, the Model Regulation makes it a deceptive or unfair trade practice to recommend the purchase of any life insurance product which includes a side fund to junior enlisted service members in pay grades E- 4 and below, unless the insurer has reasonable grounds for believing that the life insurance portion of the product, standing alone, is suitable.

Incorporation of DoD Regulations

The Model Regulation tracks or incorporates relevant DoD solicitation regulations in DoD Instruction 1344.07: *Personal Commercial Solicitation on DoD Installations*, and Army Regulation 210-7: *Commercial Solicitation on Army Installations*. These regulations identify sales practices directed at active-duty service members.