Glenn Pomeroy
Commissioner of Insurance

DEPARTMENT OF INSURANCE
STATE OF NORTH DAKOTA

BULLETIN 97-2

TO: All Insurance Companies Licensed to Market Life Insurance and Annuity Products in North Dakota

FROM: Glenn Pomeroy, Commissioner

DATE: August 1, 1997

SUBJECT: Indexed Annuity and Life Products

SCOPE AND APPLICABILITY

Annuity and life insurance products, except variable products, whose values are based in any way on the developing value of a financial index are addressed in this bulletin. This bulletin is applicable to all indexed products currently approved in North Dakota. Among the areas of regulatory concern for these products addressed in this bulletin are: potential consumer misunderstandings, investment requirements, uncertainty concerning nonforfeiture values, and unknown reserve requirements.

A product filing checklist is shown following an outline of Department review guidelines, an advertising statement, and life insurance sales illustration requirements.

INSURANCE DEPARTMENT REVIEW GUIDELINES

1. In addition to the usual filing material--policy form, application, complete actuarial memorandum, etc.--every product filing must contain each of the items listed in the product filing checklist shown below.

2. A significant review criterion will be the ease of understanding of all consumer information. It is critical that all material be both accurate and accessible to the average consumer. Therefore, the Department will be reviewing these disclosure materials with heightened scrutiny. The Department will be looking for large print, significant use of blank spaces, simplified language, and useful examples.

3. Balancing language will be a critical aspect of the review process. All product and advertising materials which emphasize the potential positive benefits of the product must equally emphasize the corresponding potential negative considerations.

ADVERTISING

All advertising material must be filed and approved for use in this state before an indexed product may be offered for sale. Therefore, do not file the product until the advertising and marketing material is fully developed and ready for review. Further, any marketing, advertising, or disclosure material developed for use with an indexed product after the initial product approval must be filed and approved before use.

LIFE INSURANCE - ILLUSTRATIONS

The illustration requirements for indexed life insurance products are set out by the North Dakota Administrative Code in Chapter 45-04-01.1, the Life Insurance Illustrations Model Regulation. All companies offering indexed life insurance products in North Dakota must file, and the Department must approve, all material showing complete compliance with this regulation before offering the product for sale. Items include all required certifications, all possible illustrations, and complete documentation of Actuarial Standard of Practice #24 compliance. This regulation has been in effect for all sales since January 1, 1997.

PRODUCT FILING CHECKLIST

Every equity indexed product filing must include **all** of the following information for the Department's review:

1. The policy form, as well as all disclosure material, must contain a disclosure statement on the face page that clearly labels this as an Equity Indexed Product.

2. All underlying numeric assumptions used in developing advertising material must be clearly disclosed.

3. A description and copy of the marketing plan and agent training program.

4. A sample of the Annual Report to the policy owner.

5. An acknowledgment statement signed by the applicant and company representative as follows:

   a. Applicant: "I have received a copy of the disclosure material and understand that the results shown, other than the guaranteed minimum values, are not guarantees, promises, or warranties."

   b. Representative: "I certify that the disclosure material has been presented to the applicant and a copy was provided to the applicant. I have not made statements which differ from this material nor have I made any promises about the expected future equity values of this contract."

6. A description of the hedging strategy that is to be used and a description of the methods for determining the effectiveness of the strategy.

7. The methodology that will be used to calculate statutory reserves.

8. Description of the methodology that will be used to calculate the statutory value of any derivative instrument used in the investment strategy to support the product.

9. A statement as to how the product will be reported for risk-based capital purposes.

10. A sales projection for the filed product together with the company capital and surplus amounts allocated for the line of business which contains the proposed product. The relationship between sales and available capital and surplus will be evaluated prior to approval in order to determine the potential effects on policy owners of the Department's approval of the product. This data will be used following the approval of the product to enable the Department to continually monitor its developing financial results.

11. Any "nonstandard" aspects of the product--high field compensation, enhanced benefits, bonuses, and so forth--which could generate unusual sales growth must be disclosed in the filing and will be used in the review of the potential effects on capital and surplus.

12. For annuities, a disclosure document which contains the material shown in the next section.

ANNUITY DISCLOSURE

The disclosure requirements for indexed annuities referred to in Section 12 above will follow the same general format of the Life Insurance Illustrations Model Regulation, N.D. Admin. Code

Chapter 45-04-01.1. That is, the requirements for indexed products include a title page, a narrative summary, a numeric summary, and tabular detail. All material must be presented in a format that is readily understandable by the reader; large print, significant use of blank spaces, simplified language, and useful examples.

NARRATIVE SUMMARY

Key Components. This section of the disclosure document is to describe all the key components of the contract. These components include, but are not limited to, the index, the index calculation method, whether the contract uses averaging or not, participation rate, caps, type of benefit, and time receiving benefit. These descriptions must be simple, understandable, readily available to the typical reader, and not misleading. Examples illustrating each concept may be helpful. The following examples are illustrative, although not required. Companies are encouraged to be innovative.

1. The index used in this contract is the XYZ index. This index has a value each day which is the stock price of three companies. Suppose the three companies are the same size and their stock prices are $1, $3, and $5. Then the XYZ index for that day would be $3 which is the average price. If the stock prices on the next day are $2, $4, and $6, then the XYZ index would be $4 for that day. The index represents the average value of the stock price for that day. Please note that the index value does not include any dividends paid.

2. Index credit is given to the contract based on the change in the XYZ index. The index value is determined at the beginning of the period. It is compared with a later value. Suppose the first value is 100 and the later value is 108. This later value is eight percent larger than the beginning value. Now, suppose the first value is 100 and the later value is 95. No index credit would be given for this period because the index value decreased.

3. Not all of the index credit is given to the contract. A portion of this value is given. This portion is called the participation rate. The participation rate for this contract IN THE FIRST YEAR is 75 percent. This means that 75 percent of the change in the index is given to the contract. Suppose the index changed 8 percent. Then 6 percent (.75 x 8) would be given to the contract.

Again, these examples are for illustrative purposes only. The critical concern is that every reasonable effort be made to provide meaningful and accessible information for the consumer.

Balancing Language. All sections of the disclosure material which emphasize the potential positive benefits of the product must equally emphasize the corresponding potential negative considerations.. This language is intended to provide a balanced view of the features of these

products. Providing a balanced picture of these products plays an especially important role in determining consumer expectation. The following examples will help illustrate balanced disclosure.

1. Averaging of index values provides higher values during a period when index values are decreasing. Suppose an index has values in consecutive periods of 5, 3, and 1. The average of these values is 3. The average is higher than the ending value. It must be disclosed that averaging provides lower values during periods when the index is increasing. The average of the values 6, 8, and 10 is 8 which is lower than the ending value, 10.

2. The participation rate is determined by the company. The current rate, the guaranteed rate, and the guaranteed period must be clearly explained. Also, factors which may cause the rate to change must be disclosed. How the rate will be determined in subsequent periods must be shown.

Hypothetical Illustrations. One of the two primary goals of these index annuity disclosure documents is to explain the internal workings of the contract. To that end, an illustration based on a hypothetical index pattern must be included in the disclosure material. The pattern must include movements of the index which will demonstrate all potential features of the product. Columns must be shown for the index values, the change in the index, the dollar effect of the change, the account value, the surrender value, and the cumulative annual earnings rate.

Minimum Value Illustration. A key feature of these products is that they provide a "floor" of value, i.e., they guarantee principal. It is critical that the consumer know exactly what this means for the product under consideration. A minimum value illustration must be provided which will simply and completely demonstrate the "floor." Attached to this bulletin is an example of an acceptable format.

NUMERIC SUMMARY

The second of the two primary goals of this disclosure material is to create a realistic expectations for the applicant as they consider this product. In order to create such a realistic expectation, it is critical that the applicant have useful information about how this product compares with other financial products available.

In particular, it is critical that the applicant understand that a significant portion of their contribution is being used to provide the guaranteed values and, therefore, is not available for the equity portion. This must be conveyed to the applicant. If the applicant believes that the full

contribution is equity invested, then they will expect the same appreciation as a variable annuity with none of the downside risk.

The purpose of the numeric summary section is to clearly place the equity indexed product in the proper light relative to other products which are available. This can be accomplished in various ways: descriptions, historical comparisons, hypothetical demonstrations, charts, graphs, or other means. The critical element is that the applicant's chance at developing an accurate expectation must be maximized.

The purpose of the numeric summary section is to create an accurate and realistic expectation for the applicant. On the same page, the statements listed above under policy filing checklist are required to be listed and signed.

TABULAR DETAIL

This section is to continue the twin goals of showing minimum values and creating the most accurate and realistic expectation for the applicant of the equity portion as possible. Minimum values must be shown in reasonable proximity to equity values.

Presentations can be provided in any reasonable format with the intent being to show meaningful aspects of the contract in a manner which will be readily accessible to the applicant. A key review criteria will be the ease of understanding of the material by the typical applicant.

GP/njb
Attachment

GUARANTEED VALUES

The values shown on this page are the MINIMUM values available at the time shown.

YOUR PAYMENT $1,000

YEARS SINCE PAYMENT	ACCOUNT VALUE	VALUE IF SURRENDER	ANNUAL EARNINGS RATE IF SURRENDER
0	$1,000	$900	*
1	1,000	927	*
2	1,000	955	*
3	1,000	984	*
4	1,013	1,013	0.32
5	1,043	1,043	0.85
6	1,075	1,075	1.21
7	1,107	1,107	1.46

* The annual earnings rate is negative if the value available is less than the amount paid.