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H. P. 1276 House of Representatives, April 2, 1979

Referred to the Committee on Business Legislation. Sent up for concurrence and ordered printed.

EDWIN H. PERT, Clerk

Presented by Mr. Howe of South Portland.

Cosponsor: Mr. Jackson of Yarmouth.

STATE OF MAINE

IN THE YEAR OF OUR LORD NINETEEN HUNDRED SEVENTY-NINE

AN ACT to Require Disclosure of Certain Information to Prospective Purchasers of Life Insurance.

Be it enacted by the People of the State of Maine, as follows:

24-A MRSA § 2153-A is enacted to read:

§ 2153-A. Life Insurance Solicitation

1. Scope.

A. Except as hereafter exempted, this section shall apply to any solicitation, negotiation or procurement of life insurance occurring within this State. This section shall apply to any issuer of life insurance contracts including fraternal benefit societies.

B. Unless otherwise specifically included, this section shall not apply to:

(1) Single premium, immediate annuities;

(2) Credit life insurance;

(3) Group life insurance;

(4) Life insurance policies issued in connection with pension and welfare

plans as defined by and which are subject to the United States Employee Retirement Income Security Act of 1974 (ERISA) PL 93-406, as amended; and

(5) Variable life insurance under which the death benefits and cash values vary in accordance with unit values of investments held in a separate account.

2. Definitions. As used in this section, unless the context otherwise indicates, the following terms shall have the following meanings:

A. A "buyer's guide" means a document which contains, and is limited to, the following language:

"BUYER'S GUIDE"

Introduction

A life insurance policy is a legal contract between you and the insurance company. In return for your payments, called "premiums", the company promises to pay a certain amount of money, called the "death benefit", when you die to the person you choose as your "beneficiary". This guide explains some of the more important aspects of life insurance. But not everything can be explained here because life insurance is complex. If you have further questions, the policy itself may answer them. If not, ask the agent or the company.

Understanding Whole Life and Term Insurance

There are two major forms of life insurance. One is called "whole life" insurance. It covers you for as long as you live. The most popular kind of whole life insurance is known as "Ordinary Life". Premiums for an Ordinary Life Policy stay the same from year to year and must be paid as long as you live.

The other major form of life insurance is called "term" insurance. It covers you for a definite period of years. The company will pay the death benefit to your beneficiary only if you die within that period. The simplest kind of term insurance is known as annual renewable. You can renew this type of policy every year, but the premium increases every time you renew. A more common form is five-year renewable term insurance. The premium for this kind of policy increases just once every five years.

Generally speaking, a young person can buy term insurance for much less than he would have to pay for the same amount of whole life insurance. But as that person grows older, the premium for the same term policy increases every time it is renewed, while the premium for a whole life policy stays the same. For example, if you buy $10,000 worth of life insurance when you are 35, you might have to pay a $200 premium for whole life but only a $60 premium for term. By the time you reach 55, however, the premium for term might have increased to $200, the same as for whole life. By age 65, the term permium might have risen to $450. On the other hand, the whole life premium would have been $200 all along.

The premium for a term policy increases every time it is renewed because the chances of your dying, and of the company having to pay the death benefit to your beneficiary, increase as you grow older. The premium for a whole life policy does not increase as you grow older because the premiums you pay when you are younger are much larger than what the company actually needs at that time to cover the risk of your death. The company puts most of what is left over into a separate account, called "cash value", which grows and earns interest every year. The interest helps pay for your policy. When you die, the company will use the case value to help pay the death benefit to your beneficiary. For example, if you buy a $10,000 policy when you are 35, by age 65 the policy might have a cash value of about $5,000. If you die that year, the company will pay your beneficiary $5,000 of its own money plus the cash value of $5,000. Of course, if you live longer and keep your policy, the cash value will continue to grow. At the same time, the company's share of the death benefit it will have to pay your beneficiary when you die will continue to decrease. So you can look at a whole life policy as a combination of (1) a kind of savings account that grows and earns interest, and (2) a decreasing amount of lifetime term insurance. While your beneficiary will receive the same death benefit regardless of when you die, the company will risk less of its own money as the years go by and your cash value increases. This is the main reason why whole life premiums do not increase as you grow older.

While premiums for an Ordinary Life policy must be paid as long as you live, premiums for some whole life policies only have to be paid for a certain number of years. For example, a policy whose premiums must be paid until age 65 is called "Life Paid Up at 65". If premiums must be paid for 20 years, the policy is called "Twenty Payment Life". with either of these policies, you are still covered for the rest of your life. The premiums are somewhat larger though because the number of premiums you have to pay is limited. Since the cash value also grows faster, the company's share of the risk decreases more quickly. For example, an Ordinary Life policy you buy when you are 35 has a cash value of about $2,200 after 15 years. But under a Twenty Payment Life policy the cash value is about $3,600.

Almost all whole life policies have a clause called a "settlement option" under which you can cash in or "surrender" the policy when you are old enough to retire and then use the cash value to buy a retirement income plan, called an "annuity", which is guaranteed by the company.

Death Benefits

The amount of the death benefit under most policies is the same from year to year. But the death benefit varies with some policies. The "Policy Summary" which is attached to every policy will show the amount of the death benefit for each of the first 5 years and in the 10th and 20th years of the policy.

Premiums

The amount of the premium under most whole life policies is also the same from year to year. But, also like the death benefit, the premium varies with some policies. The Policy Summary will show the amount of the premium for each of the first 5 years and the 10th and 20th years of the policy.

Under most policies, you can pay your premium monthly, quarterly or semi-annually, instead of annually. But if you pay in installments you will pay an extra charge based upon a percentage of the premium. If that charge amounts to an Annual Percentage Rate of more than 12%, the Policy Summary will show the rate.

Although every policy requires you to pay the premium on a certain date, the law lets you pay without penalty within a "grace period" of 30 days. If you forget to pay within this grace period, the company may drop the policy unless there is a clause in the policy that pays premiums automatically when you can "reinstate" it, or put it back into effect, by paying the premium within a limited number of days.

Policy Loans

If you buy a whole life policy, you can borrow against it for any purpose you wish once the cash value has begun to build. Generally speaking, the maximum amount you can borrow is the amount of the cash value. If you borrow against your policy, you have to pay interest on the loan, but you do not have to repay the loan itself. However, if you do not repay the loan, the amount of the loan and any interest you still owe will be deducted from the death benefit which the company pays to your beneficiary when you die, or from the cash value of the policy if you surrender it.

Dividends

Most policies sold in this State are called "participating" and pay something called "dividends". Policy dividends are not the same as dividends that stock or a credit union pays. They are not taxed as income from an investment because they are really a refund of part of the money collected in premiums. Participating policies do not have to pay dividends, but they almost always do because it usually turns out that the company collected more in premiums than it needed. This happens because the company has to set premiums based upon assumptions about future death and interest rates and the cost of doing business. Since no one can predict the future, the company makes its assumptions on the safe side. When the company's experience turns out to be better than it had predicted, there is a surplus of premium money. Part of that surplus is returned as dividends to the people who have policies. The Policy Summary will show the amount of the cash dividends you can expect to receive, based upon past experience, for each of the first 5 years and in the 10th and 20th years of the policy.

Dividends can be paid in cash or used for other purposes, like purchasing more insurance.

Rates of Return

Whole life policies do not all cost the same. some are much better buys than others. It is hard to comparison shop for the best buy in life insurance because cost is affected by so many factors and because there are so many different kinds of policies. But experts have develped a method, called "Rate of Return", which makes this job a lot easier.

Rates of Return are percentages, like interest rates. The Policy Summary shows Rates of Return for a policy if it is kept in force for 5, 10 and 20 years, respectively. These numbers can help you in 2 ways: (1) they can help you decide whether to buy whole life or term insurance, and (2) they can help you choose a whole life policy with the lowest cost. If the Policy Summary for a certain policy shows Rates of Return that are high when compared with the interest rates on other types of investments, such as savings accounts or credit union shares, then that policy is probably a good investment. If you are comparing one policy with another, look for the one with the higher Rates of Return. That policy is probably going to be a better buy over the long run.

When you compare a policy's Rates of Return with the interest rate on a savings account or other safe investment, you should remember that interest on the cash value of a whole life insurance policy is not taxed until you surrender the policy. Even then, the amount that can be taxed may be very small. So you may want to compare the Rates of Return for a policy with after-tax returns on other investments. For example, if you are in a 20% tax bracket, a 4% Rate of Return under a whole life policy is about the same as a 5% interest rate on a savings account or other fully taxable investment.

The Rate of Return for the first few years of a whole life policy is very often negative. This is because a lot of the money that would otherwise go toward building cash value is used instead to pay sales commissions and other start-up costs. So do not buy a whole life policy unless you plan to keep it for many years. A policy which may seem a good buy after 10 or 20 years may be very expensive if you surrender it within the first few years.

THINGS TO REMEMBER

TAKE YOUR TIME WHEN DECIDING TO BUY LIFE INSURANCE. THINK CAREFULLY ABOUT WHAT KIND OF PROTECTION YOU NEED AND HOW MUCH. DECIDE WHAT YOU CAN AFFORD. ASK AN AGENT TO EXPLAIN ANYTHING YOU DO NOT UNDERSTAND. SHOP FOR THE BEST BUY WITH HIGH RATE OF RETURN. DO NOT BUY LIFE INSURANCE UNLESS YOU CAN PAY FOR IT AND INTEND TO KEEP IT."

B. A "cash dividend" is the currently illustrated dividend which can be applied toward payment of the gross payment.

C. "Generic name" means a short title which is decriptive of the premium and benefit patterns of a policy or a rider.

D. "Policy summary" means, for the purposes of this section, a written statement decribing the elements of the policy including, and limited to, the following items:

(1) A prominently placed title as follows: LIFE INSURANCE POLICY SUMMARY;

(2) The name and address of the insurance agent, or, if no agent is involved, a statement of the procedure to be followed in order to receive responses to inquiries regarding the policy summary;

(3) The full name and home office or administrative office address of the company in which the life insurance policy is to be or has been written;

(4) The generic name of the basic policy and each rider;

(5) The following amounts, where applicable, for the first 5 policy years and the 10th and 20th policy years:

(a) The annual premium for the basic policy and, shown separately, for each optional rider.

(b) The amount payable upon death at the beginning of the policy year, regardless of the cause other than excluded causes, under the basic policy and, shown separately, under each optional rider;

(c) The cash surrender value at the end of the policy year under the basic policy and, shown separately, under each optional rider; and

(d) The cash dividends payable at the end of the policy year under the basic policy and, shown separately, under each option rider;

(6) If the policy is an annuity, the policy summary shall not include the items required in subparagraph (5), division (b). If the annuity contains both given and current rates, the average annual Rate of Return shall be shown under subparagraph 9 for both. In the case of flexible premium annuities, the information on savings shall be determined on the assumption that annuity consideration will be made at the rate of $1,000 per year;

(7) The effective policy loan annual percentage interest rate, if the policy contains this provision specifying whether this rate is applied in advance or in arrears. If the policy loan interest rate is variable, the policy summary includes the maximum annual percentage rate;

(8) The Annual Percentage Rate, if more than 12%, charged for the privilege of making premium payments monthly, quarterly, semi-annually or otherwise periodically and more frequently than annually;

(9) The average annual Rates of Return, where applicable, if the basic policy is kept in force 5, 10 and 20 years. The items in this subparagraph shall be diplayed separately from and more conspicuously than any other items included in the policy summary except the item required by subparagraph (7). The Rates of Return under this subparagraph shall be calculated on the basic policy only unless any optional riders have cash values at the end of the policy years for which the Rates of Return are shown;

(10) A policy summary which includes Rates of Return shall also include the following: "The Rate of Return (ROR) is an estimate of the earning power of your cash value. ROR can help you choose between whole life insurance and some other investment, as well as show you which of 2 whole life policies is a better buy. REMEMBER, LOOK FOR POLICIES WITH HIGH RATES OF RETURN;"

(11) A policy summary which includes dividends shall also include a statement that dividents are based on the company's current dividend scale and are not guaranteed; and

(12) The date on which the policy summary is prepared.

The policy summary must consist of a separate document. All information required to be disclosed must be set out in a clear and meaningful manner so as not to minimize or render any portion thereof obscure. If more than one insured is covered under one policy or rider, death benefits shall be displayed separately for each insured or for each class of insureds if death benefits do not differ within the class. Zero amounts shall be displayed as zero and shall not be displayed as blank a space.

E. "Rate of Return" means the so-called LINTON YIELD described in the Society of Actuaries "Analysis of Life Insurance Cost Comparison Index Methods" at 28-30.

3. Disclosure requirements.

A. The insurer shall provide, to all prospective purchasers, a buyer's guide prior to accepting the applicant's initial premium or premium deposit, and shall deliver a policy summary with the policy or prior to delivery of the policy. However, the insurer shall not be required to provide a buyer's guide if the applicant is purchasing an annuity.

B. The insurer shall provide a buyer's guide and a policy summary to any prospective purchaser upon request.

4. General rules.

A. Each insurer shall maintain at its home office or principal office, a complete file containing one copy of each document authorized by the insurer for use pursuant to this section. The file shall contain one copy of each authorized form for a period of 3 years following the date of its last authorized use.

B. An agent shall inform the prospective purchaser, prior to commencing a life insurance sales presentation, that he is acting as a life insurance agent and inform the propsective purchaser of the full name of the insurance company which he is representing to the buyer. In sales situations in which an agent is not involved, the insurer shall identify its full name.

C. Terms such as financial planner, investment advisor, financial consultant or financial counseling shall not be used in such a way as to imply that the insurance agent is generally engaged in an advisory business in which compensation is unrelated to sales unless that is actually the case.

D. Any reference to policy dividends must include a statement that dividends are not guaranteed.

E. A presentation of benefits shall not display guaranteed and nonguaranteed benefits as a single sum unless they are shown separately in close proximity thereto.

F. For the purposes of this section, the annual premium for a basic policy or rider, for which the company reserves the right to change the premium, shall be the maximum annual premium.

G. This section does not prohibit the use of additional material which is not in violation of this section or any other statute or regulation.

5. Failure to comply. Failure of an insurer to provide or deliver a Buyer's Guide, or a policy summary as provided in subsection 3 shall constitute an omission which misrepresents the benefits, advantages, conditions or terms of an insurance policy.

Rules and regulations. Subject to the Maine Administrative Procedure Act, the Superintendent of Insurance shall adopt rules for the purpose of defining Rates of Return and their calculation.

STATEMENT OF FACT

The purpose of this bill is to require insurers to deliver to purchasers of life insurance information which will improve the buyer's ability to select the most appropriate plan of life insurance for his needs, improve the buyer's understanding of the basic features of the policy which has been purchased or which is under consideration and improve the ability of the buyer to evaluate the relative costs of various plans of life insurance. Other attempts have been made to accomplish these purposes, most notably the "Life Insurance Model Solicitation Regulation" adopted in 1976 by the National Association of Insurance Commissioners (NAIC). However, the NAIC model has been found to be deficient, particularly in the usefulness of its cost diclosure provisions, which are both too complex and relatively meaningless for the average consumer.

This bill offers a Buyer's Guide which is more readable and informative than NAIC's version. It also provides a cost disclosure method which is simpler and more helpful to consumers than other methods. This method, known as Rate of Return, enables consumers to compare not only similar insurance plans, as does the NAIC, but also dissimilar plans. It also permits a useful comparison between cash value life insurance and other forms of investment.