

October 24, 2022

To: NAIC Members
From: Director Judith L. French, Chair
Life Insurance and Annuities (A) Committee
RE: Survey Inquiry about Enhanced Cash Value Offers on Universal Life Insurance Policies

States have become aware of certain enhanced cash surrender value endorsements being marketed to universal life insurance policyholders after policy issuance. These endorsements give a policyholder a limited time to surrender a universal life insurance policy in exchange for an amount in excess of the policy's current cash surrender value. The National Conference of Insurance Legislators (NCOIL), during its most recent meeting in July, passed a Resolution (Attachment One) regarding these enhanced cash surrender value endorsements. The NCOIL Resolution asserts that these offers violate the "smoothness test" in the *Standard Nonforfeiture Law for Life Insurance* (#808), mimic life insurance settlements without including the same consumer protections, and should not be approved by insurance departments.

The NAIC Legal Division reviewed the history of Model #808 and the *Universal Life Insurance Model Regulation* (#585), paying specific attention to information surrounding the "smoothness test" and drafted the attached memorandum (Attachment Two). The memorandum recommends conducting a survey of state insurance departments to determine the prevalence of these endorsements in the marketplace as well as how those states that have seen these specific types of endorsements to universal life insurance policies have regulated them. As a result, this survey is being sent to the NAIC members for reply.

SURVEY

The enhanced cash surrender value endorsements we are inquiring about involve an offer to a policyholder to surrender or exchange a policy before a stated expiration date in exchange for a cash payment in an amount that exceeds the current cash surrender value of the policy. ****We are asking about riders marketed and added AFTER policy issuance, not enhanced cash surrender value endorsements offered and added to a policy at the time it is issued.****

- 1) Please provide your state and contact information (name, title, email, phone number) of the individual(s) willing to answer follow-up questions.
- 2) Have any enhanced cash surrender value endorsements for universal life policies been submitted in your state? If your answer is no, please skip to question 3. If your answer is yes, please continue with (a) – (e).
 - (a) Please name the companies that submitted enhanced cash surrender value endorsements;
 - (b) Please include how many versions of the endorsement each company submitted;
 - (c) Please include the class of policies and/or policyholders to which each endorsement applied;
 - (d) Is the method for determining the enhanced cash value disclosed? If yes, please include the method in your answer; and
 - (e) Please include the disposition of the endorsement filing, and if applicable, include a statutory or regulatory reference.
- 3) Have you received any formal or informal complaints or inquiries about enhanced cash surrender value options?

Please send survey responses to Jennifer Cook at jcook@naic.org by November 21, 2022.

Atlantic Corporate Center
2317 Route 34, Suite 2B
Manasquan, NJ 08726
732-201-4133
CHIEF EXECUTIVE OFFICER: Thomas B. Considine



PRESIDENT: Asm. Ken Cooley, CA
VICE PRESIDENT: Asm. Kevin Cahill, NY
TREASURER: Rep. Tom Oliverson, TX
SECRETARY: Rep. Deborah Ferguson, AR

IMMEDIATE PAST PRESIDENTS:
Rep. Matt Lehman, IN
Sen. Jason Rapert, AR

National Council of Insurance Legislators (NCOIL)

Resolution Identifying Certain Enhanced Cash Surrender Value Endorsements As Violating The Standard Nonforfeiture Law

**Adopted by the NCOIL Life Insurance & Financial Planning Committee on July 15, 2022 and the NCOIL Executive Committee on July 16, 2022.*

**Sponsored by Sen. Travis Holdman (IN); Co-sponsored by Rep. Tom Oliverson, M.D. (TX) – NCOIL Treasurer*

WHEREAS, the Standard Nonforfeiture Law for Life Insurance, based on National Association of Insurance Commissioners (NAIC) Model #808, is a pillar of United States insurance regulation; and

WHEREAS, State legislators have agreed with the public policy in the Standard Nonforfeiture Law and adopted it across the board, a rare example of uniformity not resulting from Federal mandate or NAIC accreditation standards; and

WHEREAS, the Model has been amended from time to time, including a major set of changes in 1980, labeled “extensive and dramatic” by the regulatory actuaries who drafted and recommended them¹; and

WHEREAS, before these amendments, the Standard Nonforfeiture Law required minimum surrender values and methods of calculating them, and the “extensive and dramatic changes” included the imposition of a separate “smoothness” requirement in a new Section 8 titled “Consistency of Progression of Cash Surrender Values with Increasing Policy Duration”; and

WHEREAS, the regulatory actuaries who drafted this new “smoothness” requirement plainly stated that its “underlying purpose is to require a reasonably orderly sequence of increases,” and to correct a prior defect that allowed “sharp increases”; and

WHEREAS, the Society of Actuaries, whose members had to comply with the significant new requirement, described the new “smoothness” requirement as prohibiting “erratic cash values,” “sharp jumps” and “spikes in the nonforfeiture structure,” and making illegal cash surrender “benefits discontinuous in nature...available only during certain windows of time”²; and

¹ 1981 NAIC Proc. Vol. II p. 837

² SOA Record, 1983 Vol. 9 p. 2004; SOA Record 1996 Vol. 22, No. 1, p. 5-6; 1996 NAIC Proc. 1Q p. 888.

WHEREAS, in the last few years, no more than three life insurers, and only one as a regular business practice, have begun offering “enhanced cash surrender value endorsements,” dramatically changing the terms of well-seasoned policies from their issued and approved policy forms, seeking to incentivize consumers to terminate policies and their death benefit protection by means of limited time, enormous increases in cash surrender value, in plain violation of the Standard Nonforfeiture Law standards described above; and

WHEREAS, these endorsements were submitted by companies who self-certified compliance with the insurance code and its Standard Nonforfeiture Law and generally approved by regulators without any evidence of consideration of the Standard Nonforfeiture Law smoothness requirement; and

WHEREAS, in nearly three years of discussion, including more than six months with NCOIL’s active involvement, neither regulators nor the insurers have proffered a plausible explanation of these products’ compliance with the Standard Nonforfeiture Law; and

WHEREAS, these enhanced cash surrender value offers trigger the exact consumer protection concerns identified by regulatory actuaries at NAIC in developing the Standard Nonforfeiture Law smoothness requirement (a consumer who surrenders her contract based on the terms of the issued policy, and its annual statements and illustrations, which never contemplated limited time, spiked offers, ends up receiving a fraction of the benefit for the same premium payments as a similar risk who surrenders a day later after receiving an enhanced cash surrender value offer); and

WHEREAS, arguments have been offered in favor of “enhanced cash surrender value” products, but said arguments pertain to a wholly different product—never asserted to be in violation of the insurance code and thus not objectionable to NCOIL—with the same “enhanced cash surrender value” name, which is a common rider offered at policy issuance, consisting of not a limited time, spiked offer to terminate the policy, but is instead a product designed to support the persistence, rather than the termination, of corporate owned policies due to the tax benefits of treating the surrender value as an asset; and

WHEREAS, limited time, spiked cash surrender value offers carry substantial risks of the same sort as the regulated product they mimic, life settlements, and the carriers who offer them do not follow the consumer protection statutes created by legislators to protect policyholders offered limited time, big cash incentives to give up their policies, such as rescission rights, intermediary fiduciary duty, physician certification of (elderly) consumer competence, and disclosure of competing alternatives; and

WHEREAS, elected legislators perform an essential oversight function over executive branch regulators in ensuring that the laws they pass are enforced as intended, a particularly important function here, where regulators asked legislators to pass “extensive and dramatic” new requirements, and where the licensed entities’ conduct is in blatant violation of the plain language descriptions of the law provided by its regulatory drafters and the actuaries who implemented the law at insurers; and

WHEREAS, State Constitutions definitively vest lawmaking authority in legislators, who by legislation authorize the creation of departments of insurance to serve as statutory regulators, whose authority is limited to the execution of the public policy established by the legislative branch; and

WHEREAS, abdication of enforcement of a central consumer protection law amounts to regulatory nullification of and rewriting of the insurance code and the displacement of the legislative branch's sole lawmaking authority by the executive branch; and

WHEREAS, NOW, THEREFORE, BE IT RESOLVED, that NCOIL, now calls upon state regulators to enforce the same Standard Nonforfeiture Law smoothness requirement that regulators requested legislators to add to the insurance codes, by withholding approval of, and rescinding any previous approval of, any non-compliant "enhanced cash surrender value" endorsements providing limited time, spiked cash surrender value offers incentivizing consumers to terminate their life insurance protection, and calls upon state legislative committees with oversight of insurance to monitor insurance departments' actions with respect to this matter; and

WHEREAS, BE IT FINALLY RESOLVED THAT, that a copy of this Resolution shall be distributed to the American Council of Life Insurers (ACLI); each State's Insurance Commissioner; the National Association of Insurance Commissioners (NAIC); and the Chairs of the Committees of insurance jurisdiction in each Legislative Chamber of each State.

TO: Judith L. French (OH), Chair
Life Insurance and Annuities (A) Committee

FROM: NAIC Legal Division

RE: Certain Enhanced Cash Surrender Value Endorsements

DATE: October 24, 2022

Background

States have become aware of certain enhanced cash surrender value endorsements being marketed to universal life insurance policyholders after policy issuance. These endorsements give a policyholder a limited time to surrender a universal life insurance policy in exchange for an amount in excess of the policy's current cash surrender value. In addition, the National Council of Insurance Legislators (NCOIL) adopted in July 2022 a *Resolution Identifying Certain Enhanced Cash Surrender Value Endorsements As Violating The Standard Nonforfeiture Law*. The NCOIL resolution asserts these offers violate the "smoothness test" in the NAIC *Standard Nonforfeiture Law for Life Insurance* (#808), mimic life insurance settlements without including the same consumer protections and should not be approved by insurance departments. The NAIC Legal Division was asked to provide guidance on these certain enhanced cash surrender value endorsements and the NCOIL resolution making recommendations on next steps to establish a uniform approach for states to take on this issue.

"Cash Surrender Value" and "Enhanced Cash Surrender Value Endorsements"

Cash surrender value is money an insurance company pays to a policyholder or an annuity contract owner if their policy is voluntarily terminated before maturity or an insured event occurs. This cash value is the savings component of most permanent life insurance policies, including universal life insurance policies. Cash surrender value applies to the savings element of life insurance policies payable before death. However, during the early years of a whole life insurance policy, the savings portion brings very little return compared to the premiums paid. To reduce policy expenses in the early years, insurance companies created a cash value enhancement rider. This rider increases the cash surrender value of a policy in the early years, primarily for tax and accounting purposes. These types of riders have been utilized for years and are a common rider issued at the original issuance of the policy and are not controversial in this context.

Instead, some states are finding and the NCOIL resolution addresses a recent practice by certain life insurance companies making limited time offers to policyholders to terminate their policy in exchange for an amount exceeding the policy cash surrender value. These offers are implemented through an

endorsement (called an enhanced cash surrender value endorsement) to an in-force universal life insurance policy. The NCOIL resolution provides: “[I]n the last few years, no more than three life insurers, and only one as a regular business practice, have begun offering ‘enhanced cash surrender value endorsements,’ dramatically changing the terms of well-seasoned policies from their issued and approved policy forms, seeking to incentivize consumers to terminate policies and their death benefit protection by means of limited time, enormous increases in cash surrender value, in plain violation” of the “smoothness” requirement of the Standard Nonforfeiture Law, the underlying purpose of which “is to require a reasonably orderly sequence of increases, and to correct a prior defect that allowed sharp increases” in cash surrender values from year to year.

Finally, the resolution goes on to provide that the “limited time, spiked cash surrender value offers carry substantial risks of the same sort as the regulated product they mimic, life settlements, and the carriers who offer them do not follow the consumer protection statutes created by legislators to protect policyholders offered limited time, big cash incentives to give up their policies, such as rescission rights, intermediary fiduciary duty, physician certification of (elderly) consumer competence, and disclosure of competing alternatives.”

Standard Nonforfeiture Law

The NAIC *Standard Nonforfeiture Law for Life insurance* (#808) defines minimum cash surrender values for life insurance policies. Section 3A of Model #808 provides that the cash surrender value shall be an amount not less than the present value, on the anniversary, of the future guaranteed benefits which would have been provided for by the policy minus the then present value of the adjusted premiums as defined in Section 5c. Insurers may have higher surrender values than those required by the nonforfeiture laws, but values cannot be lower.

In 1980, the Standard Nonforfeiture Law was amended to include Section 8, *Consistency of Progression of Cash Surrender Values with Increasing Policy Duration*. This is the “smoothness” requirement referenced in the NCOIL resolution, and in simple terms it prohibits sharp jumps or spikes in the nonforfeiture structure and prohibits benefits discontinuous in nature which are available only during certain windows of opportunity.

There was a recognition at that time that Model #808 did not work well for many modern life insurance products, specifically universal life insurance products, with flexible or non-level premiums or gross premiums lower than the statutory net premium, or for products with economic options that are not valued in the product’s statutory net premium. In response, Model #808 was further amended in 1980 to also include Section 6, *Nonforfeiture Benefits for Indeterminate Premium Plans*, which allows the insurance commissioner to promulgate regulations governing the approval of any plan of such a nature that minimum values cannot be determined by the other sections of the Standard Nonforfeiture Law; e.g., universal life insurance, which was in its infancy in 1980. “The basic problem with the Nonforfeiture Law is that cash values are defined in terms of present values (prospectively), while Universal Life cash values are calculated in terms of an accumulation since issue (retrospectively).” *Why Universal Life*, Buechner, Eason & Manzler (2nd ed. 1983), page 31.

Universal Life Insurance Regulation

As universal life products gained popularity, the NAIC adopted the *Universal Life Insurance Model Regulation* (#585) in 1983 pursuant to Section 6 of Model #808. Model #585 did contain Section 6, *Nonforfeiture*, but noticeably absent from this nonforfeiture provision were any smoothness requirements that would make Section 8 of Model #808 specifically applicable to universal life products. There was much debate as to how the nonforfeiture requirements should be applied to universal life. The flexible-premium aspect of universal life policies meant that future premiums and policy benefits could not be determinable at issue, so the traditional methodology of present value of future benefits minus present value of future adjusted premiums did not appear applicable. For nonforfeiture, Model #585 broke with the methodology of Model #808 and based minimum values on a retrospective accumulation. See *Life Insurance*, Black & Skipper (12 ed. 1994), page 582. However, consistent with Model #808, minimum cash surrender values for universal life products are determined under Model #585 based only on contract guarantees at the time of issue.

Current Status of State Smoothness Requirements for Universal Life

NCOIL has noted that since the adoption of Model #585 there have been subsequent discussions at the NAIC as to whether the smoothness test should be applied to universal life insurance, with both the American Academy of Actuaries (AAA) and Society of Actuaries (SOA) having supported the position that universal life policies be subject to the smoothness requirements consistent with Section 8 of Model #808. The argument has also been made that if Section 8 of Model #808 is to apply to universal life policies, amendments to Model #585 or separate guidance specifying how Section 8 of Model #808 would be applied would be needed, since the Section 8 methodology is based on a prospective calculation of cash values that is not directly applicable to universal life products. However, the NAIC has never issued specific guidance on this issue, and we are unaware of any state that has issued such guidance.

Due to this lack of NAIC or state guidance on the applicability of Section 8 of Model #808 to universal life insurance, the NAIC Legal Division cannot at this time provide definitive guidance on whether or how the smoothness test may apply to universal life insurance policies or how any application of the smoothness test to these products would impact traditional enhanced cash surrender value endorsements.

Applicability of Model #808 to Policy Endorsements

Some states have received letters similar to the resolution adopted by NCOIL, which calls upon state insurance regulators “to enforce the same Standard Nonforfeiture Law smoothness requirement that regulators requested legislators add to the insurance codes, by withholding approval of, and rescinding any previous approval of, any non-compliant ‘enhanced cash surrender value’ endorsements providing limited time, spiked cash surrender value offers incentivizing consumers to terminate their life insurance protection.” As previously noted, under Section 3A of Model #808, the minimum cash surrender values are to be based solely upon contract guarantees at the time of issue. To the extent that benefits or premiums are revised later during the term of a contract, Section 5c.C of Model #808 provides that future minimum nonforfeiture values are recalculated at that time:

In the case of policies which cause, on a basis guaranteed in the policy, unscheduled changes in benefit or premiums; or which provide an option for changes in benefits or premiums, other than

a change to a new policy; the adjusted premiums and present values shall initially be calculated on the assumption that future benefits and premiums do not change from those stipulated at the date of issue of the policy. At the time of any change in the benefits or premiums, the future adjusted premiums, nonforfeiture net level premiums and present values shall be recalculated on the assumption that future benefits and premiums do not change from those stipulated by the policy immediately after the change. [Emphasis added].

Enhanced Cash Surrender Value Endorsements are offers to terminate an in-force policy in exchange for an amount that exceeds the policy cash surrender value. The offer and the amount of the offer is unknown at the time of original issue, and the amount is not guaranteed, and therefore pursuant to Model #808 would not be included in the nonforfeiture calculations (including application of the smoothness test) at the time of issue. However, the offer to terminate the contract in exchange for payment of an amount higher than the cash surrender value may be considered a change in the benefit (i.e. a higher cash surrender value), in which case, under Section 5c.C of Model #808, future nonforfeiture values would be recalculated (including application of the smoothness test) at the time of the change. Since the policy terminates upon payment of the endorsement, the nonforfeiture value would be the present value of the benefit, which equals the offer amount. Therefore, it can be argued that application of minimum nonforfeiture requirements to these endorsements would presumably have no impact on the amount of the offers. Again, we are not aware of any states that have addressed this issue.

NAIC Survey of State Practices with Respect to Certain Enhanced Cash Surrender Value Offers

Some interested parties argue that the smoothness requirement of the *Standard Nonforfeiture Law for Life Insurance*, NAIC Model #808, should supersede the nonforfeiture provisions of the *Universal Life Insurance Model Regulation*, NAIC Model #585. Those parties also argue that life insurance companies offering certain enhanced cash surrender value endorsements should be subject to the same disclosure requirements as viatical settlement providers (NAIC *Viatical Settlements Model Act* (#697) and *Viatical Settlements Model Regulation* (#698)) because the offers mimic viatical settlements and implicate the same consumer protection issues.

Given the lack of any known state guidance on these issues, it is the recommendation of the NAIC Legal Division that the Life Insurance and Annuities (A) Committee conduct a survey of state insurance departments as to the prevalence of these endorsements in the marketplace and how states that have seen these specific types of endorsements to universal life insurance policies, which terminate the policy in exchange for an amount that exceeds the policy cash surrender value, have regulated them. The Committee should then consider taking appropriate action with respect to the results of the survey.