COMMISSIONER OF SECURITIES AND INSURANCE

Troy Downing
Commissioner

Office of the
Montana State Auditor

ADVISORY MEMORANDUM

To: ALL LICENSED LIFE INSURERS AND ALL INTERESTED PERSONS

From: TROY DOWNING
Commissioner of Securities and Insurance, Office of the Montana State Auditor

Date: 05/05/2023

Inducing Termination of Death Benefits Through Endorsements Offering Time-Limited Enhanced Cash Surrender Values Not Available at Policy Issuance

Background

A small number of life insurers since 2019 have made enhanced cash surrender value offers, pursuant to an endorsement, not available and never contemplated at policy issuance, on certain seasoned universal life policies. These are limited time offers, frequently in an amount many times the issued policy's cash surrender value, being made for the stated purpose of inducing the owner to surrender the policy and terminate its protections for the owner's beneficiaries.

CSI has previously approved these endorsements in reliance on the filers' signed Certifications of Compliance, and their representations that each form "complies with the applicable provisions of Montana Code Annotated Title 33."

The National Council of Insurance Legislators (NCOIL) last year urged all state regulators to review whether these filings were compliant with state law.

Guidance

CSI has completed its review and concluded that short-term offers above the issued policy's cash surrender value in exchange for termination of the policy and its death benefits are non-compliant with the following provisions of the Montana Insurance Code.

<u>Unfair Discrimination, MCA § 33-18-206(1)</u>

Section 33-18-206(1), MCA, prohibits "unfair discrimination between individuals of the same class and equal expectation of life in…benefits payable…or in any other of the terms and conditions of such contract."

Examples of limited time, spiked offers reviewed by CSI include surrender value increases from $58,192 to $199,846, for 60 days; from $4,756 to $14,682, for four and a half months; from $19,037 to $360,601, for three months; and from $0 to $561,000, for 15 days.

Unfair discrimination is evident in a simple example in which two identical risks purchase the same policy on the same day and pay the same amount of premium for 20 years. If one surrenders today for $19,037 and the other receives and accepts an enhanced offer tomorrow for $360,601, then the second consumer has received almost 1,900% more benefits than the first, in return for the same 20 years of premium payments. That is "unfair discrimination between individuals of the same class and equal expectation of life in…benefits payable…or in any other of the terms and conditions of such contract."

<u>Standard Nonforfeiture Law, MCA § 33-20-210</u>

Section 33-20-210 is the Standard Nonforfeiture Law (SNFL) smoothness requirement, passed in 1983, which codifies Section 8 of NAIC Model #808 as amended in 1980.

The technical subcommittee at the NAIC which drafted the new law explained that its "underlying purpose is to require a reasonably orderly sequence of increases" in cash value and to correct a defect in the SNFL which allowed "sharp increases." Unless further limitations were adopted additional nonforfeiture "benefits might be discontinuous in nature"; and cause "spikes in the nonforfeiture structure."[1] The Society of Actuaries further described the smoothness requirement as precluding "erratic cash values"; "benefits available only during certain windows of time"; and "sharp jumps."[2]

The offers described herein do not meet the required smoothness standards, and universal life policies are not included in the list of enumerated "exceptions" to the SNFL in MCA § 33-20-212.

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[1] NAIC Proceedings 1981 Volume II, p. 837; 1996 NAIC Proc. 1st Qtr. 888.
[2] Transactions of the Society of Actuaries, 1983 Vol. 9 p. 2004; Society of Actuaries Task Force report dialog, SOA Record, Vol. 22, No. 1, May 1996, p. 5-6.

Misrepresentation Of Policies, MCA § 33-18-202

Section 33-18-202(1) prohibits "any…illustration…which…misrepresents the benefits, advantages, conditions, or terms of any insurance policy."

Enhanced Cash Surrender Value Products necessarily cause the following to occur. There is a period of time between the day the insurer decides to pursue such transactions and the day when it makes the offers. During that time, some policyholders will surrender at the issued policy's surrender amount, based on an illustration that does not inform them that they will later be eligible for a higher amount. In the example above, the first consumer surrenders for $19,037 based on an illustration that showed cash values staying at a similar amount in the future; then the next day the second consumer, an identical risk, receives an offer for $360,601. If the illustration had informed the first consumer that the policy's surrender value would increase by 1,900%, he would have held the policy for another day and received $360,601 instead of $19,037. But he never had the opportunity, because the illustration effectively "misrepresent[ed] the benefits, advantages, conditions or terms of any insurance policy," to the substantial detriment of the policyholder.

Conclusion

Although the CSI does not presently intend to pursue any enforcement actions against any insurer that has made an enhanced cash surrender value offer to a policyholder prior to May 5, 2023, CSI has concluded that these endorsements and offers violate the Montana Insurance Code.[3] Licensed life insurers, including those that have previously filed enhanced cash surrender value endorsements, should refrain from making offers on such products or face regulatory action and discipline to the full extent of Montana law. [4]

This advisory memorandum is informational only and does not enlarge, delimit, or otherwise modify any requirements of applicable law or in any way limit the authority of CSI under applicable law. CSI encourages interested persons to consult with independent legal counsel for guidance on the application of law to any particular circumstances.

[3] These products also call into question the nature of life insurance. Life insurance receives extraordinary preferential tax exemptions in return for the societal good provided by death benefit protections. The (small number of) insurers offering ECSV products, however, are proactively pursuing a stated goal of reducing claims by inducing policyholders into terminating their contracts, and their protections for their beneficiaries—in conflict with the public policy rationale for their products' preferential tax treatment.

[4] When ECSV products are offered to elderly or terminally ill individuals, such offers or transactions may also sidestep specific consumer protections at the heart of Montana's Viatical Settlement Act. *See, e.g.*, Section 33-20-1312, MCA (requiring proof that the policyholder or certificate holder has a terminal illness, is of sound mind, freely consents, and has full and complete understanding); Section 33-20-1311, MCA (requiring Commissioner-approved disclosure of alternatives, including available accelerated death benefits, and tax risks, possible claims of creditors, and possible impact on Medicaid eligibility).