COMMONWEALTH OF PUERTO RICO

OFFICE OF THE COMMISSIONER OF INSURANCE

Circular Letter AV-III-8-886-82
September 8, 1982

TO ALL LIFE INSURANCE COMPANIES AUTHORIZED
TO TRANSACT LIFE INSURANCE BUSINESS
IN PUERTO RICO

Re: Guidelines for the Submission and approval of Universal Life or Flexible Premium Adjustable Life Insurance contracts

Dear Sirs:

Universal Life or Flexible Premium Adjustable Life Insurance policies are contracts under which a certain percentage of the gross premium is accumulated with the interest credited thereon by the insurer. From the accumulated fund, periodic deductions are made to cover the cost of mortality and expenses. This fund is established solely for the benefit of the contract owner. The interest rate used in the accumulations depends generally upon the experience of the investment portfolio of the insurer, or the investment experience of the assets of the plan itself and,therefore, it is expected that these rates would be comparable to the interest rates given by financial institutions. Similarly, mortality rates depend on the mortality experience of the insurer. Both mortality and interest rates are nonguaranteed and would vary on an annual basis; and both rates would be favorable to consumers. Besides these rates, the contract provides for guaranteed rates which would comply with the requirements of the Insurance Code of Puerto Rico.

This Office recognizes that these contracts are in the consumer's best interest; however they differ in some significant respects from the traditional forms of life insurance products which are on the market today.

The following guidelines are designed to establish the contract provisions and filing requirements that these contracts must meet; they also assure that the aforesaid contracts are designed in a manner which will permit that the insuring public fully understands the operation and each element of the contract. The guidelines are not intended to cover every conceivable question that may arise. They are subject to modification and expansion as unforeseen questions arise.

When making a flexible premium adjustable life insurance contract filing with this Office, two copies of the contract must be submitted. In addition, the actuarial methodology and a sample calculation for the nonforfeiture values, as well as an actuarial memorandum describing the method to be used in calculating terminal reserves must be submitted with the filings.

I Contract provisions for compliance with sections 13.020 and 13.280 of the Insurance Code of Puerto Rico, 26 LPRA Sec. 1302 and 1328.

1. Provision must be made that the initial premium must be paid before any insurance becomes effective. It must be clear from the terms of the contract that no benefit is provided on the basis of any premium until that premium has actually been paid.

2. Provision must be made for the effective date of the policy and any future changes.

3. Provision must be made for a grace period of at least 30 days or 1 month, applicable when the accumulation value is no longer adequate to cover the monthly cost of insurance. The contract must provide that at least a thirty days written notice be sent to the contractholder's last known address prior to the contract lapsing. It should state that if the premium is not paid before the expiration of the grace period or before the expiration of the thirty days period after mailing of the notice, whichever is later, the contract will lapse. It must be clearly understood that if the insured dies during such period, the death benefit will be paid but reduced by the premium needed to cover the monthly deductions through the month of death.

4. If the contractowner has the right to increase the basic coverage, the contract must be clear as to whether a new period of contestability and suicide is applicable to the additional coverage.

5. Provision must be made for a nonforfeiture option upon default in a premium payment. The automatic deduction of the monthly cost of insurance from the accumulation value will be considered as a nonforfeiture option. The amount of death benefit in the event of discontinuance of premium payments must be clearly disclosed in the contract.

6. The policy should describe what percentage of gross premiums is considered for the accumulation of cash values and how monthly deductions are computed to cover the cost of mortality and expenses. Both the minimum monthly guaranteed

rate of interest that will be credited and maximum monthly guaranteed rate of mortality that will be used in computing the cost of insurance should be specified in the policy form. Should there be any charges upon partial or full surrender of the policy, then such charges should be stated. Further it should describe in detail the method that will be used in computing cash values.

7. A projection must be made part of the Policy Specifications showing the following minimal information:

Death Benefit

Cash Value

Paid up Term Period or
Extended Term insurance,

Paid Up Insurance Amount (if applicable)

This projection must be shown for at least twenty (20) years. It must be based on the assumption that a planned premium amount is payable for a fixed period of time, that the interest assumptions are based on guaranteed interest rates, and that the cost of insurance is based on the maximum charges. If applicable, the policy year when the cash value and paid up term period will be equal to zero must be stated. This table does not need to be captioned as "extended term insurance" or "paid up insurance", but must have understandable captions such as "Minimum Guaranteed Benefits and Values".

8. The actuarial methodology and a sample calculation for the nonforfeiture values must accompany the policy submission to this Office. Included in this must be a projection of cash values and death benefits using both guaranteed and currently assumed rates of interest and mortality. An actuarial memorandum describing the reserve valuation procedure must be submitted in duplicate. It must demonstrate that the reserves are at least as large as the minimum reserves required by section 5.100 of the Insurance Code of Puerto Rico.

Included in said memorandum there must be an actuarial demonstration in order to certify that Universal Life contracts generates cash values that are at least equal to statutory minimums as those required by section 13.280 of the Insurance Code of Puerto Rico. The first year expense charges mut be always less than or equal to those allowed under Section 3 of Rule XXVI of the Regulations of the Insurance Code of Puerto Rico.

II Additional Contract Requirements:

1. The "brief description" on the first page of the policy must be descriptive of the benefits provided.

2. All contract wording must be "readable" - as far as language, understandability and completeness within the contract.

3. All values and data shown in a contract must be based on guarantees. No figures based on nonguarantees can be included in a contract.

4. No contract should imply that coverage will be provided up to some specific date if it is not guaranteed up to that specific date. For example, some contracts include a "maturity date" beyond which coverage will not be provided. This Office objects to this term because of the traditional understanding that a death benefit will be paid at death prior to the maturity date if the scheduled premiums have been timely paid. This term however may be used if an adequate explanation is provided that coverage may not continue to the maturity date. This explanation must appear on the contract page disclosing the specific maturity date, or in a Termination of Coverage clause or in the first page of the Policy Specifications. An example of one acceptable explanation notice is a follows:

> "It is possible that coverage will Expire Prior to the maturity date of the contract where either no premiums are paid following the payment of the initial premium or subsequent premiums are not sufficient to continue coverage to the maturity date".

5. Policy captions and brief descriptive captions are acceptable such as "adjustable", "flexible", and so forth. However, slogan names such as "Universal", "T Plan", and so forth are unacceptable for use on a policy, application, or other contract forms. The policy caption and/or brief description must disclose the flexible nature of the premium.

Therefore because there is no universally accepted descriptive title for these contracts, the following must be provided: the policy rider and benefit captions, a detailed description of the basic policy coverage, and a description of the riders and supplemental benefits, if adjustable. The policy description must disclose the adjustable nature of the coverage, the protection period and the existence of the accumulation value and how it is affected by actual credited interest, expense fees and mortality costs.

6. Face amount of coverage. The initial face amount or benefit must be provided. If the cash value is included in the specified amount the death benefit must be stated. If the death benefit includes the cash value in addition to a specified amount, this must be stated.

7. Premiums. "The Minimum Guaranteed Benefit and Values Projection" must be provided based on the initial and the planned premium as specified on the application. The flexible nature of the premium amounts must be provided in detail. This explanation must disclose the time when the amount and mode of the planned premium can be changed; the minimum and/or maximum amount of any unscheduled or non planned premiums and when an unscheduled premium can be made. It must be fully understood, from the terms of the contract, how the unscheduled premiums will be applied to calculate the cash value.

If there is no minimum amount for a non "planned premium" specified in the contract then such limitation cannot be imposed by the insurer in the future. It must be stated in the policy provision if the non planned premium will be accepted subject to a maximum as the insurance company shall determine; otherwise such limitation cannot be imposed in the future.

8. Guaranteed Cash Values. Guaranteed cash surrender values must be provided based on the assumption that the planned premium is payable for a fixed period of time, that the interest assumptions are based on guaranteed interest rates, and that the mortality costs are based on the maximum charges.

9. Provision must be made for death benefits changes; it must include the conditions, requirements, limitations (if any) and the effective date of such changes. A new Projection Report, as described in Section IV of these Guidelines and an endorsement to the contract must be mailed to the policyholder to the last known address.

10. Reinstatement. There must be a provision which states that the policy may be reinstated at any time within three years (or more) after the date when the policy lapsed as described in the grace period provision and before the maturity date specified in the contract (if any). The requirements and limitations (if any), such as evidence of insurability for each life insured satisfactory to the insurer and payment of premium, must be included. It may provide for the repayment or reinstatement of any Policy Loan which existed on the date of termination with any loan interest. If the loan is not repaid or reinstated, then it may be specified that if the cash value is included on the designated amount then the outstanding policy loan and interest will be deducted from the designated amount. It must be clearly understood that this selection will be made exclusively at the option of the policyholder. The insurer may require a minimum premium sufficient to keep the policy in force for a period not to exceed two months from the effective date of reinstatement. The effective date of reinstatement must be stated in the contract. If a person other than the insured is covered by an attached rider, his

or her coverage will be reinstated according to this provision.

11. Conversion. There must be a provision to the following effect in the contract (or rider):

If a person other than the insured is covered by an attached rider and his or her coverage is terminated for reason of death of the insured or maturity of the policy or, in the case of children insurance, upon termination due to his age, then such person shall be entitled that the insurer issue to him, without evidence of insurability, an individual policy of life insurance without disability or other supplementary benefits, provided application for the individual policy shall be made, and the first premium paid, to the insurer, within 31 days after such termination. Such policy may be a "Universal Life" policy or a traditional permanent plan of insurance then available from the insurer, at the person's attained age. The converted policy shall be in an amount not in excess of the amount of life insurance which ceases because of such termination.

III In addition to the above, the insurance company must do the following:

1. Any brochures and sales material designed specifically for the product should be submitted with the policy forms.

2. A sample annual status report meeting the requirements provided in Section V of these Guidelines should be submitted with the policy forms.

3. A brief description of the company's marketing procedure for this product in Puerto Rico is required by this Office.

4. An Officer of the insurer must certify that these guidelines have been read and that the policy and the insurer's practice will comply with them.

It must be stated that any adjustments in mortality rates will be by class and based upon changes in future expectations for such factors as investment, mortality and persistency; the actuary must certify that such assumptions do not discriminate unfairly between new issues and in force policies.

5. The insurer must place on file with this Office a plan that will be used to keep the policyholder appraised of the progress of the insurance program and particularly with regards to information as to how accumulated results compare with the projections made when the policy was originally sold. Included in this plan must be an annual report

and a projection report in a form consistent with the requirements set forth in sections IV and V hereof.

6. The insurer upon request must notify in writing the policyholder of any reduction in the current rate of interest or return and any change in the mortality rate applicable to his or her policy.

7. At issue time the insurer must provide to the policyholder a projection showing, on both projected and guaranteed bases, premiums, death benefits and cash values for at least twenty (20) years. A sample of such illustration, meeting the requirements provided in section IV hereof, should be submitted with the policy forms.

8. A lapse notice should be mailed to the policyholder indicating the current status of the policy, including the date when the insurance coverage will cease based upon the current interest and mortality assumptions.

IV Projection Reports

Any Projection report that the insurer provides to the policyholder must comply with the following:

1. All projections must be made for at least twenty (20) years from the date of the report.

2. Any cash value projection based on current interest rate and mortality rate assumptions must also include a similar cash value illustration based on the guaranteed interest rate and the maximum mortality cost.

3. No projection will be made based on interest rates higher than those currently used or mortality risk charges lower than those currently used by the insurer at the date of the report.

4. Such report must include the following:

a. The current interest rate

b. The guaranteed interest rate

c. Initial premium and planned premiums

d. Minimum Death Benefits

e. Non Guaranteed projected Death Benefits

f. Guaranteed Cash Value

g. Non Guaranteed Cash Values

5. A prominent notice immediately preceding or following the projected values should be included stating the following:

> "The projected results of your insurance program may change with variation in interest rates and mortality charges. The projected values using "Current rates" of interest are not guaranteed and the values with guaranteed rates are the minimum that you will receive upon the surrender of the policy. Read your policy very carefully. In addition, there are other factors which could affect the projected values."

6. Guaranteed Cash Values

   a. If applicable, immediately preceding or following the guaranteed cash value illustration, a statement must be provided as to the date when the contract will cease to be in effect based on planned premiums being paid, interest credited at the guaranteed interest rate and the maximum cost of insurance being charged.

   b. If applicable, immediately preceding or following the guaranteed cash value illustration, a statement must be made as to the adjustable nature of the cost of insurance and the effect of any such change in the cost.

   c. If applicable, the disclosure of the loan interest charge must disclose the forfeiture of any excess interest paid on the portion of the cash value subject to loan.

V Annual Reports

1. The policy must provide for the delivery of a report which keeps the policyholder well informed of the progress of the policy. This report must be provided to the policyholder without charge at least annually. Any assumptions used in the report must be reasonable and the basis of the assumptions must be disclosed.

2. The report must provide retrospectively for the past year the following minimal information:

   a. Premium Paid

   b. Expense Charges

   c. Interest Credited

d. Mortality Charges

e. Partial Withdrawals

f. Outstanding Loans

g. Cash Surrender Values

3. In addition the report must include the following:

a. The amount of death benefits available for the following year on each life covered by the policy.

b. The rate of interest used in the calculation of the current year policy values. The similar expected rate for the period following the date of the report, including the period for which such rate is expected to remain at that level must be disclosed if it is calculated less frequently than on a monthly basis.

4. This report must comply with section IV(2), (3) (6) hereof.

5. In addition the insurer must provide upon request from the policyholder a projection report or a new proposal free of charge. Such projection must comply with section IV hereof and may be based on assumptions as to:

a. Specified amount.

b. Type of coverage option.

c. Future premiums payments as may be specified by the policyholder.

d. Such other assumptions which are necessary.

6. A copy of the annual report, completed as mentioned above, must accompany the policy submission to this Office.

VI Replacement

1. All of the requirements of Sections 1, 2 and 3 of Rule XLII of the Regulations of the Insurance Code of Puerto Rico apply to flexible premium adjustable life insurance contracts.

2. Due to the nature of flexible premium adjustable life insurance contracts, the written proposal as specified in Section 3(2) of said Rule must include the following:

a. Kind of Insurance - Because there is no universally accepted descriptive title for these contracts, the policy caption and a detailed description of the basic policy coverage must be provided. This description must disclose the flexible nature of the premium; the adjustable nature of the coverage, the protection period, and the existence of the accumulation value; and how it is affected by actual credited interest, expense fees, and mortality cost.

b. Current Benefit Amount

The initial face amount or benefit must be provided (assuming flexible premium adjustable life is the replacing policy).

If the Cash Value is included in the specified amount the death benefit must be stated.

If the death benefit includes the Cash Value in addition to a specified amount, this must be stated.

c. Policy Cash Value

Any comparative statement between the Cash Surrender Values under the policy to be replaced (if any) and those produced by this product must be provided based on the assumption that the planned premium is payable for a fixed period of time, that the interest assumptions are based on guaranteed interest rates, and that the mortality cost are based on the maximum charges.

d. Premiums - The cash value and benefit projection must be provided based on the initial premium and planned premium.

Failure to comply with these guidelines may be the basis for withdrawal of approval of the insurer's previously approved policy form, as well as the basis for the imposition of any other sanction prescribed by the Insurance Code of Puerto Rico, Strict compliance with the provisions herein stipulated is therefore required.

Cordially yours,

Juan Antonio García

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Commissioner of Insurance