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ANNOTATIONS TO POLICY LOAN INTEREST RATE BILL

A. General Discussion

The annotations elaborate on various aspects of the proposed language of the Bill.

The importance of substantial uniformity in enacting the Bill bears special emphasis. It cannot be too strongly urged that any material variation from the language of the Bill, particularly with respect to the index chosen, be carefully considered as to its impact on insurers issuing policies in more than one jurisdiction.

The Bill is intended to be an all inclusive law as to policy loan interest rates in order to achieve uniformity among the states. While some states have statutory specified maximum rates, other states are silent as to the maximum rate but may have usury laws applicable to policy loans. It is anticipated that the entire Bill will be enacted in each state and will replace any statutory language that currently applies to interest rates on policy loans.

B. Specific Discussion

The following sections key to the numbers set forth in the copy of the Bill preceding these annotations:

1. The Bill applies only to new policies issued after it is enacted. Thus, it will be some time before policies with indexed maximum interest rates on policy loans will be a substantial portion of any company's business and

have impact on the cash flow problems experienced periodically by reason of unusual policy loan activity. Section (b)(11) of AS 21.45.080, however, will permit the insurer and a holder of an outstanding policy to agree in writing to amend the policy so as to permit the application of provisions in accordance with the Bill.

2. An insurer would be required to include in a policy either an 8% maximum rate provision or an adjustable rate provision with a maximum based on an index. However, nothing in this Bill is intended to prevent an insurer from issuing all policies with an 8% maximum rate provision, all policies with an indexed maximum rate provision or some policies with one and some policies with the other.

3. A two-month period has been established between the time that is used as the monthly base for establishing the indexed rate and the time the adjustable indexed rate is determined and becomes effective. This two-month period is intended to give the insurer the necessary time in which to determine the actual rate to be charged at or below the maximum indexed rate as well as the time to notify policyholders with existing loans of any change in the rate reasonably in advance as required by subsection (c). Thus, for example, the monthly average for October is published by Moody's during the early part of November. An insurer during the remainder of November could determine the rate

that will be charged as of January 1 and take the administrative steps necessary to notify policyholders of any increase in the rate. Notices could be mailed on December 1 along with the premium notice or the policy loan or dividend statement. The rate would then become effective on January 1 as to all outstanding and new loans on or after that date.

4. This subsection provides for a floor under the indexed maximum rate approach, that is, a minimum on the maximum rate. Thus, whenever the index falls below the specified rate, the floor would apply. A minimum was considered necessary to ensure that the maximum policy loan interest rate would never be lower than the interest rate used to compute the policy's nonforfeiture values. In effect, the life insurer should, as a minimum, be able to charge an interest rate that is equivalent to the rate of interest earned by the policyholder on his policy's cash surrender values. This protects the insurer's solvency. An additional 1% has been added to the rate used to compute the nonforfeiture value in order to cover administrative expenses.

5. A policy issued with the indexed maximum rate provision must state how often the interest rate on policy loans may be changed by the company. That is, it must state whether the rate is to be determined quarterly, semiannually or annually.

6. The rate of interest on policy loans under the indexed maximum rate provision may be determined as often as every three months but must be determined by the insurer at least once a year. This permits flexibility so that each life insurer may choose a frequency of change compatible with the company's manner of doing business. The frequency with which a company intends to determine the interest rate is required to be included in the policy.

For example, if a company chose to determine interest rates once a year, it could do so by calendar or fiscal years or by policy anniversary dates. If a company chose to determine interest rates on a calendar year basis, the new rate, based on the average for October, would apply to loans outstanding or taken out on or after January 1 and would be in effect for the entire year. If policy anniversary dates were chosen, the company could establish a new rate every month for policies with anniversaries in that month and the new rate would continue for such policies until the next anniversary date. Thus, for such a company there could be twelve different rates set by reference to the indexed maximum but only one rate would apply to a particular policy from one anniversary to the next anniversary.

If a company chose to determine interest rates quarterly, it could do so on a calendar basis or by policy

anniversary dates. Thus, for example, a company could increase or decrease the interest rate as of January 1, April 1, July 1, and October 1 or at three month intervals during a policy year. The increase or decrease would be based on the index for the month ending two months would be October, January, April, and July, respectively. Rate changes would apply to all outstanding loans and new loans made after the effective date of the change but prior to the effective date of the next change.

7. Companies may increase their interest rate if the Moody's index is 1/2 of 1% or more above the rate actually being charged. Of course, a company is not required to increase the rate and may decide to keep the rate being charged well below the maximum permissible rate. This provision will prevent companies from changing the interest rate for insignificant amounts.

8. Companies are required to decrease the interest rate at the same frequency interval as they can increase the rate under the provisions of the policy whenever the indexed maximum rate is 1/2 of 1% or more below the rate actually being charged at that time. Thus, this subsection requires timely decreases in the rate as the index drops but is tempered by the 1/2 of 1% factor in order to avoid reducing the rate for an insignificant amount.

9. Provisions for notice have been established in order to protect the policyholder. Notice of the currently effective interest rate, whether the 8% maximum or indexed maximum is used, must be given at the time a cash loan is made. Advance notice of any increase in the policy loan interest rate must also be given to policyholders with outstanding loans affected by the increase. No advance notice is required of a decrease in the rate. Since it is not possible to provide advance notice with respect to automatic premium loans, notice should be given as soon as is reasonably practical after the rate is increased. Finally, all notices sent to policyholders must state the type of rate being used, that is, a maximum of 8% or the indexed maximum, and the frequency with which the company may change the variable rate.

10. Since, in many instances, it is impossible to tell in advance the amount of interest to be paid on a loan because of the flexible nature of the interest rate, there is the possibility, in situations where a maximum loan is taken, that a policy might lapse because of an increase in the interest rates. In order to avoid this possibility, the section now provides that a policy will not lapse during the policy year solely as a result of an increase in the interest rate during that policy year. The insurer must maintain coverage during that policy year until the time the

coverage would have terminated had the interest rate not been increased during that policy year. In other words, under these circumstances, the insurer must maintain coverage until the earlier of (1) the end of the policy year or (2) the time coverage would have terminated had the interest rate not been increased during the policy year. This provision along with the advance notice requirement gives the policyholder time to make sufficient payments to prevent termination of coverage.

11. The interest rate permitted on the reinstatement of policy loans for the period during and after the lapse of the policy shall be the same interest rate applicable to policy loans. This avoids the administrative complications that would ensue if a different rate were applicable to reinstatements of policy loans. However, interest on past due premiums would not be affected.

12. Since the Bill is intended as an all inclusive law as to policy loan interest rates, its provisions would be applicable to certificates issued by fraternal benefit societies. In almost all states they are governed by a separate code. The commercial insurance laws do not apply unless fraternal benefit societies are specifically mentioned. The provisions of the Bill are also applicable to annuity contracts when loans are provided for by such contracts.

13. Automatic premium loans are to be treated in the same manner as cash loans on a policy and would be subject to the same interest rate.

14. The Moody's Corporate Bond Yield Average - Monthly average Corporates was chosen as the index because it generally corresponds to the rates available to insurers on new long-term investments and consequently, its use promotes equity between policyholders who do borrow and those who do not. It is generally a smooth and stable long-term rate not subject to the volatile highs and lows from month to month of the various short-term rates. Nevertheless, it is responsive to the changing interest rates in the economy. Another factor in choosing this particular index is that it is the index adopted by the NAIC for its Model Standard Valuation and Nonforfeiture laws. Moreover, it is widely recognized and readily available. The monthly average is published by Moody's Investors Service, Inc. within a few days of the close of the calendar month. Thus, a policyholder or regulator could readily determine the maximum policy loan interest rates at any given moment.

15. Although Moody's Investors Service, Inc. has published the Corporate Bond Yield Average - Monthly Average Corporates for many years, this provision permits a similar index to be substituted in the event that Moody's or any successor thereto no longer publishes this particular index.

A substitute must be promulgated by the Director of Insurance in a regulation which would promote greater uniformity than a state by state determination and would also have a more permanent effect.

16. This section makes it clear that policies in existence prior to the effective date of the Bill could be amended, with the written agreement of the policyholder, to include the provision of the Bill.

17. The only change made in this section is a reference to the provisions of the loan interest provisions for computation of the amount to be paid on reinstatement.



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

May 25, 1982

The Honorable Ramona Barnes
Chairperson
House Judiciary Committee
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Representative *Ramona* Barnes:

I am writing to suggest that to the extent time permits in your committee's work on CSSB 535 consideration be given to the inclusion of provisions dealing with the subject of witness immunity in criminal prosecutions. As you may recall, I have submitted legislation in the past on this subject. It was favorably acted upon in the House but subsequently defeated in the Senate.

More recently during the course of a complex grand jury investigation, the state obtained a ruling from the Alaska Supreme Court that even in the absence of legislation the state could compel a witness to testify who asserted the privilege against self-incrimination through a conferral of immunity. The Supreme Court, however, subsequently ruled that the form of immunity which must be granted must be "transactional." This means that in order to obtain necessary testimony an individual must be given a full grant of immunity from prosecution for the subject matter of his testimony. The court imposed this requirement as a "rule of practice" rather than as a constitutional requirement. The state had contended that a lesser form of immunity, referred to as "use immunity", was all that is constitutionally required to substitute for the privilege against self-incrimination. The court, however, did not decide the constitutional question and the form of immunity which must be conferred in order to obtain testimony is therefore still a proper subject for legislative resolution.

Upon making inquiry, State Troopers in Anchorage recently advised me that they believed the problems which were encountered in the recent prosecutions in Anchorage in the Walker and Hopkins cases demonstrated the need for immunity legislation. After subsequent discussions with the Department of Law I fully share that belief. I also believe that these cases demonstrate why "use immunity" is

preferable to "transactional" as a matter of public policy. At present, Alaska is one of the very few jurisdictions which does not have a statutory framework for obtaining necessary testimony in criminal cases by providing immunity to witnesses. The National Advisory Committee on Criminal Justice Standards and Goals recommended in its Report of the Task Force on Organized Crime, released in December of 1976, that

States should enact or revise legislation to provide for immunity from the use of compelled testimony by witnesses before a grand jury, investigating commission, or State court having felony jurisdiction. These witnesses should receive only "use" immunity -- i.e., they should be immunized only from the use of evidence derived directly or indirectly from the compelled testimony.

Particularly with offenses that are conspiratorial in nature and committed under a high degree of secrecy by sophisticated or professional criminals, the key tool available in successfully solving and prosecuting the crime is the ability to compel testimony from a less culpable participant or an uncooperative witness.


The technical distinctions between the two types of immunity are usually understood only by persons trained in law. However, as a result of the publicity generated by two recent trials in Juneau, it is fair to say that Alaska citizens know far more about witness immunity than most people. In talking with members of the public it is clear that most citizen's notions of common sense are offended by the idea that under a "transactional" immunity standard, a convicted perjurer, for example, can be set completely free simply because his testimony is used to convict a co-defendant in a later trial. That result would not have occurred if the required immunity was "use and derivative use."

I have enclosed a draft of suggested amendments to CSSB 535 that would, if adopted, enact a "use immunity" statute in Alaska. These provisions are patterned after current federal law enacted in the Organized Crime Control Act of 1970. The constitutionality of this statute has been specifically upheld by the United States Supreme Court. While the Alaska Supreme Court has to date declined to decide the question, I am advised that there is good reason to conclude that such a statute would be upheld under the Alaska Constitution. The enclosed draft has been prepared at my request by the Chief Prosecutor who will be available to work with you and your committee on this subject if you wish. While I know the hour is exceedingly late, because of your demonstrated diligence and concern for matters of this nature plus the crescendo of current public interest, I am hopeful that in the time remaining in the current session

May 25, 1982

your committee will be able to address this important addition to CSSB 535 along with the amendments to the insanity defense on which I know your committee has already expended considerable effort.

Sincerely,



Jay S. Hammond
Governor

cc: Daniel W. Hickey
Chief Prosecutor

THE LEGISLATURE OF THE STATE OF ALASKA
TWELFTH LEGISLATURE

FISCAL NOTE

I. REQUEST

Bill/Resolution No. CSSD 841 (L&C)
 Title An act relating to insurance policy provisions on policy loans
 Requested by Labor and Commerce Committee Date 4/8/82
reinstatement of policies; & providing for an effective date.

II. FISCAL DETAIL

Agency Affected Division of Insurance
 Program Category Affected Public Protection
 BRU, Program, or Subprogram(s) Affected Division of Insurance
 (Note: If more than one budget component is affected, separate line-item amounts and funding for each component in the analysis section.)

EXPENDITURES (Thousands of Dollars)

	FY 82	FY 83	FY 84	FY 85	FY 86	FY 87
100 PERSONAL SERVICES	0					
200 TRAVEL	0					
300 CONTRACTUAL	0					
400 COMMODITIES	0					
500 EQUIPMENT	0					
600 LAND & STRUCTURES	0					
700 GRANTS, CLAIMS, ETC.	0					
TOTAL	0					

FUNDING (Thousands of Dollars)

GENERAL FUND	0					
FEDERAL FUNDS	0					
OTHER (Specify Source)	0					

POSITIONS

FULL TIME	0					
PART TIME	0					
TEMPORARY	0					

III. ANALYSIS (See Fiscal Note Preparation Instruction, Section III)

IV. DATE May 24, 1982

PREPARED BY Kenneth C. Moore, Div. of Insurance
AGENCY Commercial & Economic Development
 PHONE 465-2515

Original: Legislative Finance
 cc: Budget and Management
 Prime Sponsor (First Legislator Named)
 33-001 (Rev. 12/81)

STATE OF ALASKA

DEPARTMENT OF COMMERCE & ECONOMIC DEVELOPMENT

OFFICE OF THE COMMISSIONER

JAY S. HAMMOND, GOVERNOR

POUCH D
JUNEAU, ALASKA 99801
PHONE: 465-2500

LEGISLATIVE POSITION PAPER
SB 841
March 15, 1982

The Department of Commerce and Economic Development favors SB 841 if amended and recommends its passage.

The proposed legislation is based on a model law of the National Association of Insurance Commissioners. It would allow the use of either a fixed rate of interest on life insurance policy loans not to exceed 8% or the use of a flexible rate of interest which would be adjusted at least once a year based on an external index.

The current approach is to use a fixed rate of interest capped at 8%. This rate is generally lower than the cost of such loans and results in an impact on policyholders dividends since those funds in life insurance policy loans are not available for investment in more lucrative markets thus reducing income available for distribution as dividends. This impacts the ultimate net cost of life insurance. It also creates a subsidy of policyholders using the policy loan feature of the policy by those policyholders who do not use the policy loan feature.

The current cap has an impact on insurer liquidity thus impacting the flexibility they have in their investment portfolio. Income cannot be maximized which would accrue to the advantage of policyholders if it could be maximized.

Attached to this paper is a list of proposed amendments. Also attached is a section by section analysis and in some cases, a line by line analysis of the bill. The effect of proposed amendments is also explained in those comments.

E. W. Eboch 3/15/82

Edward W. Eboch
Deputy Commissioner

AMENDMENTS PROPOSED

On page 2, line 11
change "June 30" to read "July 1".

On page 2, line 13
following the word "issued" insert the words "on or".
change "June 30" to read "July 1".

On page 2, line 14
remove the words "permitting a maximum" and insert "specifying an".
remove the word "of" and insert "not to exceed".

On page 2, line 21
following the word "point" insert "a year".

On page 3, line 12
remove the word "because" and insert "as the sole result of the
change in"
remove the words "has changed".

On page 3, line 13
following the word "year" insert "; the insurer shall maintain
coverage during that policy year until the time at which the
policy would have terminated if there had been no change during
that policy year".

On page 4, line 2
following the word "made" insert "on or".
Change "June 30" to read "July 1"

On page 4, line 18
following the word "AS 21.45.080" insert "(c)".

COMMENTS

Introduced: 3/8/82
Referred: Labor & Commerce and
Judiciary

BY THE LABOR AND
COMMERCE COMMITTEE

NO CHANGES THIS PAGE

1 IN THE SENATE

2 SENATE BILL NO. 841

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 TWELFTH LEGISLATURE - SECOND SESSION

5 A BILL

6 For an Act entitled: "An Act relating to insurance policy provisions on
7 policy loans and reinstatement of policies; and provid-
8 ing for an effective date."

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * Section 1. AS 21.45.080(a) is amended to read:

11 (a) There shall be a provision that after three full years'
12 premiums have been paid and after the policy has a cash surrender value
13 and while no premium is in default beyond the grace period for payment,
14 the insurer will advance, on proper assignment or pledge of the policy
15 and on the sole security of the policy at a specified rate of interest
16 not exceeding eight percent a year, an amount equal to or, at the option
17 of the party entitled to it, less than the loan value of the policy.
18 The director may authorize rates of interest in excess of six percent
19 only on a finding that the holders of policies will benefit from the
20 increased earnings of the insurer resulting from the higher rates,
21 through the use of higher dividends or lower premiums, or both. The
22 loan value of the policy shall be at least equal to the cash surrender
23 value at the end of the then current policy year, except that the insurer
24 may deduct, either from the loan value or from the proceeds of the loan,
25 an existing indebtedness not already deducted in determining the cash
26 surrender value including interest then accrued but not due, the unpaid
27 balance of the premium for the current policy year, and interest on the
28 loan to the end of the current policy year. The policy may also provide
29 that if interest on an indebtedness is not paid when due it shall then

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1 be added to the existing indebtedness and shall bear interest at the
2 same rate, and that if and when the total indebtedness on the policy,
3 including interest due or accrued, equals or exceeds the amount of the
4 loan value of the policy, the policy shall terminate and become void.
5 The policy shall reserve to the insurer the right to defer the granting
6 of a loan, other than for the payment of a premium to the insurer, for
7 six months after the date of the loan application. The policy, at the
8 insurer's option, may provide for automatic premium loan, subject to an
9 election of the party entitled to elect. Except as provided in (e) of
10 this section, the required interest rates on policy loans set out in
11 this section apply only to policies issued before June 30, 1982.

12 * Sec. 2. AS 21.45.080 is amended by adding new subsections to read:
13 (c) A policy issued after June 30, 1982 shall have a provision
14 permitting a maximum interest rate on a policy loan of eight percent a
15 year,

On line 11, change "June 30" to read "July 1". Since the proposed effective date of this proposal is July 1, 1982, we feel that the use of July 1, in the language would be more consistent.

On line 13, following the word "issued", insert the words "on or" and change "June 30" to read "July 1".

On line 14, remove the words "permitting a maximum" and insert "specifying an", also delete the word "of" and insert "not to exceed".

This language change allows a policy loan interest rate up to 8% rather than requiring exactly 8% with nothing less permitted. This comports with the way it is done now and has been done in the past. It retains the "traditional" method of computing policy loan interest.

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16 | or a provision permitting an adjustable maximum interest rate
established under this subsection.

17 | An adjustable maximum rate of inter-
18 | est on a policy loan determined under this subsection may not exceed the
19 | higher of the published monthly average for the calendar month ending
two months before the date on which the rate is determined,

The principal component of this proposal is that it allows a life insurance company to use a policy loan interest rate that is adjustable subject to conditions set out in the proposal. The Insurer would have the option of offering a fixed rate of interest not to exceed 8% or of offering the adjustable rate of interest or both. The adjustable rate is based on an external index described in this section of the bill. The option selected must be described in the policy itself.

A two month period has been established between the time that is used as the monthly base for establishing the indexed rate and the time the adjustable indexed rate is determined and becomes effective. This two month period is intended to give the insurer the necessary time in which to determine the actual rate as well as the time to notify policyholders with existing loans of any change in the rate reasonably in advance as required on page 3, lines 2 - 6. Thus, for example, the monthly average for October is published by Moody's during the early part of November. An insurer during the remainder of November could determine the rate that will be charged as of January 1 and take the administrative steps necessary to notify policyholders of any increase in the rate. Notices could be mailed on December 1 along with the premium notice or the policy loan or dividend statement. The rate would then become effective on January 1 as to all outstanding and new loans thereafter.

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On line 21, following the word "point" insert the words "a year".

This clarification is needed since the period dealt with this provision could be as small as three months and as much as one year.

This provision provides for a floor under the indexed maximum rate approach, that is, a minimum on the maximum rate. Whenever the index falls below the specified rate, the floor would apply. A minimum is considered necessary to ensure that the maximum policy loan interest rate would never be lower than the interest rate used to compute the policy's nonforfeiture values. In effect, the life insurer should, as a minimum, be able to charge an interest rate that is equivalent to the rate of interest earned by the policyholder on his policy's cash surrender values. This protects the insurer's solvency. An additional 1% has been added to the rate used to compute the nonforfeiture value in order to cover administrative expenses.

A policy issued with the indexed maximum rate provision must state how often the interest rate on policy loans may be changed by the company. That is, it must state whether the rate is to be determined quarterly, semi-annually or annually.

The rate of interest on policy loans under the indexed maximum rate provision may be

or the rate
used to compute cash surrender values under the policy during the applicable period plus one percentage point.

If an adjustable maximum rate of interest is used in a policy under this subsection the policy shall contain a provision that states times for the adjustment of the interest rate for that policy.

Adjustment shall occur at least once every 12 months, but not more often than once every three months.

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determined as often as every three months but must be determined by the insurer at least once a year. This permits flexibility so that each life insurer may choose a frequency of change compatible with the company's manner of doing business. The frequency with which the company intends to determine the interest rate is required to be included in the policy.

For example, if a company chose to determine interest rates once a year, it could do so by calendar or fiscal years or by policy anniversary dates. If a company chose to determine interest rates on a calendar year basis, the new rate, based on the average for October, would apply to loans outstanding or taken out on or after January 1 and would be in effect for the entire year. If policy anniversary dates were chosen, the company could establish a new rate every month for policies with anniversaries in that month and the new rate would continue for such policies until the next anniversary date. Thus, for such a company, there could be twelve different rates set by reference to the indexed maximum but only one rate would apply to a particular policy from one anniversary to the next anniversary.

If a company chose to determine interest rates quarterly, it could do so on a calendar basis or by policy anniversary dates. Thus for example, a company could increase or decrease the interest rate as of January 1, April 1, July 1 and October 1 or at three month intervals during a policy year. The increase or decrease would be based on the

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index for the month ending two months prior to the change. For the calendar quarter example, the base months would be October, January, April, and July respectively. Rate changes would apply to all outstanding loans and new loans made after the effective date of change but prior to the effective date of the next change.

Companies may increase their interest rate if the Moody's index is 1/2 of 1% or more above the rate actually being charged. Of course, a company is not required to increase the rate and may decide to keep the rate being charged well below the permissible rate. This provision will prevent companies from changing the interest rate for insignificant amounts.

Companies are required to decrease the interest rate at the same frequency interval as they can increase the rate under the provisions of the policy whenever the indexed maximum rate is 1/2 of 1% or more below the rate actually being charged at that time. Thus, this provision requires timely decreases in the rate as the index drops but is tempered by the 1/2 of 1% factor in order to avoid reducing the rate for an insignificant amount.

26 | The interest
27 | rate being charged may be increased if the published monthly average
28 | increases by one-half percent or more

28 | and the interest rate being
29 | charged must be reduced if the published monthly average decreases by
30 | one-half percent or more.

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SB 841

1 | A life insurer shall (1) notify the policy-
2 | holder of the initial rate of interest on the loan at the time a cash
3 | loan is made; (2) notify a policyholder who obtains a premium loan of
4 | the initial rate of interest on the loan as soon as it is reasonably
5 | possible to do so after making an initial premium loan; except as
6 | provided in (3) of this subsection, notice does not have to be given to
7 | the policyholder when a second or subsequent premium loan is added; (3)
8 | send reasonable advance notice of any increase in the rate to a policy-
9 | holder who has a policy loan; and

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10 (4) include other relevant information on adjustment of interest rates in a notice required under this subsection.

Provisions for notice have been established in order to protect the policyholder. Notice of the currently effective interest rate, whether the 8% fixed maximum or indexed maximum is used, must be given at the time a cash loan is made. Advance notice of any increase in the policy loan interest rate must also be given to policyholders with outstanding loans affected by the increase. No advance notice is required of a decrease in the rate. Since it is not possible to provide advance notice with respect to automatic premium loans, notice should be given as soon as is reasonably practical after the rate is increased. Finally, all notices sent to policyholders must state the type of rate being used, that is, a maximum of 8% or the indexed maximum, and the frequency with which the company may change the variable rate.

11 The loan value of the policy shall be determined in accordance with (a) of this section.

This proposal does not act as a repealer of the current statutory provisions relating to the loan value of the policy which is found in AS 21.45.080(a) on page 1 and 2 of this proposal.

12 A policy may not be terminated in a
13 policy year because the interest rate has changed during that policy year.

On line 12 delete the word "because" and insert the words "as the sole result of the change in" also remove the words "has changed"

On line 13, following the word "year" remove the period and add "; the insurer shall maintain coverage during that policy year until the time at which the policy would have terminated if there had been no change during that

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policy year".

This provision lost something in the drafting which hopefully this correction will resolve. Since, in many instances, it is impossible to tell in advance the amount of interest to be paid on a loan because of the flexible nature of the interest rate, there is the possibility, in situations where a maximum loan is taken, that a policy might lapse because of an increase in the interest rates. In order to avoid this possibility, this provision prevents a policy from lapsing during the policy year solely as a result of an increase in the interest rate during what policy year. The insurer must maintain coverage during that policy year until the time the coverage would have terminated had the interest rate not been increased during that policy year.

See comments on Sec. 3 of the bill.

Automatic premium loans are to be treated in the same manner as cash loans on a policy and would be subject to the same interest rate.

Moody's Investors Service, Inc. has published the Corporate Bond Yield Average - Monthly Average Corporates for many years. It was chosen as the index because it generally corresponds to the rate available to insurers

14 (d) In (c) of this section

15 (1) "interest rate" includes a rate of interest charged for
16 reinstatement of policy loans for the period during and after the lapse
17 of a policy;

18 (2) "policy" includes certificates issued by a fraternal
19 benefit society and annuity contracts that provide for policy loans;

20 (3) "policy loan" includes a premium loan made under a policy
21 to pay a premium that was not paid to the life insurer as it became due;

22 (4) "policyholder" includes an owner of a policy or a person
23 designated to pay policy premiums according to the records of the life
24 insurer;

25 (5) "published monthly average" means the monthly average of
26 corporate bond yields as published by Moody's Investors Service, Inc.,
27 or its successor, or if Moody's corporate bond yield average-monthly
28 average corporates is not published, a substantially similar average,
29 established by regulation adopted by the director.

COMMENTS

on new long term investments and consequently, its use promotes equity between policyholders who borrow against their policy and policyholders who do not borrow. It is generally a smooth and stable long-term rate not subject to the volatile highs and lows from month to month of the various short-term rates. Nevertheless, it is responsive to the changing interest rates in the economy. Another factor in choosing this particular index is that it is the index adopted by the National Association of Insurance Commissioners for its Model Standard Valuation and Nonforfeiture Laws. Moreover, it is widely recognized and readily available. The monthly average is published within a few days of the close of the calendar month. Thus, a policyholder or regulator could readily determine the maximum policy loan interest rates at any given moment.

The provision permits a similar index to be substituted in the event that Moody's or any successor thereto no longer publishes this particular index.

1 (e) The provisions of (c) of this section on interest rates apply
2 to all policy loans made after June 30, 1982 except that if a policy
3 holder agrees in writing to the applicability of (c) of this section to
4 a policy issued before July 1, 1981, that subsection applies to the
5 policy.

On line 2, following the word "made" insert "on or". Also change "June 30" to read "July 1".

This section makes it clear that policies in existence prior to the effective date of this proposal could be amended, with the written agreement of the policyholder, to include the provisions of this proposal.

COMMENTS

6 * Sec. 3. AS 21.45.110 is repealed and reenacted to read:

7 Sec. 21.45.110. REINSTATEMENT. Except as provided in AS 21.45.-
8 230, there shall be a provision that unless (1) the policy has been
9 surrendered for its cash surrender value, (2) its cash surrender value
10 has been exhausted, or (3) the paid-up term insurance, if any, has
11 expired, the policy will be reinstated at any time within three years
12 (or two years in the case of industrial life insurance policies) from
13 the date of premium default upon written application, the production of
14 evidence of insurability satisfactory to the insurer, the payment of all
15 premiums in arrears with interest at a rate not exceeding six percent a
16 year compounded annually, and the payment or reinstatement of interest
17 due to the insurer on a loan on the policy with interest as provided in
18 AS 21.45.080.

19 * Sec. 4. This Act takes effect July 1, 1982.
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On line 18, following "AS 21.45.080" add "(c)"

The interest rate permitted on the reinstatement of policy loans for the period during and after the lapse of the policy shall be the same interest rate applicable to policy loans. This avoids the administrative complications that would ensue if a different rate were applicable to reinstatements of policy loans. However, interest on past due premiums would not be affected.

POLICY LOAN BILL ENACTMENTS

(As of 5/21/82)

Alabama	North Carolina
Arizona	North Dakota
Arkansas	Ohio
California	Oklahoma
Colorado	Oregon
Connecticut	Pennsylvania
Florida	Rhode Island
Idaho	South Dakota
Illinois	Tennessee
Indiana	Texas
Kansas	Utah
Maine	Vermont
Massachusetts	Virginia
Nebraska	Washington
Nevada	Wisconsin

5/24/82 32 ENACTMENTS
3 Awaiting gubernatorial Action

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May 21, 1982

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The Honorable Ramona Barnes
Chairwoman
House Judiciary Committee
Pouch V
Juneau, AK 99811

Re: SB 841

Dear Representative Barnes:

All of us have been aware that in the last two or three years interest rates have fluctuated greatly, but mostly upwards. This is not an isolated occurrence, as there have been surges of interest rates on at least four occasions in the past 20 years. It has, however, been an unusually persistent and extreme upward surge, and it has caused a number of distortions and problems throughout the Alaskan and American economies. The Legislature has constantly reviewed the needs of the people of the State with regard to interest rates, and has begun to set maximum rates on a basis which adjusts automatically to known indexes.

One place where high interest rates have caused very substantial problems is in the life insurance industry. In the past several years, borrowings against company funds by a minority of policy holders, at rates which have been held artificially very low by statute, have caused distortions that are bad for the economy, could be dangerous to some companies, and are unfair to the majority policy holders. This letter is intended to introduce you to the problem and sister states.

NATURE OF THE PROBLEM

A survey of 15 representative large life insurance companies was conducted as of September, 1981. That survey showed that loans to policy holders at rates of 5%, 6%, and 8% in the month of September alone aggregated over \$750 Million for the 15 companies. This was 9% more than was lent the month before, and 82% more than was lent by the

The Honorable Ramona Barnes
May 21, 1982
Page Two

same companies in September of 1980. In 1980, net lendings to policy holders by the same 15 companies totaled nearly \$4 Billion. That was a benefit to the borrowers, of course, but everyone else lost.

The diversion of company funds to very low interest loans to some policy holders is dramatically unfair to those who do not borrow. As one might expect, the heavy borrowing is for the most part done by those policy holders who have very large policies and some degree of financial sophistication. A majority of policy holders do not borrow against their policies, but retain their values for the purposes originally intended, the security of dependents in the case of the death of the insured. Because the diversion of these funds for policy loans means a substantial decrease in earnings as well as liquidity, the companies are unable to lower their premiums or pay higher dividends, and that is an impact that reaches those who do not borrow just as much as it reaches those who do.

The surge of policy loans has also restricted investment capital, at a time when the country is short of capital. To the extent that companies' funds were tied up in low-rate loans, they have been unable to make the kind of capital investments that they are normally involved in. This, in itself, is a substantial distortion of the economy, since many companies planning plants, office buildings, real estate developments, and other investments have not been able to find alternative sources of funding.

Some companies, faced with an extraordinary and unprecedented demand for policy loan funds, have had to raise funds by sales of securities, often at substantial losses. Some companies have not been able to liquidate enough securities, and have had to borrow at rates up to 20% in order to loan at 5% to 8%. This sort of short term borrowing by life insurance companies is relatively unusual, and obviously cannot be undertaken as a long term practice. Depending upon such factors as long term interest trends and the ability of companies to extricate themselves from long term investments in order to maintain liquidity, this problem could threaten the solvency of some companies.

NATURE OF THE SOLUTION

The bill before you, SB 841, ties interest rates on policy loans to a conservative, stable index which is responsive to long term changes in interest rates. That index is Moody's Corporate Bond Average Yield Index. This index would be applicable only to loans against policies

The Honorable Ramona Barnes
May 21, 1982
Page Three

which are issued after the effective date of the act, unless a policy holder specifically agrees in writing that the flexible rate will apply to his earlier issued policy. Other provisions protect the policy holder by requiring specific notices of rate changes at appropriate times, and prohibiting unintended lapses of policy coverage because of interest rate changes.

The general approach used in this bill has been used successfully in Canada for over 10 years. Bills substantially identical to the one proposed were enacted in 1981 in 19 states.

In 1980, the Legislature inserted a requirement in the policy loan section that required the Director of Insurance to make a finding that a proposed policy loan rate would result in a benefit to the policy holder of decreased premium or increased dividend before a rate over 6% could be authorized. That protection will still be in the statute, and the companies have no doubt at all that the benefit will be there.

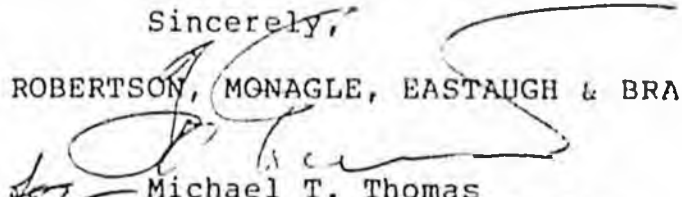
The bill is supported by life insurance companies of all kinds and sizes, by the American Council of Life Insurance, by the National Association of Life Underwriters, and by the Alaska State Association of Life Underwriters. This last support is noteworthy, since many life underwriters have been dubious about any proposal that could increase policy loan interest rates.

Accompanying this letter are a short memorandum explaining the bill, and a copy of the bill with annotations explaining particular provisions in the context of the overall proposal. A substantial amount of additional information concerning the impacts of the recent borrowing trends on the industry, and studies done in particular states about the impacts on companies in those states is available, and I would be happy to attempt to obtain any further information that you might find helpful.

I appreciate that you have many problems before you that seem to you more immediate and pressing. I would not push this bill in this particular year if we were not convinced of its necessity and fairness. Thank you for your consideration and support.

Sincerely,

ROBERTSON, MONAGLE, EASTAUGH & BRADLEY


Michael T. Thomas

For the American Council of Life Insurance

MTT/kmp
Enclosure

MEMORANDUM IN SUPPORT OF SB 841

PURPOSE OF THE BILL:

To expand the loan interest rate provision in life insurance policies, annuity contracts and fraternal benefit society certificates issued on and after the effective date of the bill to permit the offering of policies containing an adjustable maximum interest rate on policy loans.

SUMMARY OF THE PROVISIONS OF THE BILL:

AS 21.45.080 would be amended to authorize the issuance of policies with adjustable as well as fixed policy loan interest rates and a conforming amendment would be made to AS 21.45.110.

The adjustable provision would set the maximum rate on policy loans by reference to the Monthly Average Corporates yield shown in the Moody's Corporate Bond Yield Averages. The frequency with which the rates could be determined and adjusted would be limited. Provision would be made for increases and decreases in the maximum rate as conditions change. A reduction of the rate would be required when the index declined by 1/2%. Appropriate notices to policyholders of interest rate changes and protection against the termination of policies because of increases in the adjustable rate would be provided. Existing policyholders would be permitted to amend their policies to provide for the adjustable rate.

Any change in interest rate is subject to the requirement placed in the statute in 1980 that the Director of Insurance find that policyholders will benefit from higher dividends or lower premiums.

HOW THE BILL WORKS:

Companies for competitive and other reasons may continue to issue policies with a fixed interest rate, no more than 8%. The bill will also permit policies to be issued with a fully adjustable policy loan interest rate with the maximum to be set by reference to an external index. This will permit insurers to attempt to equalize yields on policy loans with other investments. While the bill permits flexible rates to meet changing conditions, it contains strict controls. It will allow companies to reduce premiums and increase dividends on future issues of policies which contain an adjustable provision. The bill would be applicable only to policies issued after its effective date but existing policyholders would be able to request that their policies be amended to provide for the adjustable rate.

A number of external indices, based on both short-term and long-term investment yields, were carefully examined for use in setting the maximum interest rate that could be charged on loans against a policy. It was concluded that the most appropriate would be the Monthly Average Corporates yield shown in Moody's Corporate Bond Yield Averages published by Moody's Investors Services, Inc. This index is based on a broad volume of seasoned long term corporate bonds traded in the market place. While it is responsive to changes in the investment market, it is relatively stable and does not swing widely from month to month as do some of the short-term rates. The Moody's series is widely recognized and respected. It has been adopted as the basis for valuation of life insurance policies and annuities by the National Association of Insurance Commissioners. Also, it is readily available to companies, regulators and individuals since the monthly average rates are published by Moody's Investors Service, Inc. in its Bond Survey shortly after the close of each month. Finally, and most importantly, this index corresponds quite closely to the yields available to life insurance companies on new long-term investments.

The bill contains provisions intended to protect the policyholder by means of notice requirements and protection against an unintended lapse in coverage due to the changing nature of the interest rate. Further, where an adjustable rate is used the maximum must go down as well as being permitted to increase when the index changes.

The bill represents a responsible solution to the policy loan problem and will be a major step toward preventing a serious recurrence of the problems which have been created by the existing fixed rate legislation. It reflects a careful balance between providing insurers with as much flexibility as possible to meet their own policy loan interest rate problems in future issues of policies while recognizing that certain safeguards must be included in order to protect policyholders of those policies.

JUSTIFICATION FOR THE BILL:

General.

Life insurance policy loans are the only form of borrowing from financial institutions limited by Alaska law to an interest rate of 8%. The difference between the present rates allowed on policies and the highest rates of interest which banks and other lenders have been allowed to charge in recent years has often been substantial. This has caused serious problems for insurers and their policyholders, as well as resulting in a shortage of availability of needed capital.

Tight credit markets and high interest rates have caused a serious policy loan drain on life insurers, now more than \$45 billion, requiring companies to borrow and raise funds by selling securities in depressed markets to fund the abnormal policy loan demand. Further, since normal investment funds have been diverted to policy loans, companies have been made unable to take advantage of higher yields of 10%, 12% and 15%. Consequently, less investment income has become available to benefit all policyholders through either higher dividends or lower premiums or both. Company studies have shown that the largest policy holders are far more likely to borrow on their policies to take advantage of the favorable interest rate differential. Thus, the non-borrowing policyholder has been forced to subsidize the more sophisticated policyholder who borrows on his policy. This forced subsidization is undesirable and should not be permitted to continue in future issues of policies.

New legislation is required to permit companies in future issues of policies to attempt to prevent this serious and periodic drain on cash flow and particularly to balance equities between policyholders who borrow and those who do not.

This bill is intended to be an all inclusive law. It would apply to any form of policy containing a loan provision such as certificates issued by fraternal benefit societies and certain annuity contracts. It has been approved by the National Association of Insurance Commissioners and 19 states enacted it in 1981. ^{1/} In 1982 as of two weeks ago at least 7 more states enacted it.

The bill is also supported by the National Association of Life Underwriters (agents and brokers of life insurance), the Alaska State Association of Life Underwriters, the American Council of Life Insurance, and the Director of Insurance.

^{1/} Alabama, Arkansas, California, Connecticut, Florida, Illinois, Indiana, Maine, Massachusetts, Nebraska, Nevada, North Carolina, Ohio, Oregon, Texas, Utah, Virginia, Washington and Wisconsin.

THE LEGISLATURE OF THE STATE OF ALASKA
TWELFTH LEGISLATURE

FISCAL NOTE

I. REQUEST

Bill/Resolution No. CSSB 841 (L&C)
 Title An act relating to insurance policy provisions on policy loans &
 Requested by Labor and Commerce Committee Date 4/8/82
reinstatement of policies; & providing for an effective date.

II. FISCAL DETAIL

Agency Affected Division of Insurance
 Program Category Affected Public Protection
 BRU, Program, Or Subprogram(s) Affected Division of Insurance
 (Note: If more than one budget component is affected, separate line-item amounts and funding for each component in the analysis section.)

EXPENDITURES (Thousands of Dollars)

	FY 82	FY 83	FY 84	FY 85	FY 86	FY 87
100 PERSONAL SERVICES	0					
200 TRAVEL	0					
300 CONTRACTUAL	0					
400 COMMODITIES	0					
500 EQUIPMENT	0					
600 LAND & STRUCTURES	0					
700 GRANTS, CLAIMS, ETC.	0					
TOTAL	0					

FUNDING (Thousands of Dollars)

GENERAL FUND	0					
FEDERAL FUNDS	0					
OTHER (Specify Source)	0					

POSITIONS

FULL TIME	0					
PART TIME	0					
TEMPORARY	0					

III. ANALYSIS (See Fiscal Note Preparation Instruction, Section III)

IV. DATE May 24, 1982

PREPARED BY Kenneth C. Moore, Div. of Insurance
AGENCY Commerce & Economic Development
 PHONE 465-2515

Original: Legislative Finance
 cc: Budget and Management
 Prime Sponsor (First Legislator Named)
 33-001 (Rev. 12/81)