COMMITTEE REPORT

HOUSE

FURTHER: Judiciary

(5)

4/20/82

Date: 4-22-82

Mr. Speaker:

The Committee on Labor & Commerce has had CSHB 841 (L&C)
"An Act relating to insurance policy provisions on policy loans and reinstatement of policies; and providing for an effective date."

under consideration and reports it back as follows:

[X] do pass with indiv. leg. [ ] do not pass

[ ] do pass with attached amendments(s)

[ ] replace with CS for ______ [ ] same title [ ] new title

and recommends individual

[ ] AND attaches a "Letter of Intent" [ ] New Fiscal Note

[ ] reports it back without recommendation

[ ] referred to the ______ Committee

MEMBERS SIGNING DO PASS	MEMBERS HAVING OTHER RECOMMENDATIONS:

CHAIRMAN

H 60 (Rev. 3/81)

Original sponsor: Labor and Commerce Committee

Offered: 4/8/82
Referred: Judiciary

IN THE SENATE

BY THE LABOR AND COMMERCE COMMITTEE

CS FOR SENATE BILL NO. 841 (L&C)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWELFTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to insurance policy provisions on policy loans and reinstatement of policies; and providing for an effective date."

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

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

(a) There shall be a provision that after three full years' premiums have been paid and after the policy has a cash surrender value and while no premium is in default beyond the grace period for payment, the insurer will advance, on proper assignment or pledge of the policy and on the sole security of the policy, at a specified rate of interest not exceeding eight percent a year, an amount equal to or, at the option of the party entitled to it, less than the loan value of the policy. The director may authorize rates of interest in excess of six percent only on a finding that the holders of policies will benefit from the increased earnings of the insurer resulting from the higher rates, through the use of higher dividends or lower premiums, or both. The loan value of the policy shall be at least equal to the cash surrender value at the end of the then current policy year, except that the insurer may deduct, either from the loan value or from the proceeds of the loan, an existing indebtedness not already deducted in determining the cash surrender value including interest then accrued but not due, the unpaid balance of the premium for the current policy year, and interest on the loan to the end of the current policy year. The policy may also provide that if interest on an indebtedness is not paid when due it shall then be added to the existing indebtedness and shall bear interest at the same rate, and that if and when the total indebtedness on the policy, including interest due or accrued, equals or exceeds the amount of the loan value of the policy, the policy shall terminate and become void. The policy shall reserve to the insurer the right to defer the granting of a loan, other than for the payment of a premium to the insurer, for six months after the date of the loan application. The policy, at the insurer's option, may provide for automatic premium loan, subject to an election of the party entitled to elect. <u>Except as provided in (e) of this section, the required interest rates on policy loans set out in this section apply only to policies issued before July 1, 1982.</u>

* Sec. 2. AS 21.45.080 is amended by adding new subsections to read:

(c) A policy issued on or after July 1, 1982, shall have a provision specifying an interest rate on a policy loan not to exceed eight percent a year, or a provision permitting an adjustable maximum interest rate established under this subsection. An adjustable maximum rate of interest on a policy loan determined under this subsection may not exceed the higher of the published monthly average for the calendar month ending two months before the date on which the rate is determined, or the rate used to compute cash surrender values under the policy during the applicable period plus one-twelfth of a percentage point multiplied by the number of months in the applicable period. 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. The interest rate being charged may be increased if the published monthly average increases by one-half percent or more and the reciprical provision of interest increase in earnings of policys.

interest rate being charged must be reduced if the published monthly average decreases by one half percent or more. A life insurer shall (1) notify the policyholder of the initial rate of interest on the loan at the time a cash loan is made; (2) notify a policyholder who obtains a premium loan of the initial rate of interest on the loan as soon as it is reasonably possible to do so after making an initial premium loan; except as provided in (3) of this subsection, notice does not have to be given to the policyholder when a second or subsequent premium loan is added; (3) send reasonable advance notice of any increase in the rate to a policyholder who has a policy loan; and (4) include other relevant information on adjustment of interest rates in a notice required under this subsection. The loan value of the policy shall be determined in accordance with (a) of this section. A policy may not be terminated in a policy year as the sole result of a change in the interest rate during that policy year. If an interest rate changes, the insurer shall maintain coverage during the policy year until the date on which the policy would have terminated if the interest rate had not changed.

(d) In (c) of this section

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

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

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

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

(5) "published monthly average" means the monthly average of

corporate bond yields as published by Moody's Investors Service, Inc., or its successor, or if Moody's corporate bond yield average-monthly average corporates is not published, a substantially similar average, established by regulation adopted by the director.

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

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

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

* Sec. 4. This Act takes effect July 1, 1982.

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April 20, 1982

Terry— This answers the questions you asked.

Honorable Terry Martin
Alaska State Legislature
Pouch V
Juneau, AK 99811

Re: CSSB 841

Dear Representative Martin:

The committee substitute introduced by the Senate Labor and Commerce Committee incorporated all of the changes recommended by the Division of Insurance. Their memo is attached. The explanation of the background and basic structure of the bill in my January letter to you remains accurate.

Thank you for taking this bill up. It passed the Senate 19 - 1 on April 20.

Sincerely,

ROBERTSON, MONAGLE, EASTAUGH & BRADLEY

Mike Thomas

Michael T. Thomas

MTT/ke
Enclosure

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF COMMERCE &
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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 amentments. 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

08-H2LH

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)".

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

IN THE SENATE

BY THE LABOR AND COMMERCE COMMITTEE

SENATE BILL NO. 841

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NO CHANGES THIS PAGE

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

* Sec. 2. AS 21.45.080 is amended by adding new subsections to read:

(c) A policy issued after June 30, 1982 shall have a provision permitting a maximum interest rate on a policy loan of eight percent a year.

COMMENTS

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.

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

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.

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

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 r[illegible] as well as the time to notify policyholders [illegible]h existing loans of any change in the rate reasonably in advance as required on page [illegible], 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.

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

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.

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.

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.

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

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 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 fiscalyears 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.

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

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.

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

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.

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

(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.

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.

A policy may not be terminated in a 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

(d) In (c) of this section

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

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

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

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

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

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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 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.

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 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.

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

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

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

* Sec. 4. This Act takes effect July 1, 1982.

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.