AMERICAN ACADEMY of ACTUARIES

March 8, 2019

Mr. Fred Andersen
Chair, IUL Illustration (A) Subgroup
National Association of Insurance Commissioners (NAIC)

Dear Mr. Andersen,

The American Academy of Actuaries'[1] Life Illustration Work Group (the Work Group) appreciates the opportunity to provide comments on questions exposed by the IUL Illustration Subgroup regarding the illustrations of Indexed Universal Life (IUL) products under Actuarial Guideline 49 (AG 49). Given the relatively short turnaround timeframe for comments, we have focused this letter on questions 1, 2, and 2a, and could respond to the remaining questions at a later date. In addition, we have chosen to address question 2 first, because our responses to the other questions expand on our response to question 2.

2. Should a higher risk / higher reward IUL product be illustrated with higher credited rates than a vanilla IUL product would be?

The Work Group would suggest posing this question slightly differently: Is it reasonable to allow for higher-risk / higher-reward IUL products to illustrate higher credited rates than a vanilla IUL product? The risk/reward tradeoff is a foundational principle in daily decision-making and especially in financial economics.

Preparing a consumer to make an informed decision by allowing the illustration of the risk/return tradeoff is reasonable and fits within Model 582's[2] goal to protect consumers and foster consumer education. Within the IUL marketplace, risk/return profiles can vary significantly between different IUL products. If IUL products with higher risk are unable to illustrate a higher credited rate, consumers would not see the value proposition of the product because greater costs would be illustrated without higher potential returns.

2a. If "yes", how should the downside of the product be communicated with applicants?

[1] The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.
[2] Model 582—The Life Insurance Illustrations Model Regulation.

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The downsides, or risks in the product from product features less favorable than the current scale, of an IUL product are currently required under either Model 582 or AG 49 and illustrated in the following ways relative to the current illustrated scale:

- differences in lapse years shown in guaranteed, midpoint, and alternate scales;
- differences in policy values shown in guaranteed, midpoint, and alternate scales;
- a table showing the last 20 years of historical index returns and corresponding credited interest rates using current index parameters; and
- a table showing the lowest annualized rate from any 25-year period over the last 66 years for the benchmark index account.

The Work Group suggests that the IUL Illustration Subgroup consider the following ideas to demonstrate downside risk:

- requiring a separate demonstration of a range of outcomes generated from scenarios run at different percentages of the maximum illustrated rate;
- requiring a demonstration of the impact of a sequence of returns, for example, a repetitive pattern where a floored return is incorporated into a pattern of positive returns averaging to the illustrated rate;
- requiring year-by-year disclosure of policy charges and credits (expressed in dollar amounts);
- requiring disclosure of the premium required to achieve the original goal(s) of the policy under different credited interest assumptions; or
- requiring additional language that provides a balanced view of the features of the policy. For example, "higher returns could require higher upfront costs with no guarantee of higher interest crediting," "comparison of single factors can be misleading if results are based on multiple factors," etc.

1. How should products with different attributes be illustrated to demonstrate the differences in product features, potential returns, and downside risk?

IUL products can have a variety of product features, including but not limited to differences in indexes, crediting methods, index parameters, charges, bonuses, and multipliers.

These different product attributes would ideally be shown provided the illustration meets a disciplined current scale (DCS) testing requirement. It would be advantageous to consumers to see the impact of product features to improve understanding of the features of the product being considered. We note that AG 49 currently limits the credited interest rates shown in illustrations of certain indexes, crediting methods, and index parameters to the credited rate associated with the benchmark index account. The benchmark index account uses the Standard and Poor's (S&P) 500, a capped annual point-to-point crediting method, a 0% floor, and a 100% participation rate.

In August 2015, the Work Group presented an educational paper to the Life Actuarial Task Force (LATF) that discussed the variety of bonus structures that are available in many life products. The paper also discussed the DCS supportability testing for life insurance products subject to the NAIC Life Insurance Illustrations Model Regulation.

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We have also attached a brief overview of the current requirements for IUL illustrations. The overview is intended to be educational and should not be construed as supporting any particular position or illustration design.

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The Work Group appreciates the efforts of the IUL Illustration Subgroup to review AG 49. If you have any questions or would like further dialogue on the above topics, please contact Ian Trepanier, life policy analyst, at trepanier@actuary.org.

Sincerely,

Donna Megregian, MAAA, FSA
Chairperson, Life Illustration Work Group
American Academy of Actuaries