June 28, 2019

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

Dear Mr. Andersen,

The American Academy of Actuaries'[1] Life Illustrations Work Group (the Work Group) appreciates the opportunity to provide comments on the questions exposed by the IUL Illustration Subgroup regarding the illustrations of Indexed Universal Life (IUL) products under Actuarial Guideline XLIX (AG 49). These comments pertain to questions not previously addressed in our March 8 comment letter.

3. In 2015, there was a decision by the Subgroup to not have a hard ceiling on the credited rate, e.g., no rate above 6.75%. Should that decision be revisited?

The Work Group does not believe that this decision should be revisited because a hard ceiling would have unintended consequences:

- It would lead to unreasonable results in a high-interest-rate environment in which portfolio rates exceed the ceiling rate, e.g., 6.75%.
- It could limit consumers' comprehension of risks and understandings of materially different products. Per questions 1 and 2, it may be better to emphasize risk and costs associated with a product.
- A hard ceiling on credited rates could impede product innovation.
- It would be unreasonable for products that augment the options budget through other charges with an asset-based fee. For example, if the options budget was comprised of a 5% portfolio interest rate plus an optional rider charge of 4% of account value, the total options budget of 9% would greatly outsize the e.g., 6.75% hard ceiling credited rate.

4. Is the interaction of the loan charges and loan credits being illustrated as expected?

Section 6 of AG 49 states that "the illustrated rate credited to the loan balance shall not exceed the illustrated loan charge by more than 100 bps." For IUL products with an index multiplier,

[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.

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AG 49 does not define the “illustrated rate credited to the loan balance” or the “illustrated loan charge.”

- “Illustrated rate credited to the loan balance” could be the illustrated rate credited before or after applying the index multiplier.
- “Illustrated loan charge” could include or not include the charge for the index multiplier.

The following example assumes that the index multiplier is credited to the loaned amounts (and the asset based charge is also assessed against loan amounts).

Example:

- Base loan charge: 4.75%
- Index multiplier charge: 2.00%
- Total loan charge: 4.75 + 2.00 = 6.75%
- Base illustrated rate: 6.50% (S&P 500 lookback rate, a.k.a. benchmark illustrated rate)
- Index multiplier: 40%
- Gross illustrated rate: 6.50% * 1.4 = 9.10%

	How apply 100 bp cap?	Resulting credit to loan	Resulting loan leverage
1	Difference between **base** illustrated rate and **base** loan charge†	min (6.50, 4.75+1.00) * 1.40 = 8.05	8.05 – 2.00 – 4.75 = 1.30
2	Difference between **gross** illustrated rate and **base** loan charge‡	min (6.50*1.40, 4.75+1.00) = 5.75	5.75 – 2.00 – 4.75 = -1.00
3	Difference between **base** illustrated rate and **total** loan charge†	min (6.50, 6.75+1.00) * 1.40 = 9.10	9.10 – 2.00 – 4.75 = 2.35
4	Difference between **gross** illustrated rate and **total** loan charge‡	min (6.50*1.40, 6.75+1.00) = 7.75	7.75 – 2.00 – 4.75 = 1.00

†100 bp cap applied **before** index multiplier
‡100 bp cap applied **after** index multiplier

We believe that the first approach is the most common illustration used today as it demonstrates how the multiplier design works differently than products without the multiplier. The second approach results in negative loan leverage if the index multiplier charge is greater than 1%, which would misrepresent the risk and reward and the product illustration would be unappealing. In the third approach, the illustrated loan credit is the same as the gross illustrated rate for unloaned amounts if the total loan charge plus the 1% is greater than the base illustrated rate and would generally result in the highest illustrated values. The fourth approach results in 100 basis points of total loan leverage when the gross illustrated rate is higher than the total loan charge plus 1%.

The above results will vary when assumed parameters in the example are changed, such as charges against loaned and unloaned accounts. Because of the possibility of different interpretations and the desire to reflect the risk/reward of products, we recommend adding clarification in AG 49 to ensure consistent application of the AG 49 provision.

5. Are there known concerns regarding illustration of volatility-controlled funds?

The Work Group is not aware of any specific issues related to volatility-controlled indexes.

Illustrated rates for these volatility-controlled indexes are limited by the benchmark index account. If a volatility-controlled index is the only index within a product, then AG 49 requires the development of a hypothetical benchmark index account per Section 4. These indexes may not have a 20-year history for display as required by Section 7 of AG 49, but illustrated credited rates are still limited by the benchmark index account.

6. Is there a concern that extreme variations of the index credit multiplier could lead to a risk-return profile similar to that of variable life even though return-of-premium (net charges and withdrawals) remains a floor? If so, is that something our subgroup, focused on illustrations, would address?

The Work Group believes that the that the risk-return profile of IUL products and variable life products is clearly different because, as the question notes, IUL products have a floor equal to return on premium less charges, while variable life products have no guaranteed minimum values and no downside performance limits. That stated, we do recognize the possibility that IUL product designs with "extreme" index multipliers could enter the market and the performance of these products would certainly be more sensitive to the performance of the underlying index.

The Work Group recognizes the value of innovative product designs that are beneficial to consumers and agrees that it is important to communicate the possible downside risks of IUL products, particularly those products with charges and features that increase sensitivity to the performance of the underlying index. We note that disclosures of certain IUL downside risks are already mandated by Model 582[2] and AG 49:

- an illustration of guaranteed values;
- a ledger for the Alternative Scale shown alongside a ledger for the illustrated scale;
- the minimum 25-year geometric average indexed return for the past 66 years; and
- a table that shows actual index changes and hypothetical crediting rates over the past 20 years.

7. Should it be recommended that LATF address the issue of whether assumptions underlying IUL illustrations should be consistent with assumptions underlying PBR and asset-adequacy testing? Why apply to only IUL?

The Work Group would like to understand what the IUL Subgroup would like to consider in terms of assumptions underlying IUL illustrations and assumptions underlying PBR and asset

[2] Model 582—The Life Insurance Illustration Model regulation

adequacy testing, as their objectives are fundamentally different. The appropriateness of assumptions depends on their use.

8. Are there issues relevant to IUL that are part of a broader concern related to non-IUL life illustrations, where engagement with A Committee may be necessary?

Bonuses are available on a variety of life insurance products, and may be relevant to discuss for non-IUL life illustrations. The Work Group presented an educational paper to LATF in August 2015 that discussed the variety of bonus structures. If you would like to review the paper, it can be viewed online.[3]

The Work Group also would propose for consideration the following broader questions for all life illustrations:

- Should there be more discussion of inforce illustrations?
- Are there any unintended consequences of the current inforce illustration rules?
- Would any of the illustrations of downside risks contemplated for IUL illustrations benefit consumers if they were included in all life illustrations?

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 Illustrations Work Group
American Academy of Actuaries

[3] At http://actuary.org/files/2015.08.11%20Illustrated%20Bonus%20Report%20Final.pdf.