



AMERICAN ACADEMY of ACTUARIES

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May 27, 2020

Mr. Mike Boerner
Chair, Life Actuarial (A) Task Force (LATF)
National Association of Insurance Commissioners (NAIC)

Dear Mr. Boerner,

On behalf of the American Academy of Actuaries¹ Life Illustrations Work Group (the “Work Group”), I appreciate the opportunity to provide comments to LATF on the “Independent Proposal.”

The methodology is very different from the methodology that has been in place for most indexed universal life (IUL) product illustrations even before Actuarial Guideline XLIX (AG 49) went into effect, and although there are few modifications to the text of AG 49 in the Independent Proposal, applying the proposal would not be a simple modification.

On the surface, the proposal appears to limit the illustrated rate to an amount approximately equal to the option budget or fixed account rate due to no risk premium being assumed on the option. This would cause the illustrated scale to be nearly identical to the alternate scale, because the alternate scale generally uses the fixed account rate. Illustrating at the fixed rate was discussed when AG 49 was originally drafted, and this concept was rejected in 2015.

We note that using an option cost-pricing formula to calculate an illustrated credited interest rate seems disconnected. The Work Group would need more time to consider whether it is reasonable to use a pricing formula such as Black-Sholes to calculate a longer-term illustrated credited rate. The Work Group would also need to consider how the short-term nature of the Black-Sholes formula (12 months) can be reconciled with ASOP No. 24, *Compliance with the NAIC Life Insurance Illustrations Model Regulation*, section 3.4.1, which states that actuaries “should consider an appropriate time frame commensurate with [business or economic] cycles” when setting investment return assumptions.

In addition, the Work Group would like to make some general comments in response to some of the verbal comments made during the presentation of the proposal. First, while options are commonly priced using a risk-neutral methodology, the pricing methodology should not be misunderstood to imply that the options themselves are risk-neutral. Second, options should be

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.

evaluated as a part of an entire investment portfolio (i.e., not in isolation), because options are often mixed with other types of investments to achieve a desired risk profile. Even though some option positions may not seem particularly valuable when considered in isolation, it does not discredit them; indeed, some investors are willing to incur costs to ensure that they are protected from rare events (i.e., investment insurance).

Finally, we also note the Independent Proposal does not address the question of what should be included in the 100-basis-point limit between loan charges and loan credits.

We hope these comments are helpful. Given the relatively short exposure period, The Work Group has not had sufficient time to evaluate all aspects of the proposal. If LATF would like us to provide more specific comments about the proposal, we would require additional time to review the proposal and the spreadsheet examples.

The Work Group appreciates the efforts of the LATF and IUL Illustration Subgroup to review AG 49. If you have any questions or would like to 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