May 27, 2020

Mr. Mike Boerner  
Chair, NAIC Life Actuarial Task Force (LATF)

Mr. Fred Andersen  
Chair, NAIC IUL Illustration (A) Subgroup

Re: ACLI Comments on AG 49-A and Independent Proposal

Dear Messrs. Boerner and Andersen:

The American Council of Life Insurers (ACLI)\(^1\) appreciates the opportunity to provide further commentary on the ACLI proposal and the Independent Proposal. We appreciate the hard work of the Life Actuarial (A) Task Force (LATF) and the IUL Illustration (A) Subgroup (Subgroup), and the contributions from the American Academy of Actuaries, individual companies, consumer advocates, and others.

The ACLI proposal best achieves the stated regulatory objectives and represents industry consensus. The ACLI proposal is a product of a year of dialogue with regulators, consumer advocates, and others. Our proposal does not represent the interests of a handful of IUL writers, but rather the input of a broad collection of companies, including those who write IUL (with and without multipliers), and non-IUL writers. We have crafted a proposal consistent with regulators’ decisions. Further, in our accompanying spreadsheet, we have provided illustrative examples of how our proposal meets the goal of regulators to restrict the illustration of multipliers and other enhancements (see below). Furthermore, for ease, we have added the Independent Proposal calculation to our spreadsheet, along with a summary of the current AG49 approach against the two proposals (‘Summary of Results’).

---

\(^1\) The American Council of Life Insurers (ACLI) advocates on behalf of 280 member companies dedicated to providing products and services that promote consumers’ financial and retirement security. 90 million American families depend on our members for life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, dental and vision and other supplemental benefits. ACLI represents member companies in state, federal and international forums for public policy that supports the industry marketplace and the families that rely on life insurers’ products for peace of mind. ACLI members represent 95 percent of industry assets in the United States. Learn more at www.acli.com.
While we appreciate the effort put forth in the Independent Proposal, we believe it goes far beyond the stated objectives, having a significant negative impact on the illustrations for all IUL products, including products without enhancements. While any initial proposal will require modification and input from other parties, the Independent Proposal has critical flaws that would further slow resolution of this important issue. We note our following concerns regarding the Independent Proposal:

1.) Independent Proposal Disregards Prior Regulator Decisions

The Independent Proposal seemingly disregards the past year of dialogue by attempting to re-litigate issues that were resolved back in 2014.

At that time, regulators considered a proposal to limit the illustrated rate to the fixed rate but rejected that proposal in favor of an approach that allows the illustration of some risk premium. Regulators also wanted to include an illustration of more conservative returns, so they created an alternate scale that illustrates at the fixed rate. The alternate scale is shown side-by-side with the illustrated scale to ensure that policyholders see both scales.

ACLI has attached our October 28, 2014 letter that addresses many of the concerns raised, notably on the rationale of the 145% factor.

2.) The Independent Proposal is Overly-Conservative

The direction from LATF was to reduce the illustrated value of charged-for index features. The Independent Proposal takes conservatism to the next level, by fundamentally changing how all IUL products are illustrated.

The Independent Proposal limits the illustrated rate to the hedge cost, dramatically restricting illustrations of all IUL products. Even in the case of the Benchmark Index Account, the illustration is limited to the hedge cost. This proposal may lead to identical illustrations across virtually every IUL product, causing confusion among policyholders who will have no way to differentiate features among carriers. This is not consistent with the regulator request.

3.) Concerns with the Independent Proposal Would Take Significant Time to Resolve

The Independent Proposal contains a number of flaws that would take substantial time to resolve and further delay implementation of a solution. In the short exposure period, we have identified the following flaws (elaborated on below): inappropriate use of Black-Scholes to model illustrated credits,
elimination of any level of risk premium, undue volatility in illustrations, and missing assumptions and inputs for the proposed approach.

The Independent Proposal approach, while reasonable for determining hedge costs, is not a reasonable basis to illustrate credits. The Black-Scholes formula is risk neutral and while appropriate to price a call or a put, it is not intended to determine the expected return on the option. Our October 28, 2014 letter (p.9) explained the justification of what ultimately led to the 145% limit in AG 49.

We have identified several technical flaws in the Independent Proposal that would further delay this process to thoroughly address. Given the Independent Proposal relies solely on hedge cost, illustrated rates could vary quite significantly from year to year. To illustrate this, we are providing the following examples. The Black-Scholes method will return a value equal to the option cost. As a result, we only need to look at historical option costs to see the variability.

<table>
<thead>
<tr>
<th>Year</th>
<th>Avg Cost 12% Cap</th>
<th>NIER</th>
<th>Illustrated Rate</th>
<th>Chg. in IR</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>4.82%</td>
<td>5.00%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td>4.89%</td>
<td>5.00%</td>
<td>5.06%</td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>4.57%</td>
<td>5.00%</td>
<td>5.13%</td>
<td>0.07%</td>
</tr>
<tr>
<td>2018</td>
<td>5.20%</td>
<td>5.00%</td>
<td>4.80%</td>
<td>-0.34%</td>
</tr>
<tr>
<td>2019</td>
<td>5.18%</td>
<td>5.00%</td>
<td>5.46%</td>
<td>0.66%</td>
</tr>
</tbody>
</table>

The Independent Proposal utilizes costs from the prior year to generate the illustrated rate for the then current year. For example, the 2016 rate of 5.06% is derived as 4.82% x (1 + 5.00%). The above table shows that, with an unchanging cap, the illustrated rate varies by 66bps over the past 3 years. In contrast, applying the AG49’s lookback calculation with a 12% cap to that index history produces a maximum illustrated rate for a 12% cap has varied by 10bps, resulting in a more consistent outcome for consumers.

While the example above assumes that a company’s cap remains the same during this sample period (2015-2019), it is also worth considering an example where the cap rate does change. Under the Independent Proposal, if the hedge cost changes each year, a change to the cap would result in no change to the illustrated rate. For example, if a 12% cap costs 5% one year, but then the costs decrease and a 13% cap now costs 5%, both would be illustrated at 5%. This would convey no important information to consumers regarding changes to their policy which would stand in contrast with AG49’s stated objective of aiding consumer understanding.

Finally, the Independent Proposal may require an administrative procedure to collect and publish historical data to be used as inputs for the Black-Scholes model, which will take time to determine.

We urge LATF to recognize that the Independent Proposal does not implement the direction from regulators and turn their attention to resolving the remaining issues with the ACLI proposal.

We look forward to a discussion on this important issue.

Sincerely,

[Signature]

cc Reggie Mazyck, NAIC