Actuarial Guideline XLIX-A – Draft [ACLI DRAFT ~~APRIL 14,~~JUNE 4, 2020]

THE APPLICATION OF THE LIFE ILLUSTRATIONS MODEL REGULATION TO POLICIES WITH INDEX-BASED INTEREST SOLD AFTER [greater of 5 months after LATF adoption and 3 months after EX/Plenary Adoption*]

Background

The *Life Insurance Illustrations Model Regulation* (#582) was adopted by the NAIC in 1995. Since that time there has been continued evolution in product design, including the introduction of benefits that are tied to an index or indices. Although these policies are subject to Model #582, not all of their features are explicitly referenced in the model, resulting in a lack of uniform practice in its implementation. In the absence of uniform guidance, two illustrations that use the same index and crediting method often illustrated different credited rates. The lack of uniformity can be confusing to potential buyers and can cause uncertainty among illustration actuaries when certifying compliance with Model #582.

In 2019, the NAIC decided that illustrations of products with multipliers, cap buy-ups, and other enhancements should not illustrate better than products without such features. This new requirement is intended to apply to illustrations on policies sold on or after the effective date of this guideline while the existing requirements continue to apply for inforce illustrations on policies sold before the effective date of this guideline.

This guideline provides uniform guidance for policies with index-based interest. In particular, this guideline:

(1) Provides guidance in determining the maximum crediting rate for the illustrated scale and the earned interest rate for the disciplined current scale.

(2) Limits the policy loan leverage shown in an illustration.

(3) Requires additional consumer information (side-by-side illustration and additional disclosures) that will aid in consumer understanding.

Text

1. Effective Date

This Actuarial Guideline shall be effective for all new business and in force illustrations on policies sold on or after [greater of 5 months after LATF adoption and 3 months after EX/Plenary Adoption].

2. Scope

This Actuarial Guideline shall apply to any life insurance illustration that meets both (i) and (ii), below:

i. The policy is subject to Model #582.

ii. The policy offers Indexed Credits.

3. Definitions

A. Alternate Scale: A scale of non-guaranteed elements currently being illustrated such that:

i. The ~~total annual percentage rate~~Annual Rate of Indexed Credits for each Index Account does not exceed the lesser of the maximum ~~total percentage rate~~Annual Rate of Indexed Credits for the illustrated scale less 100 basis points and the credited rate for the Fixed Account. If the insurer does not offer a Fixed Account with the illustrated policy, the ~~total annual percentage rate~~Annual Rate of Indexed Credits for each Index Account shall not exceed the average of the maximum ~~total percentage rate~~Annual Rate of Indexed Credits for the illustrated scale and the guaranteed ~~total percentage rate~~Annual Rate of Indexed

Commented [A1]: Addresses concern of use of "annual percentage rate"

Credits for that account. However, the ~~total annual percentage rate~~Annual Rate of Indexed Credits for each Index Account shall never be less than the guaranteed ~~total percentage rate~~Annual Rate of Indexed Credits for that account.

ii. If the illustration includes a loan, the illustrated Policy Loan Interest Credited Rate shall not exceed the illustrated Policy Loan Interest Rate. For example, if the illustrated Policy Loan Interest Rate is 4%, the Policy Loan Interest Credited Rate shall not exceed 4%.

iii. All other non-guaranteed elements are equal to the non-guaranteed elements for the illustrated scale.

B. Annual Net Investment Earnings Rate: Gross portfolio annual earnings rate of the general account assets (excluding ~~hedges~~hedge assets for Indexed Credits), less provisions for investment expenses and default cost, allocated to support the policy. ~~"~~Charges of any kind ~~are not included in~~cannot be used to increase the Annual Net Investment Earnings Rate.

C. Annual Rate of Indexed Credits: The total annualized Indexed Credits expressed as a percentage of the account value used to determine the Indexed Credits.

D. Benchmark Index Account: An Index Account with the following features:

i. The interest calculation is based on the percent change in S&P 500® Index value only, over a one-year period using only the beginning and ending index values. (S&P 500® Index ticker: SPX)

ii. An annual cap is used in the interest calculation.

iii. The annual floor used in the interest calculation shall be 0%.

iv. The participation rate used in the interest calculation shall be 100%.

v. Interest is credited once per year.

vi. The ~~hedge budget~~Hedge Budget used to determine the cap in 3 (~~C~~D) (ii) does not exceed the Annual Net Investment Earnings Rate. Charges of any kind ~~are not included when determining~~cannot be used to increase the ~~applicable~~annual cap ~~rate~~.

vii. There are no enhancements or similar features that provide additional ~~amounts credited that are linked to an index or indices~~Indexed Credits in excess of the interest ~~calculation,~~ provided by 3 (D) (i) through 3 (D) (v), including but not limited to experience refunds, multipliers ~~and~~, or bonuses.

viii. There are no limitations on the portion of account value allocated to the account.

ix. A single Benchmark Index Account will be determined for each policy. This can be either an Index Account offered with the illustrated policy or determined according to Section 4 (A) (ii) for purposes of complying with this guideline. A policy shall have no more than one Benchmark Index Account.

E. Fixed Account: An account where ~~the amounts credited~~there are ~~not tied to an index or indices~~no Indexed Credits
.

~~F. Index Account: An account where the amounts credited are tied to an index or indices.~~

~~G. Indexed Credits: Any interest credit, multiplier, factor, bonus, charge reduction, or other enhancement to policy values that is linked to an index or indices. Credits to the policy resulting from a floor are included.~~

~~H.~~F. Hedge Budget: For each Index Account, the total annualized amount assumed to be used to generate the Indexed Credits of the account, expressed as a percent of the account value in the Index Account. This total annualized amount should be consistent with the hedging program of the company.

G. Index Account: An account where some or all of the amounts credited are Indexed Credits.

Commented [A2]: Addresses Kilcoyne letter on use of "hedges" and "hedge costs".

Commented [A3]: Suggested edit to address concern of a circular reference. Language replaces prior text of: "The annualized total Indexed Credits divided by the account value used to determine Indexed Credits according to the policy features."

Commented [A4]: Language replaces prior text of: "There are no additional amounts credited that are linked to an index or indices in excess of the interest provided by the annual cap, including but not limited to experience refunds, multipliers, and bonuses."

Commented [A5]: Clarification of requirement

Commented [A6]: Definition moved to re-alphabetize

H. Indexed Credits: Any interest credit, multiplier, factor, bonus, charge reduction, or other enhancement to policy values that is linked to an index or indices. Amounts credited to the policy resulting from a floor greater than zero on an Index Account are included.

I. Loan Balance: Any outstanding policy loan and loan interest, as defined in the policy.

J. Policy Loan Interest Rate: The current annual interest rate as defined in the policy that is charged on any Loan Balance. This does not include any other policy charges.

K. Policy Loan Interest Credited Rate: The ~~annual~~annualized interest rate credited that applies to the portion of the account value backing the Loan Balance~~, as defined in the policy.~~:

i. For the portion of the account value in the Fixed Account that is backing the Loan Balance~~ that is in a Fixed Account~~, the Policy Loan Interest Credited Rate is the applicable annual interest crediting rate~~, as defined in the policy.~~

[OPTION FOR CONSIDERATION: Please see commentary on these approaches in the ACLI April 14, 2020 Comment Letter~~;~~. There is an Option 3 that would use the language ~~for~~in Option 1 ~~and Option 2 may need~~below but reduce the limit in Section 6 from 100bp to ~~be tightened up:~~50bp.]

Option 1: ii. For ~~any~~the portion of the account value in an Index Account that is backing the Loan Balance~~ that is in an Index Account~~, the Policy Loan Interest Credited Rate is the ~~total percentage rate~~Annual Rate of Indexed Credits, net of any applicable Supplemental Hedge Budget, for that account~~, as defined in the policy~~.

Option 2:ii. For any portion of the account value in an Index Account that is backing the Loan Balance ~~that is in an Index Account~~, the Policy Loan Interest Credited Rate is the total ~~percentage rate~~of the Annual Rate of Indexed Credits and all illustrated bonuses, ~~charge reductions~~ or other enhancements ~~that~~intended to impact ~~the portion of the account~~such value~~ backing the Loan Balance~~s, net of any applicable Supplemental Hedge Budget for that account~~, as defined in the policy~~.]

L. Supplemental Hedge Budget: For each Index Account, the Hedge Budget minus the minimum of the Annual Net Investment Earnings Rate and the ~~hedge budget~~Hedge Budget that ~~determines~~is used in the determination of the Benchmark Index Account . The Supplemental Hedge Budget will never be less than zero. This amount should be consistent with the hedging program of the company.

4. Illustrated Scale

The total ~~annual percentage rate~~Annual Rate of Indexed Credits for the illustrated scale for each Index Account shall be limited as follows:

A. Calculate the geometric average annual credited rate for the Benchmark Index Account for the 25-year period starting on 12/31 of the calendar year that is 66 years prior to the current calendar year (e.g., 12/31/1949 for 2015 illustrations) and for each 25-year period starting on each subsequent trading day thereafter, ending with the 25-year period that ends on 12/31 of the prior calendar year.

i. If the insurer offers a Benchmark Index Account with the illustrated policy, the illustration actuary shall use the current annual cap for the Benchmark Index Account in 4 (A).

ii. If the insurer does not offer a Benchmark Index Account with the illustrated policy, the illustration actuary shall use actuarial judgment to determine a hypothetical, supportable current annual cap for a hypothetical, supportable Index Account that meets the definition of the Benchmark Index Account, and shall use that cap in 4 (A).

B. For the Benchmark Index Account the ~~total~~ Annual Rate of Indexed Credits~~ illustrated as a percentage of the account value in the Index Account~~ shall not exceed the minimum of (i) and (ii):

Commented [A7]: Made "annualized" to address two year point-to-point.

Removed "as defined in the policy" in this definition due to the limit established in Section 6.

i. the arithmetic mean of the geometric average annual credited rates calculated in 4 (A).

ii. 145% of the Annual Net Investment Earnings Rate.

C. For any other Index Account that is not the Benchmark Index Account in 3 (C), the ~~total~~Annual Rate of Indexed Credits illustrated as a percentage of the account value in the Index Account prior to the deduction of any charges used to fund a Supplemental Hedge Budget shall not exceed the minimum of (i) and (ii):

i. The ~~maximum~~Annual Rate of Indexed Credits for the Benchmark Index Account calculated in 4 (B) plus the Supplemental Hedge Budget for the Index Account.

ii. The ~~total~~Annual Rate of Indexed Credits ~~that reflect~~reflecting the fundamental characteristics of the Index Account and the appropriate relationship to the expected risk and return of the Benchmark Index Account. The illustration actuary shall use actuarial judgment to determine this value using lookback methodology consistent with 4 (A) and 4 (B) (i) where appropriate.

D. ~~D.~~ For ~~purposes~~the Purposes of compliance with Section 6 (C) of Model #582, the Supplemental Hedge Budget ~~may cause~~is subtracted from the illustrated rate before comparing to ~~exceed~~ the earned interest rate underlying the Disciplined Current Scale.

At the beginning of each calendar year, the insurer shall be allowed up to three (3) months to update the credited rate for each Index Account in accordance with 4 (B) and 4 (C).

5. Disciplined Current Scale
The earned interest rate for the disciplined current scale shall be limited as follows:

A. If an insurer engages in a hedging program for Indexed Credits in an account, the assumed earned interest rate underlying the disciplined current scale for ~~the policy~~that account, inclusive of all general account assets, both hedge and non-hedge assets, that support the policy, net of default costs and investment expenses (including the amount spent to generate the Indexed Credits of the policy)shall not exceed:

i. the Annual Net Investment Earnings Rate, plus

ii. 45% of the lesser of (1) and (2):

1. Hedge Budget minus any ~~floor.~~ annual floor, to the extent that the floor is supported by the Hedge Budget.

2. The minimum of the Annual Net Investment Earnings Rate and the ~~hedge budget~~Hedge Budget that ~~determines~~is used in the determination of the Benchmark Index Account.

These ~~amounts~~rates should be adjusted for timing differences in the hedge cash flows to ensure that fixed interest is not earned on the ~~hedge cost.~~Hedge Budget minus any annual floor, to the extent that the floor is supported by the Hedge Budget.

The assumed earned rate used in testing the Disciplined Current Scale may not exceed the Illustrated Index Credited Rate plus the excess of the Annual Net Investment Earnings Rate over the Hedge Budget.

Guidance Note: The above approach does not stipulate any required methodology as long as it produces a consistent limit on the assumed earned interest rate underlying the disciplined current scale.

For a product with multiple Index Accounts ~~with different Hedge Budgets that are less than or equal to the NIER~~, a maximum rate in 5.A. should be calculated for each ~~set of~~account. All accounts ~~with different Hedge Budgets,~~ fixed and indexed, within a policy can be tested in aggregate.

B. If an insurer does not engage in a hedging program for Indexed Credits, the assumed earned interest rate underlying the disciplined current scale shall not exceed the Annual Net Investment Earnings Rate.

Commented [A8]: One of several edits addressing Academy 5.A Comment #3

Commented [A9]: Suggested Language to address the floor

Commented [A10]: This language shouldn't inherently disadvantage multiplier designs. The timing adjustment will impact both multiplier and non-multiplier designs. For multiplier designs, the Supplemental Hedge Budget definition allows for an amount "consistent with the hedging program of the company", which may allow the timing difference to be reflected in that value and not disadvantage a multiplier.

Commented [A11]: If a product does not have an interest spread (i.e. the full NIER is spent on hedging), it should not generate excess hedge earnings in the testing which would not be the case in reality.

Commented [A12]: Changes address VA Comment #6

Commented [A13]: Reflects Academy 5.A Comment #1

C. These experience limitations shall be included when testing for self-support and lapse-support under Model #582, accounting for all illustrated benefits including any illustrated benefits and bonuses that impact the policy's account value.

6. Policy Loans

[**OPTION FOR CONSIDERATION**: In addition to the 2 options outlined in 3.K, a third option was suggested to use the Option 1 language but reduce below from 100 to 50 bps.]

If the illustration includes a loan, the illustrated Policy Loan Interest Credited Rate shall not exceed the illustrated Policy Loan Interest Rate by more than [Options 1 and 2: 100; Option 3: 50] basis points. For example, if the illustrated Policy Loan Interest Rate is 4%, the Policy Loan Interest Credited Rate shall not exceed 5%.

7. Additional Standards

The basic illustration shall also include the following:

A. A ledger using the Alternate Scale shall be shown alongside the ledger using the illustrated scale with equal prominence.

B. A table showing the minimum and maximum of the geometric average annual credited rates calculated in 4 (A).

C. For each Index Account illustrated, a table showing actual historical index changes and corresponding hypothetical Indexed Credits using current index parameters for the most recent 20-year period.

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