AG49 Comment Letter

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

Re: ACLI proposed draft of Actuarial Guideline 49-A

Dear Mr. Andersen:

Equitable appreciates the opportunity to submit the following proposal regarding AG49-A on prospective requirements for IUL illustrations.

We believe that the ACLI draft represents quality work. However, we submit a distinct proposal from the ACLI for two reasons. First, the ACLI letter was developed prior to the recent decline in interest rates. A 10-year US Treasury yield of 0.65% interest rates does not align with the annual 4.5% net investment earnings rate assumption underlying the submitted numerical examples.

Second, we believe that the ACLI proposal has a narrow objective to ensure products with multipliers or other enhancements do not illustrate better than products without them. This has led to a result that, in our opinion, is rather extreme: that illustrated index credits reflect solely the options budget that can be supported by each company’s assumed annual net investment earnings rate. We do not believe the original goal of the AG 49 amendment was to eliminate the use of any policy charges to support illustrated indexed credits, but rather to limit the illustration of unrealistically high levels of indexed credits. We are concerned that the resulting proposal may not align well with the actual mechanics of the contracts being illustrated, which would reduce rather than enhance consumer understanding.

Our proposal has been informed by the discussions behind the ACLI draft but diverges in its form and substance in a manner that reflects our understanding of regulator objectives.

The remainder of this letter is organized to accomplish the following objectives:

1- Articulate our understanding of the regulator governance objectives for IUL illustrations
2- Propose a governance framework to accomplish each regulator objective
3- Outline specific parameters to calibrate the proposed framework

I. Our understanding of the IUL illustration governance objectives

The stated goals of AG 49 are to guide determinations of maximum illustrated crediting rates and to identify additional side-by-side illustrations to enhance consumer understanding. We
believe this reflects a broader regulator desire to ensure policy illustrations depict a realistic projection of long-term policyholder returns upon which a current or prospective policyholder can establish realistic expectations for account performance and funding requirements.

From a technical perspective, we bifurcate the elements of the illustration that require governance into the:

a) **Size of the “option budget”:** the amount of total contract value “put at risk” by investing in equity options or other risky investments.

b) **Rate-of-return on the “option budget”:** the illustrated long-term return of the instruments in which the option budget is invested.

Figure 1: Elements of the IUL illustrated return and associated regulator concerns

With respect to the size of the option budget, we understand the foremost regulator concern to be option budgets that are substantially larger than what can be supported by investing the contract value at yields on prevailing high-quality investments. Similarly, we understand the manifestation of that concern to be poor performance of large option budget investments which can lead to more rapid reductions in contract value beyond what clients expect.

With respect to the returns on the option budget, we understand the foremost regulator concern to be illustrated returns well in excess of high grade investment yields. Such returns are considered both volatile and unlikely to be sustained over long-periods, and any performance below illustrated rates-of-return may require the policyholder to contribute substantial premiums to maintain the policy in force.

II. Proposed illustration governance framework
In order to address these concerns, Equitable believes regulators should seek to govern both elements of the illustrated IUL return. That said, Equitable favors a more lenient “guardrail approach” that simply caps the size of the option budget. This would couple with stricter governance on the rate-of-return of the option budget. This approach reflects our beliefs that:

- A policyholder may reasonably seek a contract with greater market exposure than what can be created by an option budget supported only by prevailing yields on high quality investments – and hence who desire a larger option budget

- The policyholder expectation for contract performance should not rely on excessive long-run outperformance of the instruments in which the option budget (of whatever size) is invested

Equitable proposes a framework that governs distinctly each element of the illustrated return. We believe this approach offers the simplest governance framework for regulators and companies as well as aligns with the two aforementioned beliefs.

Table 1 below summarizes the proposed governance framework:

<table>
<thead>
<tr>
<th>Illustration element</th>
<th>Regulator concern</th>
<th>Governance approach</th>
<th>Rationale for approach</th>
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</table>
| Size of option budget| • Budgets well in excess of levels supported by high quality fixed income assets | • “Guardrail”  
• Cap amount of option budget as % of contract value | • Allows adequate illustration of products designed to offer more/less market exposure  
• However, establishes an “upper bound” for the annual contract exposure |
| Return on option budget investments | • Returns on budgets which are unlikely to be sustained over long periods | • “Return limit”  
• Cap annual return on option budget investments | • Explicitly regulates the long-run returns on instruments in which option budgets are invested |

III. Proposed framework parameterization

Equitable believes the parameters for the proposed governance framework should permit illustration of products designed to suit customer needs, but also recognize the limits of downside risk expected for an IUL policy (before a Variable policy may become more appropriate). Moreover, we also seek to integrate the regulator feedback received during the preceding months of discussion on AG49.

The table below contains our proposed framework parameterization and the supporting rationale for the parameterization.
The guardrail on the “size of the option budget” would be 5% in prevailing market conditions. We believe this cap balances the ability to create products with meaningful exposure market performance with the desire to limit contract value declines from underperformance. Moreover, to account for potential changes in prevailing investment yields we include a provision to increase the maximum option budget should prevailing investment yields rise in the future.

Governance over the illustrated rate-of-return on option budget investments contains two elements: a cap on the illustrated rate, and a requirement to project a “plausible but prudent” downside case. Equitable supports a prudent cap on the illustrated rate-of-return within the range of 110% - 130%. The 110% is a level advocated by NY DFS, which reflects the allowance of a prudent risk premium associated with converting the option budget into risky instruments (e.g., a 5% option budget is then illustrated to earn 5.5% in perpetuity). However, we also support a rate-of-return of up to 130%, which reflects the realization of a considerable risk premium (e.g., a 5% option budget is illustrated to earn 6.5% in perpetuity). We would not support levels above 130% on a sustained basis. Moreover, we believe levels close to 130% would require the parallel “downside” illustration of 85-100%. This level is consistent with no additional risk premium earned – a level consistent with a traditional fixed account. We support no lower than 85-100% to ensure the policyholder does not dismiss the downside case illustration as an unrealistic stress scenario. We believe that the existing Alternate Scale illustration could perform this role, if combined with a requirement for the prospective policy owner to acknowledge in writing that they have reviewed it and understand the downside risk.

Thank you once again for the opportunity to share our thoughts with you on this important issue. Please do not hesitate to contact me should you have any questions or concerns regarding our proposal.

<table>
<thead>
<tr>
<th>Illustration element</th>
<th>Governance approach</th>
<th>Proposed parameter</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size of option budget</td>
<td>• “Guardrail”&lt;br&gt;• Cap amount of option budget as % of contract value</td>
<td>• Max(5%, Annual Net Investment Earnings Rate)</td>
<td>• Floors annual loss of value at 5% of CSV&lt;br&gt;• Allows higher option budgets if prevailing investment yields rise&lt;br&gt;• Permits carriers to offer meaningful market exposure even in low interest rate environments (e.g. point-to-point cap of 10%+)</td>
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<tr>
<td>Return on option budget investments</td>
<td>• “Return limit”&lt;br&gt;• Cap annual return on option budget investments</td>
<td>• Cap set to [110%-130%]&lt;br&gt;• Requirement to illustrate 100%</td>
<td>• Caps option budget performance at realistic levels&lt;br&gt;• Zero outperformance (fixed account return) is a plausible yet prudent downside case</td>
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Aaron Sarfatti, ASA

Chief Risk Officer