Dear Mr. Andersen,

Equitable provides the following comments in response to the December 9, 2021 IUL Exposure, both as a reminder of Equitable’s 2020 proposal (attached), and also to indicate how the proposal would relate to illustrations of Volatility Controlled Funds (VCFs). More specifically, Equitable believes that reconsideration of its 2020 proposal is appropriate if it is decided that substantive changes to AG 49-A are necessary in order to address regulators’ concerns.

In essence, Equitable’s 2020 proposal would uniformly guardrail illustrations (1) by tying illustrated index credits to the option budget, and (2) by imposing a guardrail on assumed excess returns irrespective of the mechanics of the strategy. We think such an approach would be sensible under a “no free lunch” assumption.

One reason for adoption of AG 49-A was regulators’ concern that additional fees charged by insurers to fund multipliers and other indexed enhancements exposed policy owners to the risk that such relatively expensive policies would underperform policies without such fees and enhancements, if illustrated index performance did not materialize. While VCFs as described in the exposure document wouldn’t present the same concern (since the illustrated performance wouldn’t be reliant on charging additional fees), such VCFs could nevertheless expose policyholders to additional risk that loaned policies will collapse due to insufficient net policy value, if illustrated loan arbitrage (including the fixed bonus) doesn’t actually materialize.

It should be noted that any problem posed by relatively high values illustrated for VCFs isn’t primarily related to fixed bonuses. Any unused hedge budget for a VCF could be used in many other ways to increase illustrated values, such as to reduce COI charges or expense charges. In fact, fixed bonuses are a relatively transparent way of providing higher illustrated values, as compared to COI or other charge reductions which may be much less visible to policyholders.

The philosophy behind AG 49 was to use a traditional capped S&P 500 indexed account (the BIA) as a guardrail against overly optimistic illustrations. In order to achieve the subsequent goal that products with indexed enhancements should not illustrate better than products without such enhancements, AG 49-A in effect limited each company’s illustrated hedge budget to not exceed such company’s annual net investment earnings rate (ANIER).

While the limitation of the illustrated hedge budget to each company’s ANIER achieved the immediate objective of regulators, it does not comport well with the expected decline of current portfolio ANIERs given today’s far lower prevailing investment yields. In contrast, Equitable’s proposal limited the amount of each indexed account’s hedge budget that can be used to support illustrated indexed credits to the greater of the ANIER and 5%. This higher limit was based on the belief that (1) policyholders may reasonably seek contracts with greater market exposure than what can be created by a hedge budget supported only by prevailing yields on high quality assets, and (2) better governance of illustrated rates of return under Equitable’s proposal would allow for more latitude in the illustration of hedge budgets that rely in part on moderate supplemental charges and not exclusively on investment returns.

However, please note that Equitable’s proposed limit on the amount of the hedge budget that could be used to support the illustrated scale to max (ANIER, 5%) would limit the use of higher charges to support illustration of higher multipliers or other indexed enhancements, similar to the existing AG 49-A. It would also have the effect of limiting illustrated loan leverage.

One important element of Equitable’s proposal for AG 49-A was (1) the continuation from AG 49 of the allowance for more than one BIA and (2) the corresponding requirement that the assumptions for account charges and additional amounts credited (i.e., fixed bonuses) must be consistent between each BIA and the indexed accounts for which it acts as a guardrail. This protective feature of AG 49 was not included in the ACLI proposal for AG 49-A that was ultimately adopted.

Under Equitable’s proposal, for a VCF as described in the exposure document, the corresponding BIA would need to provide a fixed bonus that was at least as high as that provided by the VCF, and charges for the BIA could not be increased beyond the charges for the VCF, ensuring consistency between the hedge cost assumptions of the VCF and the BIA guardrail. More importantly, this aspect of Equitable’s proposal would ensure consistency of charge and credit assumptions between BIAs and all future indexed accounts they govern (not just VCFs), ensuring continued future efficacy of the BIA guardrails.

Equitable’s proposal integrated the best elements of the Independent Proposal and the ACLI proposal that was ultimately adopted – this integration is explained in detail in the table on page 3 of the proposal. Equitable’s proposal to this extent represented a compromise between the two approaches.

By replacing the look back approach to computing the BIA guardrail with the Black Scholes formula for option valuation plus a reasonable risk premium (we suggested 20% rather than 45%), Equitable’s proposal would have the added benefit of encouraging insurers to move away from dependence on “certain subsets of history” in evaluating past performance, and toward a more standardized and uniform method based on modern financial theory and practice. Under Equitable’s proposal, total illustrated index credits (including any indexed enhancements) would be limited to at most 6% (computed as 120% of 5%) per annum, except for insurers who have ANIERs of greater than 5% per annum.

Equitable’s attached 2020 proposal was written during the period of development leading up to adoption of the final version of AG 49-A, and hence the redline of the ACLI’s proposal that was submitted at that time (attached) would need to be updated. Equitable would welcome the chance to participate in any such effort, should regulators decide that substantive changes to AG 49-A are needed.

Thanks very much for the opportunity to share our thoughts with you and the other members of the IUL Illustration (A) Subgroup on these important matters.

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