

June 17, 2020

Fred Andersen
Deputy Commissioner of Insurance
Minnesota Department of Commerce
Chair, NAIC IUL Illustration (A) Subgroup

Re: Proposed Changes to Actuarial Guideline 49 Loan Illustration Provisions – Added Example

Fred:

On behalf of the companies listed below (the “IUL Coalition”), we are submitting examples in addition to our June 12 letter in support of Option 1 in the draft of Actuarial Guideline 49 (“AG 49-A”) that was submitted by the ACLI to the Life Actuarial Task Force (“LATF”). Our objective through these examples is to increase understanding about each of the three loan options that LATF is considering, and their potential impact.

Lincoln Financial Group
Pacific Life Insurance Company
National Life Group
John Hancock
Sammons Financial Group

These examples demonstrate each of the following key takeaways:

- The impact of fixed persistency bonuses is vastly overstated if the corresponding charge is not included.
- Our examples show Option 2 results in policies with fixed persistency bonuses illustrating worse than policies without fixed persistency bonuses when indexed loans are also illustrated.
- Option 1 does not create the risk of runaway illustration values.
- Option 2 creates inconsistent treatment of non-index credits between indexed loans and standard loans.

Discussion

Concerns about Option 1 claim that it creates the risk of “runaway illustrations,” (i.e., that non-indexed features could significantly enhance illustrated values). These concerns fail to acknowledge the critical fact that the illustrated values would also need to reflect the corresponding cost of the benefit. Our examples show that while the benefits of non-indexed features can be material, once the associated cost is also included the resulting net impact on illustrated values is less material.

The hypothetical examples below assume the illustration of an IUL policy where the insured’s issue age is 55 years old, premiums are paid on the policy for 15 years and an indexed loan is taken for 20 years. The

illustrated loan interest crediting rate is 6% and the loan interest charged rate is 5%, so the illustration values are at the maximum 1% difference between the index loan credited rate and charged rate.

Based on the above assumptions, the following hypothetical examples compare how Options 1, 2 and 3 impact illustrated values under three different scenarios:

- (A) No fixed bonus
- (B) 0.50% fixed bonus paid each year on both loaned and non-loaned values
- (C) 1.00% fixed bonus – paid each year on both loaned and non-loaned values

Options 1 and 3 allow the full amount of the bonus to be included in illustrated values for both loaned and non-loaned values. Option 2 limits the illustration of the bonus to non-loaned values only. Option 3 has lower illustrated values than Option 1 because the 1% loan leverage limit is reduced to 0.50%. Standard loans are also included as a comparison point.

| Bonus not linked to index performance | Maximum annual loan | | | |
|---------------------------------------|---------------------|----------|----------|---------------------------|
| | Option 1 | Option 2 | Option 3 | Std Loan Option 1, 2, & 3 |
| None | 58,202 | 58,202 | 55,160 | 52,421 |
| 0.50% | 66,995 | 63,406 | 63,406 | 60,176 |
| 1.00% | 76,906 | 68,869 | 72,666 | 68,869 |

As expected, if only the bonus amount is included without reflecting the associated cost, the illustrated values could be significantly higher when adding a fixed bonus. This is not how the illustrated values are determined, however. In actual practice, the carrier needs to offset the cost of the bonus to maintain profitability levels, and to pass illustration testing. This offset results in a material change in the illustrated values and mitigates the risk of runaway illustrations.

The examples were then updated to include the following costs:

- No fixed bonus, no additional cost
- 0.50% fixed bonus, with an associated cost of 5.59% of premium
- 1.00% fixed bonus, with an associated cost of 10.92% of premium

| Maximum annual loan | | | | |
|---------------------------------------|----------|----------|----------|--|
| Bonus not linked to index performance | Option 1 | Option 2 | Option 3 | Std Loan Option <u>1, 2, & 3</u> |
| None | 58,202 | 58,202 | 55,160 | 52,421 |
| 0.50% | 61,503 | 58,190 | 58,190 | 55,217 |
| 1.00% | 64,816 | 57,997 | 61,217 | 57,997 |

| Change in maximum annual loan | | | | |
|-------------------------------|----------|----------|----------|--|
| Change from no bonus | Option 1 | Option 2 | Option 3 | Std Loan Option <u>1, 2, & 3</u> |
| 0.50% | 3,301 | (11) | 3,030 | 2,796 |
| 1.00% | 6,614 | (204) | 6,057 | 5,577 |

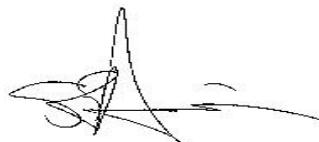
When reflecting the cost of the bonus in Options 1 and 3, the illustrated values are increased by adding a fixed bonus. Option 2 shows reduced illustrated values. This reduction results because, while the full amount of the bonus needs to be accounted for in setting the cost of providing the bonus, Option 2 does not allow the bonus to be illustrated on loaned values. This example demonstrates, however, that the additional illustrated value from an indexed loan is relatively modest when compared to the impact on standard loan illustrated values. The treatment of the fixed persistency bonus is consistent between Indexed Loans and Standard Loans for Option 1 (similar size increase in maximum annual loan) while the treatment is inconsistent between Indexed Loans and Standard Loans for Option 2 (maximum annual loan decreases for Indexed Loans but increases for Standard Loans).

Furthermore, the policyholder would also see a reduction in early cash value on the illustration due to the added charge to cover the associated cost of the bonus. This would be an important consideration for a policyholder evaluating the costs and benefits of the bonus.

In conclusion, these examples demonstrate that the impact on illustrated values from adding a fixed bonus on indexed loan illustration values is not significantly greater than illustrated values for a standard loan. They also address stated concerns about a significant risk that illustrated values will substantially increase under Option 1. For the reasons outlined in our June 12 letter, we urge LATF to adopt Option 1.

We appreciate the opportunity to provide input to the IUL Subgroup and look forward to further discussions.

Respectfully Submitted,



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cc: Reggie Mazyck, NAIC