June 12, 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

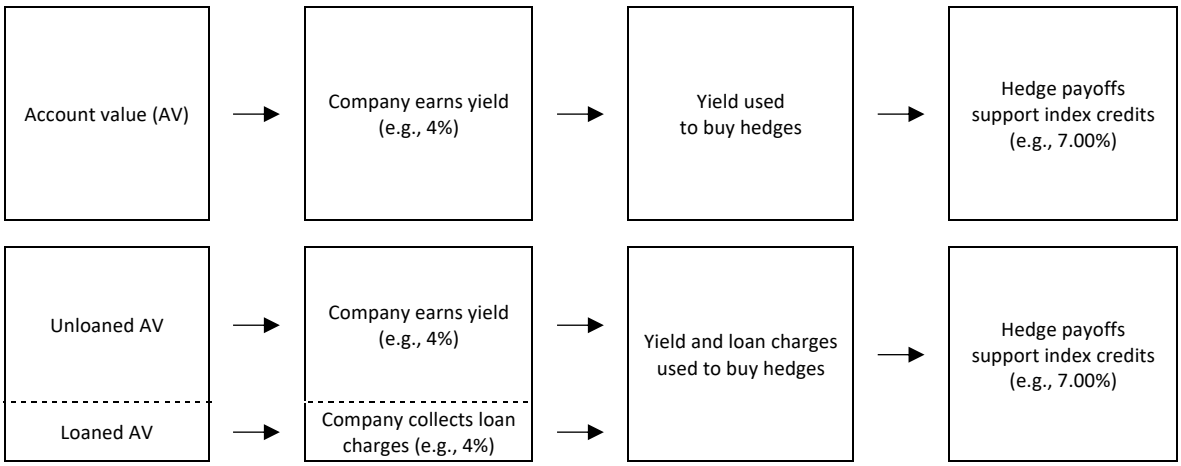
Fred:

On behalf of the companies listed below (the "IUL Coalition"), we are submitting this 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").

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

Background

Indexed loans allow policyholders to take loans from their policies and continue to earn indexed interest on the loaned policy cash values designated by the insurer as loan collateral. The mechanics that support indexed interest on loaned values are very similar to the mechanics that support indexed interest on unloaned values:



The same risk premium that supports index credits in excess of the company's portfolio yield also supports index credits in excess of the collected loan charge.

Although the mechanics that support indexed interest on loaned and unloaned values are very similar, the presence of a loan balance can make IUL policies more sensitive to indexed returns. Thus, when LATF first adopted AG 49, regulators chose to limit the illustrated "loan leverage" (the difference between the illustrated credits on cash values held as loan collateral or "indexed loan credit" and the loan charge) to 100 basis points.

Today, LATF has exposed three options for consideration. Each of those options would limit indexed loan leverage inclusive of all index multipliers, index bonuses, and other index credits. The options differ in the following ways:

- Option 1 would limit indexed loan leverage to 100 basis points;
- Option 2 would limit all indexed *and non-indexed* loan credits in excess of the loan charge to 100 basis points; and
- Option 3 would limit indexed loan leverage to 50 basis points.

The IUL Coalition Supports Option 1

Option 1 achieves the stated goal of imposing an appropriate level of new, additional conservatism on illustrations of indexed loan leverage. Option 1 is consistent with the underlying principles underlying the original loan leverage rule in AG 49. Options 2 and 3, on the other hand, go beyond regulators' stated concerns about IUL illustrations and would create new limits on illustrations applicable to all IUL products.

The purpose of the original loan leverage rule in AG 49 was to limit the difference between the indexed loan credit and the loan charge. That limit was considered desireable because "leverage" causes increased policy sensitivity. That rationale does not, however, apply to non-indexed credits. Non-indexed credits (e.g. a fixed, guaranteed persistency bonus or wellness credits) are not supported by hedge returns that can vary and do not contribute to increased policy sensitivity. Instead, non-indexed credits are supported by mechanisms that are not dependent on indexed returns, such as policy charges and/or margins on COIs. Furthermore, there are already limits to the amount of non-indexed credits that can be illustrated, as the illustrated level of non-indexed credits are subject to self-support/lapse-support tests. We therefore urge LATF to adopt Option 1 in AG 49-A because it addresses regulator concerns and accomplishes the purpose of the loan leverage rule in AG 49 without unnecessarily limiting non-indexed credits.

In addition to concerns that have been expressed about the use of the term "charge reductions" in Option 2, we do not support Option 2 for additional reasons. Specifically, Option 2 goes beyond indexed loan leverage by limiting <u>all</u> credits, regardless of whether they are tied to an index. Option 2 would apply to illustrations for all products - including products without multipliers or other enhancements. Option 2 would also discourage innovation. For example, a company desiring to offer non-indexed bonuses would need to illustrate the charges related to the bonus, yet would also be prohibited from illustrating the benefit on loaned account values with indexed loans. Option 2 would also introduce inconsistencies that would cause customer confusion (e.g. inconsistent treatment of features between unloaned AV vs loaned AV, standard loans vs indexed loans, max illustrated rate vs lower illustrated rates, and UL vs IUL).

Likewise, we do not support Option 3 because it would also add conservatism for illustrations of all IUL products (including products without multipliers or other enhancements). The 100 basis point loan leverage limit already includes conservatism for index loans.

The following example demonstrates the impact of the different options:

	Pre AG49	AG49	AG49-A Option 1	AG49-A Option 2	AG49-A Option 3
A. Assumed illustrated rate	7.00%	7.00%	7.00%	7.00%	7.00%
B. Asset based charge	2.00%	2.00%	2.00%	2.00%	2.00%
C. Index multiplier	50%	50%	50%	50%	50%
D. Index loan charge rate	4.00%	4.00%	4.00%	4.00%	4.00%
E. Section 6 Limit[1]	n/a	5.00%	5.00%	5.00%	4.50%
F. Index loan credit rate[2]	8.50%	5.50%	5.00%	5.00%	4.50%
Loan Leverage (Total Index Credits - Charge Rate = F – D)	4.50%	1.50%	1.00%	1.00%	0.50%
G. Non-indexed bonus (e.g. persistency bonus) applicable to indexed loaned amount	0.25%	0.25%	0.25%	0.00%	0.25%
Allowed to illustrate on indexed loaned amount?					
Wellness credits	Yes	Yes	Yes	No	Yes
Fixed, guaranteed persistency bonus	Yes	Yes	Yes	No	Yes
Other non-indexed credits & bonuses	Yes	Yes	Yes	No	Yes

[1]100 bps for AG 49 (excluding index multiplier and charge), 100 bps for Option 1 (including index multiplier and charge), 100 bps for Option 2 (including ALL bonuses and credits), 50 bps for Option 3

[2]Equals min(A,E) x (1 + C) - B for Pre AG 49 and AG 49, Equals min(A,E) for AG 49-A Options 1, 2, and 3

Observations

- Option 1 substantially limits the indexed credit to the loan amount, and adds conservatism for illustrations of products with multipliers or other enhancements beyond the current rule in AG 49 to address the stated concerns
- Option 2 would add even more conservatism for illustrations of all products because it would not allow the illustration of non-indexed credits & bonuses such as wellness credits or fixed, guaranteed persistency bonuses
- Option 3 would also add more conservatism for illustrations of all IUL products

March 25 IUL Coalition Comment Letter

In our comment letter dated March 25, 2020, we provided additional support for Option 1. For ease of reference we are providing a summary of key points from that letter:

1. Non-indexed credits do not contribute to loan "leverage." As described in the ACLI comment letter, loan "leverage" is when the index credit is higher than the loan charge. Non-indexed credits do not impact the index return or the loan charged rate, so ***Option 1 and Option 2 provide the same limit to loan leverage***.

2. Option 2 creates inconsistencies.

    a. **Loaned vs. Unloaned Values within IUL product**. Option 2 would allow the illustration of non-indexed credits on unloaned values but not on loaned values. The leads to difficulties for a consumer to compare and understand the costs associated with a loan and the impact on benefits under the policy.

    b. **Standard Loans vs. Indexed Loans within IUL product**. Option 2 would allow the illustration of non-indexed credits on Standard Loans but not on Indexed Loans. This creates confusion to the consumer when determining which type of loan would be best suited for them.

    c. **Maximum illustrated rate vs. lower illustrated rates.** Option 2 would allow the illustration of non-indexed credits at lower illustrated rates. This is misleading because it gives the consumer the impression that the bonus amount truly varies by index performance.

    d. **UL vs. IUL.** Option 2 would create a discrepancy between UL and IUL illustrations because UL policies can illustrate non-indexed credits on loaned values. This difference will make it more difficult for the applicant to understand which product better suits his or her needs and will also make it more difficult to compare the mechanics of each product.

3. Innovative products will be disadvantaged. Many innovative products are designed to add non-indexed credits that could increase a customer's policy value. The best way for a customer to understand the benefits derived from these features is in the illustration. Option 2 would create a disadvantage for innovative product designs, such as policies that offer wellness credits to customers who engage in activites that help them live longer and healthier lives.

4. Option 1 does not provide any undue "optimism" compared to Option 2. The illustration of non-indexed credits does not any additional optimism because the credits will be paid regardless of future index performance. Therefore the level of "optimism" in projecting uncertain events like indexed returns is identical between the two options.

In conclusion, AG 49 was created to limit the illustration of indexed performance. Option 2 goes beyond the scope of AG 49 by restricting the illustration of non-indexed credits and would add conservatism for all IUL products (including products without multipliers or other enhancements). Option 3 would also add conservatism for all IUL products (including products without multipliers or other enhancements). Thus, the IUL Coalition urges LATF to adopt Option 1 in AG 49-A because Option 1 limits the illustration of indexed loan credits while allowing for the illustration of innovative non-indexed product features.

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

Respectfully Submitted,

Scott R. Harrison
High Point Strategies, LLC
scott@highpointstrategies.llc

cc: Reggie Mazyck, NAIC