Valmark Financial Group, LLC
130 Springside Drive
Akron, OH 44333
P 330-576-1234 **TF** 800-765-5201

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Mr. Reggie Mazyck, Life Actuary
National Association Insurance Commissioners
IUL Illustration (A) Subgroup
11353 Liberty Street
Fulton, MD 20759

Via Email @ rmazyck@naic.org and VIA Overnight Delivery

Dear Mr. Mazyck and Members of the Committee:

Thank you for the opportunity to comment on what Index Universal Life ("IUL") promoters call "proprietary indexes" and what the committee refers to as volatility-controlled funds. I commend the NAIC for again turning to address continued abuses and misleading consumer information with IUL life illustrations. In our experience, the core issue with IUL continues to be the inappropriate marketing of IUL through overly aggressive, highly complex illustrations leading consumers to have unreasonable expectations of far higher credits to their policies than they have, or will ever, receive from these products. The consumer is left with a myriad of resulting issues including loss of protection, additional outlays, and even income tax exposure.

I am CEO and Chairman of the Valmark Financial Group. We believe in the importance of life insurance products in protecting families and businesses. We are proud of our role in helping advisors put in place over $60 billion of insurance protection for clients and have extensive experience with all kinds of life insurance issued through scores of carriers. Our group also weighed in with a comment letter in May 2020 as part of the NAIC's and this Committee's attempt to address IUL abuse through *Actuarial Guideline XLIX-A* ("AG 49-A"). Our company works with and though 126 independently owned financial services firms that offer a wide range of financial products including life insurance and annuity products.

The financial professionals in these firms have clients and prospects who come to them for second opinions on schemes that utilize proprietary indexes as a key element in selling IUL contracts. Because of my writings and social media posts on IUL sales abuses in the marketplace, consumers who either purchased one of these programs or who were close to committing millions of dollars in premiums (some on a leveraged basis) have also sought me out for a second opinion. Additionally, we have helped our financial professionals work through dozens of additional proposals and in-force plans sold by other agents.

In the last 2 years since AG 49-A was put in place, we have seen dozens of proposed and in-force IUL plans -- many featuring these proprietary indexes. A significant number of these policies are also leveraged though premium financing using external bank debt. In our opinion, AG 49-A and its narrow focus on certain types of bonuses did not stop IUL illustration abuse, AG49-A just moved the locus of the abuse to illustrations with proprietary indexes especially as cap rates have continued to fall. To put it bluntly, every time regulatory action is taken to rein in abuse,

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the product promoters find new ways to circumvent both the spirit and language of the regulations.

It has become abundantly clear that proprietary indexes' heavy reliance upon back-tested models further inflates consumer expectations of returns even to the point of where consumers believe the AG 49-A limited illustration are a "conservative baseline" for the returns they will likely see. They have little or no understanding that these back-tested returns for a hypothetical index that did not exist during the time measured, nor for the discretionary contractual elements that could negatively impact them. It is inherently misleading to apply today's economic climate (portfolio yields, options pricing, market volatility) that determine cap rates, participation rates, thresholds to a past economic period which would have had different factors at play in every year of the back-tested models.

We believe that proprietary indexes just take the abuse of IUL to a new level and are purposefully designed to maximize IUL sales, by leading the consumer to believe that they will get higher returns than a capped S&P 500 index, while reducing financial risk and costs for the issuer. These indexes evade the purpose and the spirt of previous attempts by the NAIC to restrain unethical marketing of IUL products in AG 49. Our concern with these indices' centers on 3 key issues: First, these products are far too complex for consumers to understand and in fact even most of the agents who sell them do not know how they work. Second, the use of back tested returns is misleading to consumers and set unreasonable expectations of return. And third, the structure of these proprietary index options lets insurance companies indirectly do exactly what AG 49-A was meant to prohibit with bonuses and multipliers.

The complexity of index calculations is not understood by consumers buying these products and most people selling them

Our first exposure to these proprietary indexes was in Index annuity products, before these indexes were featured in IUL products. (See enclosed whitepaper, All That Glitters Is Not Gold, that Valmark produced to help our advisors better understand how one of these indexes functioned in an annuity.) In that paper, we document the wide divergence between what the contract language provided, and the marketing materials inferred the customer would receive. Presumably, after the client had paid their premium, they could read the 26-page contract and the 156-page index description and have all of 10 days to determine if their purchase was in their best interest. If the policyholder had a Ph.D. in finance, they could, theoretically, make an informed decision on the many variables that would impact their policy's performance, including various policy charges and the myriad of ways the insurance company could change the cap or spreads as well as fund allocations to low-yielding buckets in the index and ultimately discontinue and substitute indexes at their unilateral discretion. The whitepaper took a team of experienced professionals several days to dissect these documents and outline our understanding of this one investment option in a single contract. We have yet to meet a single policyholder who we believe understands these complexities to make an informed decision.

Back-tested returns used in marketing materials and illustration lead consumers to believe that they will earn substantially more than they are likely to earn

Previous regulatory attempts to reign the "overpromise risk" has primarily focused on aggressive IUL illustrations. Proprietary indexes usually magnify this problem. One illustration we reviewed from a leading IUL carrier showed a "30-year historical index performance" with multiplier credits averaging 10.73% with various range of returns over 10, 15, 20, and 25 years all earning no less than 9.46% in the illustration materials. The clear implication of the entire presentation was that the 6.33% AG 49-A limited rate was a baseline that was certain to be exceeded and very conservative. Under these conditions, of course it made sense to borrow millions of dollars to buy this policy.

We've subsequently examined the actual returns of the proprietary index annuity we focused on in our 2019 whitepaper. The results are telling. The average return was far less than standard equity returns and in a 5-year period (where equity markets were up substantially, averaging between 16% and 18% per year depending upon whether you included dividends), the proprietary index averaged a return of less than 4% a year. See the following table for actual returns:

Year	S&P 500 Price Index	JP Morgan Mosaic II[1]	JP Morgan Mosaic II /w Floor[2]
2017	19.42%	6.68%	6.68%
2018	-6.24%	-0.32%	0.00%
2019	28.88%	6.84%	6.84%
2020	16.26%	-2.11%	0.00%
2021	26.02%	4.91%	4.91%
Total	84.34%	16.00%	18.43%
5-year avg	16.86%	3.20%	3.70%

Not unsurprisingly, back-tested returns often assume that all the unfavorable contractual levers that can be pulled by companies, at the expense of the consumer, will not be pulled. Again, not unsurprisingly, these back-tested returns often assume initial caps, participation rates, spreads and multipliers are maintained during their entire lookback period. This practice in based upon the erroneous assumption that today's underlying economic climate remained the same for the entirety of the back testing period -- including portfolio yield, options pricing, options budget, volatility, and options demand. The hindsight of knowing which markets, at which times, performed well leads to what amounts to "time machine investing." Historically a switch to

[1],[2] For the sake of demonstrating relative expected past performance of an index compared to the expected past performance of the Nationwide New Heights fixed indexed annuity using the JP Morgan Mosaic II index allocation, the hypothetical calculations used the following methodology. Actual annual Mosaic II index performance for calendar years beginning January 2017 through November 2021 was taken and reduced each calendar year by the 1.50% spread currently applied to the Mosaic indexed annuity allocation Strategy A as of February 1, 2022. These new annual returns were then used to calculate the total return of an investment in 2-year term increments to reflect the 2-year term on the indexed annuity strategy, with 0% being the lowest possible return over a 2-year term. These returns do not reflect any actual performance or client experience. Actual client performance in the Nationwide New Heights indexed annuity is based on index allocation, declared rate allocation, declared rate, strategy spreads, and index performance during the 2-year term from contract anniversary to contract anniversary. Clients should reference their account with Nationwide to see their actual performance.

fixed income, when rates were falling, produced positive results, but it would not if bond yields increased from our current historical lows. If we could go back in time and build an index, why not build a FAANG index which invests in the five most popular, best-performing, American technology companies: Meta (formerly known as Facebook), Amazon, Apple, Netflix, and Alphabet (formerly known as Google)?

In fact, the original AG 49 was instituted, in part, to address exotic indexes projecting significant returns through their cherry-picking of esoteric indexes, like the Hang Seng, in years of outsized returns.

We have consistently argued that even the basic assumption underlying AG 49, allowing companies to assume a 45% options profit to support their cap rates, is unstainable and unrealistic. Time has borne this belief out. Instead of avoiding the decline in interest rates, IUL policies have magnified these declines as drops in cap rates have produced dramatically lower illustrated rates.

<u>The complexity of IUL is well beyond the ability of most consumers to understand</u>

IUL policies are the most complex form of life insurance sold today. It takes an immense technical knowledge of life insurance to fully comprehend the mechanics of IUL especially when coupled with the use of a proprietary index. Meticulous reading by well-informed and experienced professionals still may not spot the deception by omission or inference rampant in many IUL illustrations. We've included with this letter an example of the methodology of one such index -- the S&P Prism Index. Does the average consumer understand "trend signals," "a binary position indicator," "90-day volatility of excess returns," "the 200-day excess return of each sub-index," "scaled volatilities," and "inverse weights with regard to target volatility?" Will these consumers actually "refer to the Risk Control indices section of the index mathematics document for equations 55, 56, 59, and 60, where the underlying index is the reference index calculated above and: K_{rb} = Min (100% ,5.5%/Realized Volatility$_{t-2}$)?" It's doubtful they will. In fact, it's simply preposterous to believe a consumer (or their agent) is equipped to comprehend these complexities.

<u>Proprietary indexes exploit a loophole in AG 49-A</u>

Proprietary indexes were designed to hide the drop in standard capped indexes like the S&P 500 that IUL products have historically had and lock in lower options prices. These proprietary indexes, the creation of very smart investment bankers, are designed to be good for the profitability of life insurance companies because they are predicable. At times when options prices are high, these proprietary indices reduce exposure to indexes and options costs. These theoretical excess options profits can be used to support multipliers and bonuses.

Others that have followed this debate will opine more clearly how these proprietary indexes allow the very loopholes in AG49-A to continue. Theoretical excess options budgets are being used to support the very bonuses that NAIC sought to address with AG-49 A magnifying illustrated values.

Conclusion

Unfortunately, the disappointment IUL policyholders are experiencing today is not new to the life business. As bond and crediting rates have dropped over the last 30 years, general account products have seen declines in credited rates, unachieved projections, and disappointed policyholders. Life insurance ended up costing more and paying less in benefits than expected. A new and quite disturbing trend is the tremendous amount of leverage consumers are being encouraged to take on through IUL premium financed bank loans. Consumers of various economic means are unknowingly betting significant parts of their liquid net worth on the arbitrage between bank loans and what they believe will be credited to IUL policies. This is an uninformed bet against loaded dice with little or perhaps no prosect of winning for the policyholder.

We continue to see overly aggressive IUL premium financed proposals and transactions harming consumers in very significant ways. This activity emanates primarily from insurance-only licensed producers who operate with no oversight of their sales materials or advice and without the supervision of a FINRA-registered broker-dealer or the Securities & Exchange Commission. These proposals and transactions often involve millions of dollars in a complex product that neither they nor consumers fully understand. Their advice to consumers to leverage the purchase of these complex products and pledge an illiquid investment against loans, sometimes which exceed the client's entire liquid net worth, to pay for the purchase of IUL policy boarders on criminal. There is no real financial arbitrage in these transactions, just regulatory arbitrage.

The NAIC needs to investigate these practices and create a much more robust solution for dealing with this problem rather than attempting superficial changes to how IUL is illustrated. I would welcome the opportunity to share with the committee numerous actual examples of this abuse should the NAIC decide to address this ongoing problem. Again, thank you for the opportunity to be part of your effort to protect consumers.

Sincerely,

Lawrence J. Rybka, JD, CFP®
Chairman, CEO

Enclosures