Financial Security…for Life.

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Senior Actuary

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

Re: ACLI proposed draft of Actuarial Guideline 49-A

Dear Mr. Andersen:

The American Council of Life Insurers (ACLI)[1] appreciates the opportunity to submit the following draft of AG49-A on prospective requirements for IUL illustrations.

During the March 3rd call of the Subgroup, multiple commenters suggested possible language to revise the Guideline. ACLI reviewed the various proposals and attempted to harmonize a version that both addresses concerns raised by regulators while providing consumers with the information necessary to make informed decisions on products they are considering for purchase.

The attached revisions (Attachment One) borrow concepts raised by the various drafts, and we're appreciative of all the thought that went into each of these efforts. There are relatively small changes from the previously submitted March 24th draft, which are highlighted in the attachment. We note that, while this draft reflects our best-effort, there remain items that require additional consideration.

Accompanying the draft is a spreadsheet that walks through several examples of how the mechanics of this proposal are operating. One tab, 'ACLI 04-14-20 Draft-BIA HB=NIER', demonstrates how this works when the BIA hedge budget is equal to the NIER; these results should be consistent with the March 24th draft. Tab 'ACLI 04-14-20 Draft-BIA HB<NIER' shows the mechanics when the BIA hedge budget is less than the NIER, which shows the impact of many of the additional edits in this proposed version.

Consistent with the ACLI's established opposition to retroactivity, AG49-A assumes that these new requirements are applicable on a prospective-only basis, and solely for policies issued after the guideline's effective date.

ACLI notes the following in this best-effort draft:

- Definitions in Section 3 were refined from the earlier ACLI 02-21-20 draft.
- Language in Section 4 and 5 were largely borrowed from the Securian et al draft, with several modifications. We note the language in Section 5 requires additional consideration.
- For the treatment of Policy Loans (Section 6 and within the definition of "Alternate Scale"), industry is offering two proposals for regulators to consider. We note that the language in this

[1] The American Council of Life Insurers (ACLI) advocates on behalf of 280 member companies dedicated to providing products and services that promote consumers' financial and retirement security. 90 million American families depend on our members for life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, dental and vision and other supplemental benefits. ACLI represents member companies in state, federal and international forums for public policy that supports the industry marketplace and the families that rely on life insurers' products for peace of mind. ACLI members represent 95 percent of industry assets in the United States. Learn more at www.acli.com.

section may require additional modification. This language attempts to capture the two main approaches previously submitted.

Indexed UL products may allow the loaned amount to remain in the index and earn index credits. When the index return is higher than the loan charged rate then the loan is “leveraged”. IUL products are the only product type where actuarial guidelines contemplate this type of leveraging in illustrations. An objective for regulators in tightening this language is to ensure that the Supplemental Hedge Budget is not double counted.

During a straw poll at the end of the October 17 conference call, the vote favored language similar to Option 2. However, some of the language proposed subsequent of this call was similar to Option 1. We lay out arguments below for each approach, and we recommend further discussion on the topic.

We note there are advantages of each approach:

- **Option 1:** 100 bp loan leverage limit only applies to index credits:
    - Provides consistent treatment of illustrated bonuses between fixed UL and indexed UL, as well as consistent treatment of standard loans and indexed loans within an indexed UL.
    - Is consistent with the original scope of AG49, which was to apply to index-linked credits.
    - Allows for the illustration of consistent maximum crediting rates between IUL policies with a loan and IUL policies without a loan.
    - The Option 2 language may pose technical difficulties to implement.
    - The Option 2 language may be read to disadvantage innovative product designs, such as policies that offer wellness credits to customers who engage in activities that help them live longer and healthier lives.
- **Option 2:** 100 bp loan leverage limit applies to index credits and other types of bonuses:
    - If the limit only applies to Index Credits, loan leverage may exceed 100 bps using fixed rate bonuses or other innovative product designs.
    - Since all index accounts will illustrate similarly under the new AG 49, other bonus types may become more common.
    - This is a maximum illustration limit to prevent illustrations that are overly optimistic.
    - Products could still offer other bonus types and demonstrate how they work at lower interest rate illustrations or when loans are not illustrated.

We look forward to a discussion of our proposed language. Thank you.

Sincerely,

cc Reggie Mazyck, NAIC

~~Adopted by the Life Insurance and Annuities (A) Committee – Dec. 11, 2016~~
~~Adopted by the Life Actuarial (A) Task Force – Nov. 17, 2016~~

Actuarial Guideline XLIX-A – Draft [ACLI DRAFT APRIL 14, 2020]

THE APPLICATION OF THE LIFE ILLUSTRATIONS MODEL REGULATION TO POLICIES WITH INDEX-BASED INTEREST SOLD AFTER [greater of 5 months after LATF adoption and 3 months after EX/Plenary Adoption*]

Background

The *Life Insurance Illustrations Model Regulation* (#582) was adopted by the NAIC in 1995. Since that time there has been continued evolution in product design, including the introduction of benefits that are tied to an ~~external~~ index or indices. Although these policies are subject to Model #582, not all of their features are explicitly referenced in the model, resulting in a lack of uniform practice in its implementation. In the absence of uniform guidance, two illustrations that use the same index and crediting method often illustrated different credited rates. The lack of uniformity can be confusing to potential buyers and can cause uncertainty among illustration actuaries when certifying compliance with Model #582.

In 2019, the NAIC decided that illustrations of products with multipliers, cap buy-ups, and other enhancements should not illustrate better than products without such features. This new requirement is intended to apply to illustrations on policies sold on or after the effective date of this guideline while the existing requirements continue to apply for inforce illustrations on policies sold before the effective date of this guideline.

This guideline provides uniform guidance for policies with index-based interest. In particular, this guideline:

(1) Provides guidance in determining the maximum crediting rate for the illustrated scale and the earned interest rate for the disciplined current scale.

(2) Limits the policy loan leverage shown in an illustration.

(3) Requires additional consumer information (side-by-side illustration and additional disclosures) that will aid in consumer understanding.

Text

1. Effective Date

This Actuarial Guideline shall be effective ~~as follows:~~for all new business and in force illustrations on policies sold on or after [greater of 5 months after LATF adoption and 3 months after EX/Plenary Adoption].

~~i. Sections 4 and 5 shall be effective for all new business and in force life insurance illustrations on policies sold on or after September 1, 2015.~~

~~ii. Effective March 1, 2017, Section 4 and Section 5 shall be effective for all in-force life insurance illustrations on policies within the scope of this actuarial guideline, regardless of the date the policy was sold.~~

~~iii. Sections 6 and 7 shall be effective for all new business and in force life insurance illustrations on policies sold on or after March 1, 2016.~~

2. Scope

This Actuarial Guideline shall apply to any life insurance illustration that meets both (i) and (ii), below:

i. The policy is subject to Model #582.

~~ii. Interest credits are linked to an external index or indices.~~
ii. The policy offers Indexed Credits.

3. Definitions

A. Alternate Scale: A scale of non-guaranteed elements currently being illustrated such that:

i. The ~~credited rate~~total annual percentage rate of Indexed Credits for each Index Account does not exceed the lesser of the maximum ~~credited~~total percentage rate of Indexed Credits for the illustrated scale less 100 basis points and the credited rate for the Fixed Account. If the insurer does not offer a Fixed Account with the illustrated policy, the ~~credited rate~~total annual percentage rate of Indexed Credits for each Index Account shall not exceed the average of the maximum ~~credited~~total percentage rate of Indexed Credits for the illustrated scale and the guaranteed ~~credited~~total percentage rate of Indexed Credits for that account. However, the ~~credited rate~~total annual percentage rate of Indexed Credits for each Index Account shall never be less than the guaranteed ~~credited~~total percentage rate of Indexed Credits for that account.

ii. If the illustration includes a loan, the illustrated ~~rate credited to the loan balance does~~Policy Loan Interest Credited Rate shall not exceed the illustrated ~~loan charge.~~Policy Loan Interest Rate. For example, if the illustrated Policy Loan Interest Rate is 4%, the Policy Loan Interest Credited Rate shall not exceed 4%.

iii. All other non-guaranteed elements are equal to the non-guaranteed elements for the illustrated scale.

B. Annual Net Investment Earnings Rate: Gross portfolio annual earnings rate of the general account assets (excluding hedges for Indexed Credits), less provisions for investment expenses and default cost, allocated to support the policy. Charges of any kind are not included in the Annual Net Investment Earnings Rate .

~~B.~~C. Benchmark Index Account: An Index Account with the following features:

i. The interest calculation is based on the percent change in S&P 500® Index value only, over a one-year period using only the beginning and ending index values. (S&P 500® Index ticker: SPX)

ii. An annual cap is used in the interest calculation.

iii. The annual floor used in the interest calculation shall be 0%.

iv. The participation rate used in the interest calculation shall be 100%.

v. Interest is credited once per year.

~~vi. Account charges do not exceed the account charges for any corresponding Index Accounts within the policy in any policy year. If Index Accounts with different levels of account charges are offered with the illustrated policy, more than one Benchmark Index Account may be used in determining the maximum illustrated crediting rates for the policy's Index Accounts, subject to the requirements of 5.D.. However, for each Index Account within the policy, only one Benchmark Index Account shall apply. Any rate calculated in 4 (B) shall not apply for an Index Account if the account charges for the applicable Benchmark Index Account exceed the account charges for that Index Account in any policy year. Account charges include all charges applicable to an Index Account, whether deducted from policy values or from premiums or other amounts transferred into such Index Account.~~

vi. ~~**Additional amounts credited**~~The hedge budget used to determine the cap in 3 (C) (ii) does not exceed the Annual Net Investment Earnings Rate. Charges of any kind are not included when determining the applicable cap rate.

vii. There are ~~not less than the~~no additional amounts credited ~~for any corresponding Index Accounts within the policy in any policy year. Any rate calculated in 4 (B) shall not apply for an Index Account if the additional amounts credited for the applicable Benchmark Index Account~~ that are ~~less than the additional amounts credited for that Index Account in any policy year. Additional amounts include all credits that increase policy values~~linked to an index or indices in excess of the interest calculation, including but not limited to ~~experience refunds or~~multipliers and bonuses.

viii. There are no limitations on the portion of account value allocated to the account.

ix. A single Benchmark Index Account will be determined for each policy. A policy shall have no more than one Benchmark Index Account.

~~C.~~D. Fixed Account: An account where the amounts credited ~~rate is~~are not tied to an ~~external~~ index or indices.

~~D.~~E. Index Account: An account where the amounts credited ~~rate is~~are tied to an ~~external~~ index or indices.

F. Indexed Credits: Any interest credit, multiplier, factor, bonus, charge reduction, or other enhancement to policy values that is linked to an index or indices. Credits to the policy resulting from a floor are included.

G. Hedge Budget: For each Index Account , the total annualized amount assumed to be used to generate the Indexed Credits of the account, expressed as a percent of the account value in the Index Account. This amount should be consistent with the hedging program of the company.

H. Loan Balance: Any outstanding policy loan and loan interest, as defined in the policy.

I. Policy Loan Interest Rate: The annual interest rate that is charged on any Loan Balance. This does not include any other policy charges.

J. Policy Loan Interest Credited Rate: The annual interest rate credited that applies to the portion of the account value backing the Loan Balance, as defined in the policy.

i. For the portion of the account value backing the Loan Balance that is in a Fixed Account, the Policy Loan Interest Credited Rate is the applicable annual interest crediting rate, as defined in the policy.

[OPTION FOR CONSIDERATION: Please see commentary on these approaches in the ACLI Comment Letter; language for Option 1 and Option 2 may need to be tightened up:

Option 1: ii. For any portion of the account value backing the Loan Balance that is in an Index Account, the Policy Loan Interest Credited Rate is the total percentage rate of Indexed Credits, net of any applicable Supplemental Hedge Budget, for that account, as defined in the policy.

Option 2:ii. For any portion of the account value backing the Loan Balance that is in an Index Account, the Policy Loan Interest Credited Rate is the total percentage rate of Indexed Credits and all illustrated bonuses, charge reductions or other enhancements that impact the portion of the account value backing the Loan Balance, net of any applicable Supplemental Hedge Budget for that account, as defined in the policy.]

K. Supplemental Hedge Budget: For each Index Account, the Hedge Budget minus the minimum of the Annual Net Investment Earnings Rate and the hedge budget that determines the Benchmark Index Account. The Supplemental Hedge Budget will never be less than zero. This amount should be consistent with the hedging program of the company.

4. Illustrated Scale

The ~~credited rate~~total annual percentage rate of Indexed Credits for the illustrated scale for each Index Account shall be limited as follows:

A. Calculate the geometric average annual credited rate for ~~each applicable~~the Benchmark Index Account for the 25-year period starting on 12/31 of the calendar year that is 66 years prior to the current calendar year (e.g., 12/31/1949 for 2015 illustrations) and for each 25-year period starting on each subsequent trading day thereafter, ending with the 25-year period that ends on 12/31 of the prior calendar year.

i. If the insurer offers ~~an applicable~~a Benchmark Index Account with the illustrated policy, the illustration actuary shall use the current annual cap for the ~~applicable~~ Benchmark Index Account in 4 (A).

ii. If the insurer does not offer ~~an applicable~~a Benchmark Index Account with the illustrated policy, the illustration actuary shall use actuarial judgment to determine a hypothetical, supportable current annual cap for a hypothetical, supportable Index Account that meets the definition of ~~a~~the Benchmark Index Account, and shall use that cap in 4 (A).

B. For ~~each applicable~~ the Benchmark Index Account~~,~~ the total Indexed Credits illustrated as a percentage of the account value in the Index Account shall not exceed the minimum of (i) and (ii):

~~iii.~~i. the arithmetic mean of the geometric average annual credited rates calculated in 4 (A)~~.~~ ~~**shall be the maximum credited rate(s) for the illustrated scale.**~~

ii. 145% of the Annual Net Investment Earnings Rate.

C. For any other Index ~~Accounts using other equity, bond, and/or commodity indexes, and/or using other crediting methods, the illustration actuary shall use actuarial judgment to determine the maximum credited rate~~ Account that is not the Benchmark Index Account in 3 (C), the total Indexed Credits illustrated as a percentage of the account value in the Index Account prior to the deduction of any charges used to fund a Supplemental Hedge Budget shall not exceed the minimum of (i) and (ii):

i. The maximum Indexed Credits for the Benchmark Index Account calculated in 4 (B) plus the Supplemental Hedge Budget for the ~~illustrated scale. The determination shall~~Index Account.

ii. The total Indexed Credits that reflect the fundamental characteristics of the Index Account and the ~~parameters shall have the~~ appropriate relationship to the expected risk and return of the ~~applicable~~ Benchmark Index Account. ~~In no event~~The illustration actuary shall use actuarial judgment to determine this value using lookback methodology consistent with 4 (A) and 4 (B) (i) where appropriate.

~~B.~~ D. For purposes of compliance with Section 6 (C) of Model #582, the ~~credited rate for~~Supplemental Hedge Budget may cause the illustrated ~~scale~~rate to exceed the earned interest rate underlying the Disciplined Current Scale. ~~applicable rate calculated in 4 (B).~~

At the beginning of each calendar year, the insurer shall be allowed up to three (3) months to update the credited rate for each Index Account in accordance with 4 (B) and 4 (C).

5. Disciplined Current Scale
The earned interest rate for the disciplined current scale shall be limited as follows:

A. If an insurer engages in a hedging program for ~~index-based interest~~Indexed Credits, the assumed earned interest rate underlying the disciplined current scale ~~shall not exceed 145%~~for the policy, inclusive of ~~the annual net investment earnings rate (gross portfolio earnings less provisions for investment expenses and default costs) of the~~all general account assets ~~(excluding hedges for index-based credits) allocated to support the policy.~~and hedge assets that support the policy, net of default costs and investment expenses (including the amount spent to generate the Indexed Credits of the policy)shall not exceed:

i. the Annual Net Investment Earnings Rate, plus

ii. 45% of the lesser of (1) and (2):

1. Hedge Budget minus any floor.

2. The minimum of the Annual Net Investment Earnings Rate and the hedge budget that determines the Benchmark Index Account.

These amounts should be adjusted for timing differences to ensure that fixed interest is not earned on the hedge cost.

The above approach does not stipulate any required methodology as long as it produces a consistent limit on the assumed earned interest rate.

For a product with multiple Index Accounts with different Hedge Budgets that are less than or equal to the NIER, a maximum rate in 5.A. should be calculated for each set of accounts with different Hedge Budgets.

B. If an insurer does not engage in a hedging program for ~~index-based interest~~Indexed Credits, the assumed earned interest rate underlying the disciplined current scale shall not exceed the ~~annual net investment earnings rate of the general account assets allocated to support the policy~~Annual Net Investment Earnings Rate.

C. These experience limitations shall be included when testing for self-support and lapse-support under Model #582, accounting for all illustrated benefits including any illustrated benefits and bonuses that impact the policy's account value.

~~D. If more than one Benchmark Index Account is used for an illustrated policy, each set of Index Accounts that correspond to each Benchmark Index Account must independently pass the self-support and lapse-support tests under Model #582, subject to the limitations in 5 (A), (B), and (C). All experience assumptions that do not directly relate to the Index Accounts as to expenses, mortality, investment earnings rate of the general account assets, lapses, and election of any Fixed Account shall equal the assumptions used in the testing for the entire policy.~~

6. Policy Loans

If the illustration includes a loan, the illustrated ~~rate credited to the loan balance~~Policy Loan Interest Credited Rate shall not exceed the illustrated ~~loan charge~~Policy Loan Interest Rate by more than 100 basis points. For example, if the illustrated Policy Loan Interest Rate is 4%, the Policy Loan Interest Credited Rate shall not exceed 5%.

7. Additional Standards

The basic illustration shall also include the following:

A. A ledger using the Alternate Scale shall be shown alongside the ledger using the illustrated scale with equal prominence.

B. A table showing the minimum and maximum of the geometric average annual credited rates calculated in 4 (A).

C. For each Index Account illustrated, a table showing actual historical index changes and corresponding hypothetical ~~interest rates~~Indexed Credits using current index parameters for the most recent 20-year period.

