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Mr. Fred Andersen  
Chair, Index Universal Life (IUL) Illustration (A) Subgroup (Subgroup) 

Via Email: jfrasier@naic.org

Indexed Universal Life (IUL) Illustration (A) Subgroup  
Exposure for Model Reg 582 Ideas

Dear Mr. Andersen:

The Coalition of Concerned Insurance Professionals appreciates the opportunity to comment on this Exposure Draft for Model Reg 582 revisions.

The Subgroup is seeking comments to the following:

• Which Model Reg 582 subsections to consider opening
  o Provide an opinion on aspects of proposed Model Regulation revision concepts that are actuarial in nature and aspects that may be non-actuarial.

• Concepts for draft revisions to address broad IUL illustration issues

• Whether such addressing of broad issues could occur without revising the Model Regulation

We will first address the specific comments requested by the Subgroup addressing Index UL and then provide a broader and historical perspective on Model Reg 582.
Index UL and Targeted Revisions to Model Reg 582

We believe that any attempt to open Model reg 582 to include Index UL must first address AG49-A concerns. Accordingly, we recommend the combination of Phase 1 – The Securian Proposal (with an effective date of March 2023) and Phase 2 – The Coalition Proposal (with an effective date of January 2024) AG49-A amendments in the plan to reopen Model 582. These two phases are transitional prerequisites that are assumed to have been implemented by 1/1/2024 and will facilitate a more orderly addition of indexed methodologies into Model Reg 582 and allow any Reg 582 working group to commence following this year’s NAIC winter meeting.

Prior to addressing targeted revisions to Model Reg 582, the AG49-A as amended, will have established for index UL illustrations the following:

i. Removal of the lookback methodology described in Section 4(A) of AG 49-A that uses historical index return data combined with declared elements to produce a maximum illustrated rate

ii. Installation of the Hedge Budget in Section 4(C) as the maximum illustrated rate for any indexed account.

iii. Disclosure of the Hedge Budget in Section 7 for each Indexed Account as the basis for the illustrated rate

iv. Reduction of the 45% factor in Section 5(A)(i) to 0% and clarification of actuarial supportability testing to align with changes made to Section 4. This will bring non-BIA accounts into alignment with the BIA account, and also create consistency in illustrations between Indexed UL and other fixed life insurance products.
In no way does the elimination of the lookback from Section 4(A) reduce the ability for the consumer to understand the mechanics of indexed crediting or the product. The ability to demonstrate the variability and hypothetical historical returns of indexed crediting is already available in the illustration through the tables described in AG 49-A Section 7(C). We believe these tables should remain and could be enhanced by Model Reg 582 amendments adopting a standardized stochastic analysis of volatility for life insurance products and require illustrations to show consumers the probability of the illustrated assumptions to sustain to policy maturity.

Appropriate sales of Index UL can continue while modifications to #582 are explored to holistically incorporate indexed crediting.

The examination of targeted sections of #582 to address Index UL are as follows:

- Section 4(D) of 582 states that “‘Disciplined current scale’ means a scale of non-guaranteed elements constituting a limit on illustrations currently being illustrated by an insurer that is reasonably based on actual recent historical experience.”

- ASOP 24 clarifies that the investment return factor of the disciplined current scale “should be reasonably based on recent actual investment experience, net of default costs, of the assets supporting the policy block.” In the case of Indexed UL, the assets supporting the policy block are a diversified portfolio of fixed income assets with demonstrable recent experience as would be found in any other fixed life insurance product.

- However, ASOP 24 goes further, stating that “if interest credits are linked to an external index or indices, then the investment return factor is sensitive to business or economic cycles...When
determining the investment return factor for policies within the scope of AG 49, actuaries should comply with limitations imposed on the assumed earned interest rate underlying the disciplined current scale.”

- In our view, this standard of practice goes beyond the scope of #582 by addressing the return on assets – specifically options – that are used to hedge a particular product feature rather than assets that are used to support the policy block. Furthermore, it delegates the limitation on the disciplined current scale to AG 49/AG 49-A, which determines the earned interest rate for the disciplined current scale in Section 5, essentially using the Annual Rate of Indexed Credits as determined by the hypothetical historical lookback methodology in Section 4 to determine the limit. In other words, the tail wags the dog.

- In order for the lookback methodology to be comprehensively and cohesively written into #582, the model must be adjusted to delineate between assets that support a block of business, assets used to hedge particular features in the business and other assets that may contribute to returns in a policy indirectly, as in participating Whole Life. From there, it must determine appropriate frameworks for determining assumed investment returns for each category, including potentially using a hypothetical historical lookback methodology as is currently found in AG 49-A. This will undoubtedly be a long, arduous and complex process because of the far-reaching nature of the question.

- By contrast, the Coalition Proposal is consistent with #582 as written because it references only the assets used to support the policy block. It assumes that hedge assets are not in scope and
does not require the life insurer to determine a separate investment return for those assets.

Broad Historical Perspective of Model Reg 582

Model Reg 582 Objectives in 1995
1. Differentiate guarantees from nonguaranteed elements
2. Demonstrate how the product works

The industry succeeded with #1 and failed with #2 as a result of the combination of product innovations by insurers (generally a good thing) and the Model’s scope limitations (variable excluded and future products such as NLG UL and IUL were unanticipated and ultimately incompatible with the Model). The time has come to resolve this.

The shift away from guarantees by many carriers - to indeterminate premium universal life policies introduced in the late 1970s - has enormously complicated the selling and buying process. Because universal life policies do not have specified premiums, and the required funding cost to sustain the policy until death would not be known for a number of years of fluctuating crediting rates (and policy expenses in a number of instances), producers (and their clients) have had no choice but to interpret “how the policy works” and “what the policy will cost” from computer-generated policy illustrations. Yet, as the Society of Actuaries commented in 1991:

“How credible are any non-guaranteed numbers projected 20 years into the future, even if constructed with integrity? How does a consumer … [or agent!] … evaluate the credibility of two illustrations if they are from different companies - or even from the same company - if different products with different guarantees are being considered?
Most illustration problems arise because illustrations create the illusion that the insurance company knows what will happen in the future, and that knowledge has been used to create the illustration.”

Competitive practices led to the unintended and inappropriate use of illustrations as projections of nonguaranteed outlays, values and distribution, and spawned more than 40 years of “who has the best price” via comparative positioning. The illustration-based recommendations of a “best-price” product invariably rely on the most attractive current, nonguaranteed crediting and expense projections and/or the appearance of lowest premiums.

A 2016 academic paper by Professors Daniel Gottlieb and Kent Smetters determined that “…nearly 88% of universal life policies ultimately do not terminate with a death benefit claim.” This quote was footnoted to state “While term policies have a larger annual lapse rate, permanent policies are usually more likely to lapse over the actual life of the policy due to their longer duration.” The paper was updated in 2021 with similar statistical findings.

Under such circumstances of lapse, all anticipated income tax benefits of life insurance not only disappear, but if there has been a deferred gain in the policy, ordinary income taxes will be due by the policy owner in the year of lapse.

Broader Recommendations Concerning #582

While Index UL illustrations have been the focus of attention in recent years, the abusive use of nonguaranteed projections is not limited to Index UL. To continue to allow for innovations in product design that can benefit consumers, fulfillment of the objectives from 1995 requires:
1. Expansion to include all illustratable life insurance products, and
2. Replacement of constant assumed crediting rate projections with a principles-based regulation that allows for nonlinear representations of the NAIC’s second purpose of the Model: To facilitate the consumer’s understanding how the subject policy works.

We believe these objectives cannot be implemented without revising Model Reg 582 more broadly. Accordingly, we propose the following:

1. Establish a target for an NAIC vote on model amendments no later than December 31, 2025.

2. Establish a working group made up of five representatives appointed by the NAIC with representation from the industry, the profession and consumer groups with the charge to develop a principles-based model regulation amendment to 582. The model amendments should replace the constant rate illustration projection in favor of some dynamic methodology that can be standardized for consistent adoption by all manufacturers and distributors. The working group’s objective should be the same as in 1995 but to eliminate the prevailing practice to using nonguaranteed illustrations as projections, used primarily and deceptively as a competitive comparison tool.

3. Establish that this working group collaborates with a FINRA working group to harmonize 582 as amended to include registered and variable life insurance products for illustrations. This working group should also address the glaring issue in IUL policies – that while clarified as general account products and therefore not requiring securities licensing – agents not holding a securities license are asked for (and often provide) investment advice as to the selection of complex index options.
Concepts in the scope of an amended 582 regulation which could be addressed by a working group should include:

- Fixed premium versus indeterminate premium use
- Products classified as securities (i.e., Variable UL and WL)
- Fixed Index (zero floor methodologies) (AG49 as amended)
- Structured index methodologies (negative floor or buffered)
- Recast Regulation definitions and treatment of nonguaranteed versus guaranteed elements with the explicit inclusion of products such as WL, NLG UL, NLG VUL, Hybrid fixed or variable, and Term.
- No Lapse Guarantee (AG37, AG38 as amended)
- Hybrid products (where the death benefit is accelerated or enhanced by riders, policy endorsements, etc. for LTC, Chronic, Critical or Terminal Illness)
- Self-supporting and non-lapse supported sections of the model are expanded to invalidate use in nonguaranteed illustrations of charge funded crediting or COI offsetting.

Signed,

The Coalition of Concerned Insurance Professionals