

Fred,

Thank you for the opportunity to comment on potential revisions to AG49. While we see merits in the Supplemental Option Budget approach, we believe that it is unable to address the full spectrum of designs that could lead to effective illustrated rates well in excess of the AG49 maximum illustrated rate for the Benchmark Index Account (BIA). For example, it is not effective for dealing with the implications of alternative crediting strategies and hybrid indices that have higher imputed option profits based on the hypothetical historical lookback methodology in AG49 Section 4(A), which already provide for means of illustrating returns well in excess of the BIA maximum illustrated rate in products available for sale today. It is also not clear how the concept of a Supplemental Option Budget would interact with persistency funded multipliers, bonuses or cash infusions, as are commonly found on Indexed UL products currently in market.

As a result, we believe that alternatives to the Supplemental Option Budget approach should be considered that will better align Indexed UL illustrations to Fixed Indexed Annuity illustrations and address the full spectrum of potential indexed crediting and product designs. This letter outlines an alternative methodology with specific AG49 language recommendations. We believe that the changes we are proposing to AG49 will accomplish the goals set forth by the regulators while maintaining the ability for life insurers to clearly differentiate crediting strategies and products on the basis of risk and return characteristics using historical index return data.

Our recommendation is for two primary modifications to AG49. The first is to move the hypothetical historical lookback methodology currently used in 4(A) to the crediting rate reports described in Section 7. We also recommend that Section 7 be augmented to encompass best case, worst case and most recent case historical returns over 10 years, aligning Indexed UL illustrations with Fixed Indexed Annuity illustrations. Finally, we recommend that Section 7 be clarified to allow any additional credits or charges contractually related to providing indexed interest which, again, is in accordance with Fixed Indexed Annuity illustrations. Taken together, these changes will augment the insurer's ability to show how variability of returns can impact crediting performance in a variety of scenarios for each indexed crediting option, thereby increasing consumer understanding of the crediting mechanics and potential risks and returns of the strategies.

Second, we recommend using an option valuation methodology for Section 4(A) with pricing inputs being drawn from the previous calendar year. We recommend using the Black-Scholes formula, a universally accepted valuation methodology for derivatives, including call options, and is commonly applied to the valuation of financial products containing derivatives-based payoffs, such as warrants and retail structured products. Replacing 4(A) with an option valuation formula aligns the maximum illustrated rate with the denominator for all indexed-linked credits in the contract, regardless of whether they are funded through the insurer's portfolio yield, additional policy charges or persistency. This modification to 4(A) will eliminate the illustrated benefits of multipliers and buy-up caps.

It would also align the illustrated benefits of alternative crediting strategies and hybrid indices with the Benchmark Index Account. There would be differences in the illustrated rates for the various accounts based solely on the fair market value of the options, which is a true and reasonable indicator to consumers of the current intrinsic value of the indexed crediting option. However, consumers would still be able to see the potential risks and rewards of these strategies in the hypothetical historical crediting reports described in Section 7 based on historical index returns. By combining these two approaches, consumers will be able to make an informed decision about choosing an indexed crediting strategy based on both the current fair-market valuation of the replicating options for the strategy (Section 4(A)) and its potential to deliver performance in a variety of historical return scenarios (Section 7).

The changes to the AG49 language proposed herein would accomplish the following goals stated by regulators:

1. Standardizing illustrated rates across Benchmark Index Account options, in accordance with the stated goals of the original Indexed UL Illustration Subgroup in 2013.
2. Limiting the ability for alternative crediting strategies and indices to illustrate more advantageously than traditional indices and crediting strategies, in accordance with the stated goals of the original subgroup.
3. Ensuring that products with multipliers illustrate similarly to products without multipliers, in accordance with the recent vote taken by the IUL Illustration Subgroup.
4. Ensuring that products with buy-up caps illustrate similarly to products without buy-up caps, in accordance with the vote taken at the most recent NAIC meeting in Austin.
5. Bringing Indexed UL illustrations into alignment with Fixed Indexed Annuity illustrations.
6. Maintaining of the majority of the current AG49 language, including the 145% factor for illustration actuary testing, thereby avoiding a time-intensive rework of the guideline.

The language proposed herein would also satisfy the following concerns raised by life insurers:

1. Continuing to provide for the ability of life insurers to differentiate their products and crediting methodologies by demonstrating the potential for different indexed crediting options to offer different risk/return profiles, including multipliers, buy-up caps and proprietary/hybrid indices.
2. Providing for illustrated loan arbitrage to a similar degree as Whole Life, thereby ensuring that Indexed UL is not at a competitive disadvantage to Whole Life in terms of illustrated loan treatment.
3. Providing for the continued illustration of persistency-based, embedded multipliers and bonuses, thereby ensuring that Indexed UL is not at a competitive disadvantage to other types of Universal Life products.

Specific AG49 language changes, with accompanying comments, are appended. We appreciate the opportunity to comment and respectfully submit our proposal.

Signed,

Bobby Samuelson, Executive Editor, The Life Product Review

Larry Rybka, President & CEO, Valmark Financial Group

Joseph M. Belth, professor emeritus at Indiana University

Chris Hause, FSA, President, Hause Actuarial Solutions

Richard M. Weber, President, The Ethical Edge, Inc

Barry Flagg, President, Veralytic

Stephen R. Leimberg, Publisher, Leimberg Information Services, Inc

Bill Boersma, President, OC Consulting Group

Tom Love, VP, Insurance Analytics, Valmark Financial Group

Mike Brohawn, President, Your Life Insurance Solution

Steven Roth, President, Wealth Management International, Inc., Licensed Life & Disability Insurance Analyst

Ben Baldwin Jr

Suggested AG49 Language Modifications

1. Replace 4(A) with:
 - A. Calculate the value of the replicating option trades for the Benchmark Index Account over the preceding calendar year, based on the Black-Scholes formula using the following inputs calculated on each trading day:
 - i. Average closing implied volatility for 12-month, at-the-money S&P 500 call options
 - ii. Average closing implied volatility for out-of-the-money 12-month S&P 500 call options with a normalized strike price equal to the currently declared cap
 - iii. Average dividend yield on the S&P 500
 - iv. Average 12-month LIBOR

This section is designed to replicate the reasonable price of replicatively hedging the current index parameters in the Benchmark Index Account. An alternative approach may be for the NAIC to publish standard tables of the estimated price for hedging index participation parameters at defined intervals (0.25%, for example) with allowance for insurers to interpolate between the datapoints. This would limit the degree to which insurers with identical index participation parameters would have different illustrated performance. LIBOR may also be exchanged for another measure of Risk Free Rates.

2. Replace 4(B) with:
 - B. The value calculated in 4(A) shall be the maximum credited rate(s) for the illustrated scale.

3. Remove 3(A) – The Alternate Scale

4. Replace 4(C) with:
 - C. For other Index Accounts using other equity, bond, and/or commodity indexes, and/or using other crediting methods, the illustration actuary shall use actuarial judgement to determine the maximum credited rate for the illustrated scale. The determination shall reflect the fundamental characteristics of the Index Account as relates to the inputs for the Black-Scholes valuation formula, including realized volatility, implied volatility, volatility targets (if applicable), embedded fees (if applicable), deduction of an interest rate component (if applicable), dividend participation (if applicable) and other factors that may apply.

This section is designed to ensure that products using different crediting methodologies, indices or combinations of the two illustrate in the same methodology as the Benchmark Index Account in accordance with their fundamental, underlying characteristics

5. Replace 7 with the following:
 - A. A table showing the minimum and maximum of a geometric average for any available Benchmark Index Account using the following methodology:

- i. Calculate the geometric average annual credited rate for each applicable 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.
 - ii. Calculate the arithmetic average of the geometric average annual returns in all 25-year periods
 - B. For each Index Account illustrated, a table showing actual annual historical index changes and corresponding hypothetical interest rates using current index parameters, including any applicable asset-based charges and asset-based interest bonuses or index credit multipliers paid within the first 10 years of the policy:
 - i. The 10-year period with the lowest calculated returns within the period referenced in 7(A)(i)
 - ii. The 10-year period with the highest calculated returns within the period referenced in 7(A)(i)
 - iii. The most recent 10-year historical period as calculated on the final trading day of the preceding calendar year
 - C. If an index has not been in existence for 10 years, the table shall replace the figures with the maximum available back-tested performance.

This section is designed to bring Indexed UL illustrations into alignment with Fixed Index Annuity illustrations. These demonstrations will also provide latitude for insurers to demonstrate the potential risk and return profiles of various crediting strategies, indices and policy mechanisms.

The following sections of AG49 were not altered for the following reasons:

5. There is no need to change the 145% provision in 5(A) as it will provide a cushion for the inevitable mismatches between the standardized illustrated price of the replicating options calculated in 4(A) and the insurer's own pricing for options, expectations of prices or cap-setting process. Retaining the 145% will allow insurers who have economies of scale in hedging, are supporting higher caps with higher policy charges or other designs to illustrate benefits and costs accordingly. However, it may be advisable to adopt some of the clarifications to this language previously proposed in other comment letters.
6. There is no need to change the 100 basis points allowance for illustrated loan arbitrage. As with Section 5, there are inevitable mismatches between what an insurer is willing to charge on a loan and the value of what it may credit by providing current index participation parameters. This section preserves the ability for insurers to reflect those changes. However, it may be prudent to add clarifying language about the inclusion of illustrated bonuses and multipliers for the 100bps allowance.