

July 2, 2019

Mr. Fred Andersen

Chair, IUL Illustrations (A) Sub-group

National Association of Insurance Commissioners

Frederick.Andersen@state.mn.us

Re: Menu of Options - IUL Illustrations – May 24, 2019, 13 through 16

Dear Mr. Andersen,

I appreciate the opportunity to provide comments on the questions exposed by the IUL Illustrations Sub-group regarding the illustrations of Indexed Universal Life Insurance (IUL) products under the Life Insurance Illustration Model Regulation (LIIMR) and Actuarial Guideline XLIX (AG 49).

I am a recently retired product development actuary with 10 years of experience in the pricing and design of IUL products and over 30 years of individual life insurance development. My comments represent myself only and are based on my experience. They do not represent those of any employer.

IUL products offer an important and unique investment feature to the cash value life insurance customer, namely the combination of equity exposure with capital protection. When used properly in the management of an IUL policy, this feature can provide a combination of lower premiums and higher account values than other Universal Life products and lower risk of market loss than Variable Life Insurance products.

AG 49 was a significant step towards consistency in the indexed based credits shown in an IUL illustration. Since its introduction, product designs and company interpretations have evolved enough to warrant several changes to AG 49 in order to achieve that goal once again.

The most important number in the marketing of IUL products is one of three values from the current side of the illustration:

1. The maximum “income” or annual distribution (whether withdrawal or loan) over a period of years corresponding to a period of retirement for a supplemental retirement income marketing approach.

2. The maximum cash surrender value at a given policy duration for a marketing approach emphasizing the accumulation of wealth.
3. The minimum premium for a marketing approach emphasizing the death benefit.

While individual sales can be based on a number of factors, the vast majority of sales decisions focus on the product that illustrates the highest value (or lowest in the case of premium) of these three numbers. Therefore, disclosure, while necessary and helpful to explain what is being purchased, will have no effect on comparisons among products.

The most effective way to control the fairness of a comparison among products is to restrict the index based interest credits, so that the purchase decision moves to secondary characteristics like the level of risk of a given outcome and the level of discretion and transparency in the process of achieving an indexed credit.

The following are specific comments on the Menu of Options - IUL Illustrations – May 24, 2019, 13 through 16.

**Menu ID #13: “ Clarify whether charges can impact assumed earned interest underlying the DCS “**

Yes, AG 49 should be modified to clarify whether charges impact the assumed earned interest underlying the DCS. Current practice is influencing product design in a way that increases customer risk.

Instead, AG 49 should limit the assumed earned interest on the equity hedge portfolio to equal the interest earned on the fixed portion of the portfolio times the 145% assumed equity return. This means that using product charges to raise the illustrated index credits will have a neutral effect. The charges, even if used to purchase extra market equity, will only support a dollar for dollar illustrated index credit.

For example, a \$100 fixed income portfolio with a 5% earned rate, will have a limit on the assumed earned interest underlying the DCS of  $5\% * 145\% * \$100 = \$7.25$ . With a \$2 additional charge for expanded equity participation, the assumed earned interest will still be \$7.25, with no additional assumed interest from the hedge of the additional equity.

Note that this does not restrict product design or product performance, only the illustrated credits. It also does not disadvantage the illustration of products with these extra equity charges, despite the extra risk assumed by the customer. That extra risk and potential reward can be addressed by disclosure once the illustrated values for two products are comparable.

The reasoning for this restriction is that otherwise, the competitive charges will only continue to escalate to increase the assumed earned interest and illustrated values, while showing none of the risk of moving more of the account value out of the “capital protected” category and into the “equity exposure” category.

**Menu ID #14: “Limit the use of variable / indexed loans “**

Yes, AG 49 should be modified to clarify the limit on the effect of variable / indexed loans in illustrations. Current product designs and interpretations of AG 49 make the 1% limit a variable instead of a hard limit.

Instead, AG 49 should limit the total illustrated indexed based credits for the portion of the account value backed by an indexed loan to the loan interest charge rate plus 1% times the average indexed loan balance. Factors, bonuses, additional credits that relate to the performance of the index should change that limit. The total illustrated indexed based credits for portion of the account value backed by the rest of the indexed account (after the average indexed loan balance) is limited by AG 49, Section 4 and the LIIMR support tests.

For example, a \$100 Indexed Account with a 7% AG 49 maximum rate, after all multipliers, bonuses, and additional index based interest, will have a limit on the illustrated indexed credits of  $7\% * \$100 = \$7$ . If \$50 is the average indexed loan balance with a index loan rate of 3%, then the maximum illustrated indexed loan credit will be  $4\% * \$50 = \$2$  and the maximum illustrated indexed non-loan credit will be  $7\% * \$50 = \$3.5$ , for a total maximum illustrated indexed credit of \$5.5

This limit also does not restrict the product design or the policy credits, only the illustrated results. It will show a potential benefit of the loan leverage and how the loan leverage works. It does not show the maximum benefit, but it also does not penalize the illustration for the increased risk to that illustration caused by the possibility that indexed based credits will be lower than the loan charge rate.

**Menu ID #15: “Have consistent treatment of various IUL product types “**

No, AG 49 need not have consistent treatment of various IUL product types.

Until a consistent measure of risk can be shown to be influential to the purchase decision, it is reasonable to restrict the illustrated values associated with riskier (or perceived to be riskier) product alternatives. The original AG 49 was intentionally not consistent in its treatment of indices other than the S&P 500. The S&P 500 was used as the Benchmark due to its broad use and the perception that it was generally well known and understood.

AG 49 can be flexible enough to show in the illustration how different product features work mechanically, while restricting the values most likely to cause confusion in the risk versus return tradeoff.

**Menu ID #16: “Application of AG 49 constraints to cash value internal rate of return “**

Yes, AG 49 constraints should apply to the index based credits, no matter how they increase the account value (or any other policy values ).

Applying a limit to a portion of the product design, while not limiting economically equivalent (or more risky) features elsewhere in the design, will undermine the intent of AG 49. While the original approach addressed this issue by regulating the assumed interest rate and illustrated credited rate, relying on the

rest of the LIIMR rules to apply the interest rate correctly, product designs are now complex enough to broaden the scope of AG 49 to regulate the cash value and asset accumulation directly.

The intent of the AG 49 could be furthered by having each illustration actuary submit to the American Academy of Actuaries working group on illustrations a description for research purposes of how the LIIMR and AG 49 were applied to a sample illustration for each IUL product.

Sincerely,

A handwritten signature in cursive script that reads "Stephen J. O'Brien".

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