The questions below are provided by the IUL Illustration (A) Subgroup. The Subgroup is requesting interested regulators and interested parties respond to these questions. The responses will be considered during subgroup deliberations related to further development of AG 49. Additionally, if you think there are additional questions the Subgroup should consider, please feel free to submit them.

Feedback should be sent to Reggie Mazyck (RMazyck@naic.org) by close of business March 8, 2019.

Here are IUL Illustration questions for consideration:

1. How should products with different attributes be illustrated to demonstrate the differences in product features, potential returns, and downside risk? Current company illustrated performance, with ±2% range, and market rate for total of 4 results.

2. Should a higher risk / higher reward IUL product be illustrated with higher credited rates than a vanilla IUL product would be? Yes, but indicate company history crediting higher rate than vanilla market.
2a. If "yes", how should the downside of the product be communicated with applicants? Yes. One example is a side-by-side alternate scale showing lower returns for the higher risk product than would be shown for a "regular" IUL product. Another example is a separate demonstration of how returns could develop in an adverse scenario (potentially impacted by the sequence of returns).

3. In 2015, there was a decision by the Subgroup to not have a hard ceiling on the credited rate, e.g., no rate above 6.75%. Should that decision be revisited? No, as long as company indicates history of crediting higher rates.

4. Is the interaction of the loan charges and loan credits being illustrated as expected?

5. Are there known concerns regarding illustration of volatility-controlled funds?

6. Is there a concern that extreme variations of the index credit multiplier could lead to a risk-return profile similar to that of variable life even though return-of-premium (net charges and withdrawals) remains a floor? Yes. If so, is that something our subgroup, focused on illustrations, would address? Higher return comes with higher risk so indicating risk level would be important.

7. Should it be recommended that LATF address the issue of whether assumptions underlying IUL illustrations should be consistent with assumptions underlying PBR and asset-adequacy testing? Yes.

8. Are there issues relevant to IUL that are part of a broader concern related to non-IUL life illustrations, where engagement with A Committee may be necessary?

March 8, 2019

Mr. Fred Andersen
Chair, IUL Illustration (A) Subgroup
National Association of Insurance Commissioners (NAIC)

Dear Mr. Andersen,

The American Academy of Actuaries'[1] Life Illustration Work Group (the Work Group) appreciates the opportunity to provide comments on questions exposed by the IUL Illustration Subgroup regarding the illustrations of Indexed Universal Life (IUL) products under Actuarial Guideline 49 (AG 49). Given the relatively short turnaround timeframe for comments, we have focused this letter on questions 1, 2, and 2a, and could respond to the remaining questions at a later date. In addition, we have chosen to address question 2 first, because our responses to the other questions expand on our response to question 2.

2. Should a higher risk / higher reward IUL product be illustrated with higher credited rates than a vanilla IUL product would be?

The Work Group would suggest posing this question slightly differently: Is it reasonable to allow for higher-risk / higher-reward IUL products to illustrate higher credited rates than a vanilla IUL product? The risk/reward tradeoff is a foundational principle in daily decision-making and especially in financial economics.

Preparing a consumer to make an informed decision by allowing the illustration of the risk/return tradeoff is reasonable and fits within Model 582's[2] goal to protect consumers and foster consumer education. Within the IUL marketplace, risk/return profiles can vary significantly between different IUL products. If IUL products with higher risk are unable to illustrate a higher credited rate, consumers would not see the value proposition of the product because greater costs would be illustrated without higher potential returns.

2a. If "yes", how should the downside of the product be communicated with applicants?

[1] The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.
[2] Model 582—The Life Insurance Illustrations Model Regulation.

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The downsides, or risks in the product from product features less favorable than the current scale, of an IUL product are currently required under either Model 582 or AG 49 and illustrated in the following ways relative to the current illustrated scale:

- differences in lapse years shown in guaranteed, midpoint, and alternate scales;
- differences in policy values shown in guaranteed, midpoint, and alternate scales;
- a table showing the last 20 years of historical index returns and corresponding credited interest rates using current index parameters; and
- a table showing the lowest annualized rate from any 25-year period over the last 66 years for the benchmark index account.

The Work Group suggests that the IUL Illustration Subgroup consider the following ideas to demonstrate downside risk:

- requiring a separate demonstration of a range of outcomes generated from scenarios run at different percentages of the maximum illustrated rate;
- requiring a demonstration of the impact of a sequence of returns, for example, a repetitive pattern where a floored return is incorporated into a pattern of positive returns averaging to the illustrated rate;
- requiring year-by-year disclosure of policy charges and credits (expressed in dollar amounts);
- requiring disclosure of the premium required to achieve the original goal(s) of the policy under different credited interest assumptions; or
- requiring additional language that provides a balanced view of the features of the policy. For example, "higher returns could require higher upfront costs with no guarantee of higher interest crediting," "comparison of single factors can be misleading if results are based on multiple factors," etc.

1. How should products with different attributes be illustrated to demonstrate the differences in product features, potential returns, and downside risk?

IUL products can have a variety of product features, including but not limited to differences in indexes, crediting methods, index parameters, charges, bonuses, and multipliers.

These different product attributes would ideally be shown provided the illustration meets a disciplined current scale (DCS) testing requirement. It would be advantageous to consumers to see the impact of product features to improve understanding of the features of the product being considered. We note that AG 49 currently limits the credited interest rates shown in illustrations of certain indexes, crediting methods, and index parameters to the credited rate associated with the benchmark index account. The benchmark index account uses the Standard and Poor's (S&P) 500, a capped annual point-to-point crediting method, a 0% floor, and a 100% participation rate.

In August 2015, the Work Group presented an educational paper to the Life Actuarial Task Force (LATF) that discussed the variety of bonus structures that are available in many life products. The paper also discussed the DCS supportability testing for life insurance products subject to the NAIC Life Insurance Illustrations Model Regulation.

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We have also attached a brief overview of the current requirements for IUL illustrations. The overview is intended to be educational and should not be construed as supporting any particular position or illustration design.

*****

The Work Group appreciates the efforts of the IUL Illustration Subgroup to review AG 49. If you have any questions or would like further dialogue on the above topics, please contact Ian Trepanier, life policy analyst, at trepanier@actuary.org.

Sincerely,

Donna Megregian, MAAA, FSA
Chairperson, Life Illustration Work Group
American Academy of Actuaries

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OVERVIEW OF CURRENT REQUIREMENTS FOR IUL ILLUSTRATIONS

This overview provides a simplified summary of the current minimum requirements for Indexed Universal Life (IUL) illustrations and uses generic terminology. Please note that many illustrations include additional information and are required to use terminology that matches the terminology used in the policy contract.

Narrative summary

- Description of policy features, riders or options shown in the illustration

Ledgers

- Detail for at least policy years 1 through 10, every 5 years thereafter, until age 100/policy maturity/expiration
  - *Companies commonly show all policy years until policy maturity and sum totals every 5 or 10 years*
- Premium outlay (assumed payment scale on which the illustration is based)
- Guaranteed death benefits and values
  - Must be shown before nonguaranteed values
  - Must be referenced on pages with nonguaranteed values
- Account values shown in close proximity to surrender values
- Surrender values
- Disclosures
  - Benefits and values are not guaranteed
  - Assumptions are subject to change
  - Actual results may be more or less favorable
- Alternate scale ledger assuming fixed rate in all years shown alongside illustrated scale ledger (AG 49)

Guaranteed scale						
Age	End of policy year	Premium outlay	Net distributions	Account value	Surrender value	Death benefit
46	1	$25,000	$0	$xxxx	$yyyy	$zzzz
47	2	$25,000	$0	$xxxx	$yyyy	$zzzz
48	3	$25,000	$0	$xxxx	$yyyy	$zzzz
49	4	$25,000	$0	$xxxx	$yyyy	$zzzz
50	5	$25,000	$0	$xxxx	$yyyy	$zzzz
Total		*$125,000*	*$0*			
51	6	$25,000	$0	$xxxx	$yyyy	$zzzz
52	7	$25,000	$0	$xxxx	$yyyy	$zzzz
53	8	$25,000	$0	$xxxx	$yyyy	$zzzz
54	9	$25,000	$0	$xxxx	$yyyy	$zzzz
55	10	$25,000	$0	$xxxx	$yyyy	$zzzz
Total		*$250,000*	*$0*			
…						
66	21	$0	$[Loan]	$xxxx	$yyyy	$zzzz
67	22	$0	$[Loan]	$xxxx	$yyyy	$zzzz
68	23	$0	$[Loan]	$xxxx	$yyyy	$zzzz
69	24	$0	$[Loan]	$xxxx	$yyyy	$zzzz
70	25	$0	$[Loan]	$xxxx	$yyyy	$zzzz
Total		*$500,000*	*$[Total]*			
…						

Nonguaranteed scales

				Alternate scale			Illustrated scale		
Age	End of policy year	Premium outlay	Net distributions	Account value	Surrender value	Death benefit	Account value	Surrender value	Death benefit
46	1	$25,000	$0	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
47	2	$25,000	$0	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
48	3	$25,000	$0	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
49	4	$25,000	$0	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
50	5	$25,000	$0	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
Total		*$125,000*	*$0*						
51	6	$25,000	$0	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
52	7	$25,000	$0	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
53	8	$25,000	$0	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
54	9	$25,000	$0	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
55	10	$25,000	$0	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
Total		*$250,000*	*$0*						
…									
66	21	$0	$[Loan]	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
67	22	$0	$[Loan]	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
68	23	$0	$[Loan]	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
69	24	$0	$[Loan]	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
70	25	$0	$[Loan]	$aaaa	$bbbb	$cccc	$dddd	$eeee	$ffff
Total		*$500,000*	*$[Total]*						
…									

Numeric summary (typically included on signature page)

- Death benefits, values, premium outlay, and lapse years (if applicable) at years 5, 10, 20, age 70 for three scales:
  - Guaranteed scale (guaranteed credits and charges)
  - Illustrated scale
  - "Midpoint" scale (credits and charges at average of illustrated and guaranteed scales, dividends at 50% of illustrated scale)

				Guaranteed scale		Midpoint scale		Illustrated scale	
Year	Age	Total premium outlay	Total distributions	Surrender value	Death benefit	Surrender value	Death benefit	Surrender value	Death benefit
5	50	$125,000	$0	$yyyy	$zzzz	$bbbb	$cccc	$eeee	$ffff
10	55	$250,000	$0	$yyyy	$zzzz	$bbbb	$cccc	$eeee	$ffff
20	65	$500,000	$0	$yyyy	$zzzz	$bbbb	$cccc	$eeee	$ffff
25	70	$500,000	$[Total]	$0	$0	$bbbb	$cccc	$eeee	$ffff
Lapse year				24 (Age 69)		26 (Age 71)		75 (Age 120)	

Minimum and Maximum Table (AG 49)

- A table showing minimum and maximum historical 25-year averages from the benchmark index lookback

Lowest 25-year period	Average (maximum illustrated rate)	Highest 25-year period
4.32%	6.86%	8.72%

Note: Table assumes 11.75% benchmark index account cap

Actual Historical Index Changes and Corresponding Interest Rates (AG 49)

- For each account illustrated, actual historical index changes and corresponding interest rates using current index parameters for the most recent 20-year period

	Index Option 1		Index Option 2		Index Option 3	
	S&P 500 index change	Interest rate	S&P 500 index change	Interest rate	Hang Seng index change	Interest rate
1999	19.53%	11.75%	19.53%	13.57%	65.72%	18.21%
2000	-10.14%	0.00%	-10.14%	0.00%	-4.83%	0.00%
2001	-13.04%	0.00%	-13.04%	0.00%	-26.01%	0.00%
2002	-23.37%	0.00%	-23.37%	0.00%	-15.15%	0.00%
2003	26.38%	11.75%	26.38%	16.85%	29.46%	18.21%
2004	8.99%	8.99%	8.99%	8.88%	11.51%	17.84%
2005	3.00%	3.00%	3.00%	3.24%	6.64%	10.29%
2006	13.62%	11.75%	13.62%	12.99%	26.33%	18.21%
2007	3.53%	3.53%	3.53%	3.68%	45.69%	18.21%
2008	-38.49%	0.00%	-38.49%	0.00%	-46.46%	0.00%
2009	23.45%	11.75%	23.45%	7.69%	49.65%	18.21%
2010	12.78%	11.75%	12.78%	2.16%	6.09%	9.44%
2011	0.00%	0.00%	0.00%	0.00%	-21.67%	0.00%
2012	13.41%	11.75%	13.41%	12.91%	23.16%	18.21%
2013	29.60%	11.75%	29.60%	24.40%	2.83%	4.39%
2014	11.39%	11.39%	11.39%	10.92%	0.01%	0.02%
2015	-0.73%	0.00%	-0.73%	0.00%	-8.34%	0.00%
2016	9.54%	9.54%	9.54%	7.12%	5.38%	8.34%
2017	19.42%	11.75%	19.42%	17.95%	29.88%	18.21%
2018	-6.24%	0.00%	-6.24%	0.00%	-10.53%	0.00%

March 5, 2019

Mr. Fred Andersen
Chair, IUL Illustrations (A) Subgroup
National Association of Insurance Commissioners

Dear Mr. Andersen,

Thank you for this opportunity to provide input on potential enhancements to Indexed Universal Life (IUL) illustrations that are being considered by your committee. I strongly support the continued evolution in IUL product design and more critically the illustration technology used to demonstrate efficacy. Refining and modernizing illustrations will promote greater reliability and transparency in our industry; drive overall value for consumers, and fuel the expansion of the next iteration of products in the marketplace.

The life insurance industry adopted “the illustration” approximately 40 years ago as the primary method of communicating policy performance attributes and operational cash flow dynamics. And, for nearly that entire span of time, the industry as a whole has tended to over-illustrate and underperform on policyholder expectations. Improving risk/reward transparency is particularly important as IUL products continue to expand. Recent data shows that IUL sales were up 12 percent year-over-year in 2018, with Q3 sales estimated at $529 million. Consumers need and deserve a clearer view of a policy’s longer term performance dynamics, especially given that almost six in 10 Americans have zero retirement savings and are looking for financial instruments to help them close the gap.

I’ve spent my entire professional career within the life insurance arena, and these numbers ring true to me. Over the past three decades I’ve specialized in developing intellectual property employing quantitative methods. My body of work includes Patents Pending which have substantial application with regard to the performance dynamics confronting the IUL Illustration Subgroup.

While other sectors of the financial services industry have refined their technology, disclosures and transparency, life insurers have instead added unnecessary complexity, poor transparency and have relied on a flawed demonstration method that truly creates a dichotomy between illustrated performance and likely real life performance. As an

industry regulator, the NAIC plays an important role in ensuring strong consumer protection while encouraging industry creativity and evolution. It is my firm belief that we've just scratched the surface of index products near term and future importance but the industry will require some regulatory help to fully realize it's potential.

Illustrations, Transparency and Performance

The recent IUL illustration subcommittee conference call focused on a few primary topics: Consumers' ability to comprehend illustration dynamics, treatment of policy distributions, demonstrating upside as well as downside performance, and compliance with AG49 guidelines. These issues are at the root of the dilemma which has confronted the life insurance industry for decades.

Longstanding illustration issues have been accentuated recently by technology that too often implies unrealistic performance expectations. Illustrative performance is manufactured through a byzantine series of fees, charges and expenses that are designed to fund stated *'multipliers'* of the policy's notional value. While in compliance with existing NAIC model regulations, these dynamics often don't translate to enhanced long-term outcomes. It's essential that the industry be required to provide full disclosure and complete transparency of the policy processes (including all fees/charges/expense including process order), as well as an accounting of the *'options budget'* and the underlying derivative pricing assumed.

NAIC's implementation of regulation AG49 seemingly created a vehicle to demonstrate average performance over several decades of exposure. The retrospective AG49 process yields a single number which stands as the maximum crediting rate input for a given illustration. AG49 was implemented with the purpose of addressing some of the then common problems of overstating the crediting rates and the over performance packed into policy spread loans. The theory postulated at the time was that AG49 took into consideration index performance highs/lows and that the derived average was reasonable over the long-term; and, when combined with a hardened loan spread of 100bps, AG49 would fix the IUL industry's illustration over performance problems.

Currently, carriers present what amounts to a cash flow summary as an illustration, based on a straight-line crediting rate scenario. However, actual performance is derived from financial indices which can fluctuate greatly over time, and policy costs occur whether the index is hitting the cap or at 0%. Under AG49 regime the industry has never confronted the actual effects of several factors such as: serial return risk, correlation risk, lower cap/participation rates and becoming overly reliant on the S&P 500 as the near sole indexing strategy for the industry. As currently designed, and in compliance with AG49, illustrations always present a consumer with a winning scenario based on assumed current expenses.

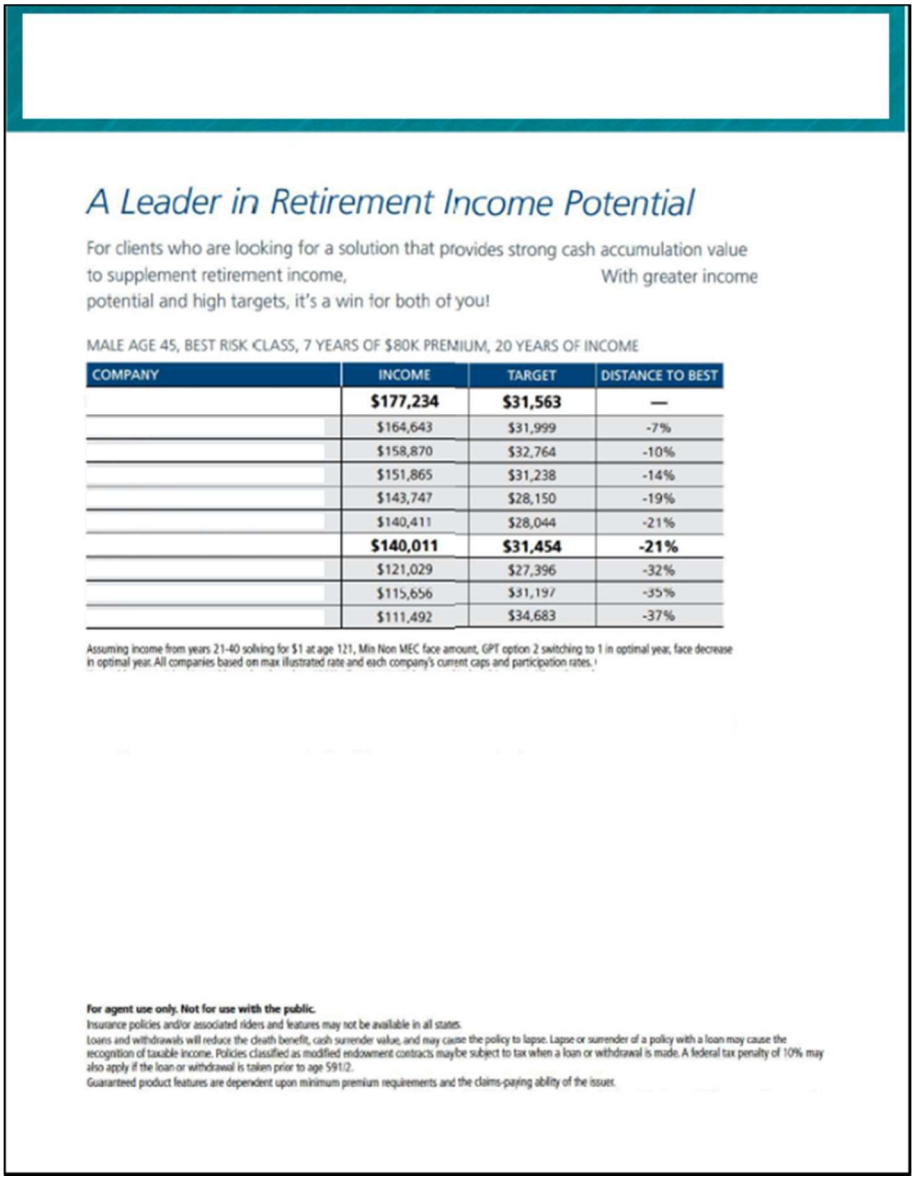
To proactively address this issue, our industry needs a new pathway to display and quantify performance metrics. It needs viability analysis that is specific to the individual

scenario presented in an illustration, can benchmark outcomes, and can allow the policy to perform in its natural state unrestricted by AG49. This technology is called a Monte Carlo simulation. I've used this technology to quantify the efficacy of policy design for nearly two decades. Given the current level of complexity within carrier's illustration software systems integrating Monte Carlo simulation technology should not be overly burdensome for carriers to support.

Advancing Transparency with Comprehensive Simulations

Case in point, my use of Monte Carlo simulation technology starts with the creation of product clones where I reverse engineer the product algorithm, expenses charges, policy charges, COI charges and fees of the policies. My clones are run based on the given client scenarios (i.e. age, risk class, face amount, premium, policy disbursements, index methods, cap rates) through thousands of iterations. Within each iteration, the crediting rates (and if desired derivative pricing and cap rates) is randomized year by year based on underlying distribution parameters (capital market assumptions). With the completion of each iteration I track outcomes – cash value at given years, lapse year, etc. At the end of the simulation we can provide an objective outcome analysis of the illustrated scenario being proposed. Typically, I perform two different simulations, each based on differing capital market performance engines so that I can postulate a high-low viability analysis.

For example, this sample industry comparative performance stack ranking has a design scenario that assumes these characteristics:



A Leader in Retirement Income Potential

For clients who are looking for a solution that provides strong cash accumulation value to supplement retirement income, With greater income potential and high targets, it's a win for both of you!

MALE AGE 45, BEST RISK CLASS, 7 YEARS OF $80K PREMIUM, 20 YEARS OF INCOME

COMPANY	INCOME	TARGET	DISTANCE TO BEST
	$177,234	**$31,563**	—
	$164,643	$31,999	-7%
	$158,870	$32,764	-10%
	$151,865	$31,238	-14%
	$143,747	$28,150	-19%
	$140,411	$28,044	-21%
	$140,011	**$31,454**	**-21%**
	$121,029	$27,396	-32%
	$115,656	$31,197	-35%
	$111,492	$34,683	-37%

Assuming income from years 21-40 solving for $1 at age 121, Min Non MEC face amount, GPT option 2 switching to 1 in optimal year, face decrease in optimal year. All companies based on max illustrated rate and each company's current caps and participation rates.

For agent use only. Not for use with the public.
Insurance policies and/or associated riders and features may not be available in all states.
Loans and withdrawals will reduce the death benefit, cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income. Policies classified as modified endowment contracts maybe subject to tax when a loan or withdrawal is made. A federal tax penalty of 10% may also apply if the loan or withdrawal is taken prior to age 59½.
Guaranteed product features are dependent upon minimum premium requirements and the claims-paying ability of the issuer.

- Male
- Best risk class
- Funding annual premiums of $80k for 7 years into the derived minimum death benefit
- Starting in the 21st year the policy has stated policy disbursements annually for 20 years

I scored most of the top carriers listed in the brochure with MC technology employing two capital market performance engines, each simulation running 1,000 trials on each IUL policy and its underlying index methods at the assumed cap rate.

I restricted the disbursement amount to a common $160k annually and scored the performance based on the policy's ability to survive through an objective age of 95. Based on these circumstances the best performing carrier policy/index achieved a viability score of 44% on one Monte Carlo simulation engine and 9% on the other. Effectively, this study demonstrates that the best performing policy/index combination depicted in the stack ranking failed to survive through age 95 in 56% and 91% of observed trials respectively. While those viability results may seem shockingly low, it's important to keep in mind that carriers have been accentuating specific design elements

in a closed loop. Once the first carrier configured a method to stimulate their illustration results, they were rewarded with substantial gains in market share. And the race for illustration supremacy ensued. But, based on the same client scenario, a more refined quantitative policy design would result in Monte Carlo scores denoting a viability score approximating $80\%^{+}$ and $60\%^{+}$ respectively!

The problem nested into many of the current IUL designs isn't apparent initially, but given a series of adverse returns and/or reductions to cap rates the lattice work of policy charges can quickly depressurize resulting in even greater stress cast onto the policy. I've been collaborating on research with the Minnesota Center for Financial and Actuarial Mathematics which is part of University of Minnesota's School of Mathematics to add academic rigor to the problem of illustration performance versus real life performance and we intend to publish white paper(s) in the summer of 2019. Monte Carlo simulation technology is uniquely positioned to reset the industry toward more viable long term outcomes. It is my recommendation the NAIC incorporate Monte Carlo simulation into the model regulations governing carrier illustrations. Embracing Monte Carlo technology would place the insurance industry in-line with numerous other consumer-centric industries helping customers to make informed long-term decisions.

Bringing Monte Carlo to the Industry

To fully incorporate this technology, the NAIC would have to promulgate the rules governing the Monte Carlo simulation engines. Based on my experience, the capital market input assumptions is the key to achieving credible results. After much discovery I settled on two primary sources for my Monte Carlo inputs: J.P. Morgan Asset Management's Long-Term Capital Market Assumptions and Morgan Stanley's Inputs for GIC (Global Investment Committee) Asset Allocation. Both of these sources have to be refined to account for dividends that accompany their total return assumptions. But with these two sources you gain a fairly conservative capital market outlook and more progressive capital market outlook. These bodies of work contain critical ingredients: mean returns, standard deviations and asset correlations on a wide variety of asset classes. As with the existing model illustration requisites, the Illustration Actuary would also be attesting to the conformance with Monte Carlo simulation engines. The engines would be sealed and could not be manipulated by home office personnel or agents.

When I perform a Monte Carlo Simulation, one of the functions the program solves for is an AG49 equivalency calculation derived from the randomly simulated capital market returns. It's been my experience the AG49 equivalents are slightly below in one engine and right in-line with the carrier's retrospective AG49 calculation in the other engine. Incorporating one page of an illustration – possibly the signature page with results from Monte Carlo simulation viability analysis – would empower consumers and would provide a balanced perspective as to long-term performance, including an important reality that sometimes these policies do fail. In the short term, carriers will experience some transitional pain in their processes but that will lead to better policy designs, improved long-term viability and sales growth given the resulting shift toward credibility.

Our country is in need of credible solutions to help fund the growing retirement crisis. IUL can serve to fund long-term needs, while applying quantitative methods and more specifically designed products that hold greater promise for the industry and the economy, allowing consumers at all levels equal opportunity for greater prosperity.

It's my belief the entire permanent life insurance industry (i.e. IUL, whole life, universal life and variable life) and the annuity industry would benefit greatly from full and total disclosure as well as the implementation of Monte Carlo technologies. The edge this technology could provide is an unprecedented degree of outcome management which would prove highly valuable for consumers, policyholders, agents, financial advisors, carriers, industry and the NAIC. I am grateful for the opportunity to share my perspectives and would enjoy the opportunity to speak with you and the committee about this next foundational shift in our industry.

Sincerely,

Mark Smith
(612) 202-9090
mark.smith@tonkagroupllc.com

Comments on the IUL Illustration Questions Exposed through March 8

Comment received from Tom Taylor

Thank you for fielding responses to the list of IUL questions to be considered. I suggest the following question be added to the list:

Do IUL illustrations sufficiently convey the impact of lower interest rates on future index caps and other index crediting parameters, and is additional or enhanced disclosure needed to effect such understanding by the public?

I appreciate the work the IUL Illustration subgroup is doing and look forward to following the progress.

Sincerely,

Tom Taylor

Comments on the IUL Illustration Questions Exposed through March 8

Comment received from Tom Kilcoyne

Please accept the following brief responses to the IUL Illustration questions open for public comment. Note that these are my own comments as an interested regulator and do not represent a position of the Pennsylvania Insurance Department. The responses are presented inline.

1. How should products with different attributes be illustrated to demonstrate the differences in product features, potential returns, and downside risk?

Random scenarios should be emphasized using projection factors/assumptions closely aligned with recent or current option pricing assumptions.

2. Should a higher risk / higher reward IUL product be illustrated with higher credited rates than a vanilla IUL product would be?

Possibly, on average, but using non-level index returns and corresponding credited rates.

2a. If "yes", how should the downside of the product be communicated with applicants? One example is a side-by-side alternate scale showing lower returns for the higher risk product than would be shown for a "regular" IUL product. Another example is a separate demonstration of how returns could develop in an adverse scenario (potentially impacted by the sequence of returns).

The same pattern of index results as suggested in item 2 above may be appropriate, but lower/unfavorable to expose downside risk. Examples noted in 2a above should also be explored.

3. In 2015, there was a decision by the Subgroup to not have a hard ceiling on the credited rate, e.g., no rate above 6.75%. Should that decision be revisited?

An attractive, level index return (or credited rate) should be disallowed. It gives a faulty impression and invites product designs tailored to an unrealistic projection.

4. Is the interaction of the loan charges and loan credits being illustrated as expected?

Not entirely. Results driven by the presence of a loan should not be uniformly or unduly favorable.

5. Are there known concerns regarding illustration of volatility-controlled funds?

Yes. "Historical" performance is often misleading, and the implications of back-casting are not likely understood by the average applicant. In some cases, an arbitrary "base date" is given the same visibility as the inception/live/launch date. The "history" of an invisible hypothetical index that no one followed, and that had no impact on investor behavior, is not relevant for illustration or consumer education purposes. Indexes using a tactical allocation algorithm and a volatility-control mechanism become a significant aspect of product design and can include overweighting, embedded charges, and may not be anchored to benchmark indexes such that a reasonableness check can be undertaken by the owner. Further, there is no firm expectation of the continuing availability/utility of such indexes. If an index no longer illustrates well it can be replaced with another reverse-engineered index that does.

Comments on the IUL Illustration Questions Exposed through March 8

6. Is there a concern that extreme variations of the index credit multiplier could lead to ~~a risk~~ an expected-return profile similar to that of variable life even though return-of-premium (net charges and withdrawals) remains a floor?

Yes.

If so, is that something our subgroup, focused on illustrations, would address?

Yes.

7. Should it be recommended that LATF address the issue of whether assumptions underlying IUL illustrations should be consistent with assumptions underlying PBR and asset-adequacy testing?

Reliable assumption-setting best practices should be considered in generating random scenarios for illustration purposes.

8. Are there issues relevant to IUL that are part of a broader concern related to non-IUL life illustrations, where engagement with A Committee may be necessary?

This may be an appropriate time to step back and consider the possibility of broader concerns.

Thank you for considering the above comments.

Tom

Thomas P. Kilcoyne | Life Actuary

From: Tomasz Serbinowski <tserbinowski@utah.gov>
Sent: Thursday, February 21, 2019 4:03 PM
To: Andersen, Frederick (COMM) <frederick.andersen@state.mn.us>
Subject: Re: IUL Illustration Subgroup

Fred, here is my take on the first three items in your list.

Ad 1.

I think that there is a huge difference between the goal of illustrating the features versus potential returns or downside risk. One could easily demonstrate features with some prescribed returns that do not differ from one product to the next. Also, I think that the industry will compromise on demonstrating downside as long as we allow them to show very attractive returns. I think that this goes to the dynamic of the sale where the "expected" return weighs more than anything else.

I think that the problem is that the insurer is actually allowed to choose the rate at which to illustrate. When you buy a mutual fund, broker does not select for you an "expected" return. They may give you information on the past performance over the range of past periods but do not tell you which one is most meaningful.

Also, If I understand the process behind the illustration certification, it leads to results for IUL that cannot be theoretically justified. The actuary may be able to show that based on expected portfolio returns a number of strategies is supportable. However, this in itself does not determine the illustrated rate.

Allowing illustration to use the rate that is based on the past performance is unfounded. It invites looking for strategies that were successful in the past and then claiming that they would be successful in the future. Maybe we should have the consumers choose the index returns based on the range of past outcomes.

Ad 2.

Maybe. The problem is that the "expected" return often lacks theoretical support and is shown as if it were a level return (same return each year). So a product with higher expected return looks better. It is unclear if it is possible to make a presentation that would convince the prospective buyer that a product with lower return might outperform the one with higher return occasionally.

Ad 2a.

To the extent that the additional "expected return" is in exchange for additional fees, this approach might work. But it won't fix the issue of "innovative" strategies and custom indices that can be hedged with the same cost. In that case, a strategy that wins retrospectively will continue to look better.

Tomasz Serbinowski, Actuary
Utah Insurance Department
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Global Atlantic
FINANCIAL GROUP

March 8, 2019

Mr. Fred Andersen
Chair, IUL Illustrations (A) Subgroup
National Association of Insurance Commissioners

Dear Mr. Andersen,

Global Atlantic Financial Group, and Accordia Life and Annuity Company appreciate the opportunity to provide comments to the questions exposed by the IUL Illustrations Subgroup regarding the illustrations of Indexed Universal Life (IUL) products under Actuarial Guideline 49 (AG 49). The history of our company is one of the longest in the delivery and service of IUL products in the industry. It is from this rich history that we have some key insights to offer in the discussion around this important topic.

AG49 was an important development for the benefit of policy owners in many ways. It facilitated consistency and transparency across carriers in how we communicate to policy owners through the important tool of an illustration. In concert with other important regulations such as the illustration actuary attestation, we believe the intention was met. However, since adoption there have been product developments that have resulted in a deviation from this intention.

We believe that there are a few key areas of focus that should be addressed to update AG49 or adherence, and recapture the intention of appropriate consistency and transparency. Specifically, the use of leverage via implied or explicit additional charges to the policy owner, how the value of leverage is illustrated and how the outcome of leverage flows into illustrations that use participating loans.

Issues

We believe that giving options to the policy owner is valuable as long as there is an appropriate representation of risk and reward of the options. The recent development of products with charges connected to significant multipliers to the index interest credit are not providing an appropriate representation. Simply put, the selection of one of these multiplier options with a charge are only showing an incremental return that comes from the option. The risks or downside of this leverage are not being displayed or understood.

Illustrations utilize sophisticated calculations, yet at the same time are very limited in their sophistication. Since many illustrations illustrate a level return assumption at or close to the maximum illustration rate, the illustrated result with a multiplier only illustrates an incremental return in excess of the charge. Because our current regulations limit an illustrated rate in a given year to the maximum under AG49, there is no current method to illustrate alternative outcomes by year to show how much the leverage can deteriorate account values with low returns intermittently or on a sustained basis. Given this, incremental increases in the illustrated performance of a product simply results by offering higher multipliers with a given fee. Will the next iteration of products move from 5%/7.5% charge to 10%/15% charge?

Global Atlantic
FINANCIAL GROUP

Beyond the limitations of the illustration, the risk of leverage dramatically increases when a policy is not funded adequately. This is a very important consideration since it has been a systemic issue for the life insurance industry. By not adequately disclosing the risk of leverage, but instead only promoting the benefit of it, we are essentially at risk to accentuate an historical issue in our industry.

In addition to the unbalanced representation of the potential performance of these features, an additional issue is how the projected returns flow into the illustration when participating loans are utilized. AG49 appropriately limited the difference between the rate credited on loaned funds and the rate charged on loaned funds for participating loans. The products with a charge and high multipliers are only adhering to this portion of the regulation with the index interest credit before applying the multiplier. Since the underlying illustrations as noted above only show a net increase in the return for using this feature, the incremental effect on accumulation continues to occur when a loan is used. As a result, the loan leveraged assumed by the illustration dramatically increases beyond the AG49 intention.

Recommendation

We do believe that options should be available to the policy owner, but the risk and reward of the options should be presented in a more balanced way. When significant charges are utilized to multiply the index return, we need to require a view that shows what can happen when expected returns are not met and the underlying charges deteriorate account values. There are many ways to do this, so we will leave it up to the continued discussion of this effort to define alternatives.

When participating loans are used, we simply suggest that the underlying intention of AG49 gets applied against the total credits associated with index returns, not just the interest crediting portion before the addition of the multiplier.

Summary

The original AG49 adoption accomplished its intention of consistency and transparency. Since the introduction of AG49, there have been product developments that have created illustrations that deviate from the intention of AG49. The product features that have driven this deviation are primarily those with significant multipliers with an implied or explicit charge. Their projected returns are not adequately showing the risk of using this leverage. If we do not correct this, the industry will be forced to additionally adopt these features to remain competitive. It will be unhealthy for our industry and consumers. Instead, we need to address how these features are appropriately demonstrated inside of illustrations, for a more balanced view of both risk and reward.

Tom Doruska
Head of Life Product Development

David P. Wilken
President - Life

March 8, 2019

Fred Andersen
Deputy Commissioner of Insurance
Minnesota Department of Commerce
Chair, NAIC IUL Illustration (A) Subgroup
Via email to Tiffany Lewis (tnlewis@naic.org)

Re: NAIC Illustration (A) Subgroup – Preliminary Responses to Questions 1, 2 & 2a

Fred:

This letter addresses questions 1, 2 and 2a of the 8 questions posed by the NAIC Illustrations Subgroup, and is submitted on behalf of the following companies:

Lincoln Financial Group
National Life Group
Nationwide
Pacific Life
Transamerica

These responses represent our best effort to address these questions by the March 8 deadline. We began work on responding to these questions immediately after they were exposed. Despite multiple conference calls and various draft responses, we found that due to the breadth and complexity of the issues involved, we need additional time to provide full and complete responses. Therefore, the following responses should be considered preliminary. We look forward to further deliberations that will enable us to provide more specific and concrete responses.

1. How should products with different attributes be illustrated to demonstrate the differences in product features, potential returns, and downside risk?

We agree that this is an important and relevant question that pertains to all illustrated life products. In our view, however, it is an exceedingly broad question and can only be answered in specific detail after the Subgroup and interested parties work through the remaining questions and other questions or issues that may arise.

2. Should a higher risk/higher reward IUL product be illustrated with higher credited rates than a vanilla IUL product would be?

Yes. Illustrated credited rates should reflect the product's actual mechanics. Assuming the same index account parameters, the maximum illustrated growth rate for all products should be the same. Similarly, a higher risk/reward IUL product should be illustrated with higher credited rates than a vanilla IUL product.

2a. If "yes," how should the downside of the product be communicated with applicants? One example is a side-by-side alternate scale showing lower returns for the higher risk product than would be shown for a "regular" IUL product. Another example is a separate demonstration of how returns could develop in an adverse scenario (potentially impacted by the sequence of returns).

This is another important question that merits careful consideration. We agree that the risk of a product needs to be effectively communicated to prospective customers. We have not yet had the opportunity to arrive at a single consensus recommendation on how to communicate the risk of a product most effectively, but offer the following preliminary thoughts:

- We agree that the downside risk can potentially be communicated either through an alternate scale or through a scale that demonstrates the potential impact of a sequence of returns.
- Consideration could be given to developing an illustration numeric summary page that juxtaposes results from multiple market scenarios.
- Consideration could also be given to improving the effectiveness of current illustrations by refining or replacing the current AG49 Alternate Scale and/or moving it to the proposed numeric summary page.

We again appreciate the opportunity to provide input to the Subgroup and look forward to further exploring the issues in the weeks ahead.

Respectfully Submitted,

Lincoln Financial Group
National Life Group
Nationwide
Pacific Life
Transamerica

ERNEST R. ARMIJOS, FSA, MAAA
Product Design, Life Insurance Division

March 8, 2019

Filed Electronically

Fred Andersen
Chair, IUL Illustration (A) Subgroup
National Association of Insurance Commissioners

Re: IUL Illustration (A) Subgroup; Preliminary Responses to Questions 1, 2 and 2a

Dear Mr. Andersen:

Thank you for the opportunity to provide comments on the questions posed to the IUL Illustration (A) Subgroup (the "Subgroup") regarding its review of Actuarial Guideline 49 ("AG 49").

As an industry leader in providing indexed universal life ("IUL") products to consumers, Pacific Life joins in the letter provided separately by several leading IUL companies. We support the Subgroup's goal of ensuring that consumers have access to timely information that helps them make informed decisions, and also acknowledge the complexity of the issues involved in responding to the questions posed. We believe that further deliberation is necessary to ensure that any changes to AG 49 contemplated by the Subgroup do not have the unintended consequence of chilling product innovation or limiting consumer choice. Marketplace innovation benefits consumers and has helped them access products that provide the features and benefits that their families need. We look forward to engaging with the Subgroup over the coming weeks and months to identify what changes, if any, are necessary and appropriate to achieve the goals of the Subgroup.

In the meantime, Pacific Life offers the following preliminary responses to Questions 1, 2 and 2a consistent with the focus of the Subgroup for its Tuesday, March 12, meeting.

Q1. How should products with different attributes be illustrated to demonstrate the differences in product features, potential returns, and downside risk?

We believe that an illustration that applies a range of potential returns to policy mechanics, showing both the potential gains and losses under various alternative market scenarios, ideally derived from historical equity growth returns, may help consumers

better understand the potential volatility associated with IUL products, whether or not the particular IUL product has bonus features. The NAIC has established some precedent for this approach in its Annuity Disclosure Model Regulation's use of historical returns.[1]

The Subgroup may also consider a summary page comparing key illustrated metrics (e.g., accumulated value, distribution amounts, lapse duration, etc.) at certain intervals to effectively contrast the impact of the historical scenarios against the base flat rate illustration and the alternate scale illustration.

Q2. Should a higher risk / higher reward IUL product be illustrated with higher credited rates than a vanilla IUL product would be?

We believe that all products should be illustrated in a manner consistent with their underlying mechanics. In the case of higher risk / higher reward IUL products, these mechanics have the potential for higher credits than that of vanilla IUL products, and the illustrations should communicate both the higher potential reward and the higher potential volatility risk.

The Subgroup could consider how the use of alternative historical scenarios, as suggested above, would provide consumers with a better understanding of how policy mechanics drive risk associated with index growth volatility.

2a. If "yes", how should the downside of the product be communicated with applicants? One example is a side-by-side alternate scale showing lower returns for the higher risk product than would be shown for a "regular" IUL product. Another example is a separate demonstration of how returns could develop in an adverse scenario (potentially impacted by the sequence of returns).

As proposed above, we believe that the downside risk of the products could be demonstrated by illustrating product mechanics through various alternative historical scenarios. In suggesting alternative scenarios, we are mindful that the Subgroup will to consider the extent to which additional disclosure represents effective communication and the point beyond which additional numbers render the message more obscure.

We look forward to exploring these further with you.

Very truly yours,

Ernest R. Armijos

[1] NAIC Annuity Disclosure Model Regulation, Section 6F(9)

March 10, 2019

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

Dear Mr. Andersen,

AXA Equitable very much appreciates the efforts of the Subgroup and provides the following comments in response to your request.

In considering the specific questions posed by the Subgroup, we found it helpful to take a step back, and to first consider two more fundamental questions:

(A) What is the purpose of illustrations?

(B) With respect to illustrations of index-linked products, how is AG 49 possibly falling short today?

Although we have arrived at our own preliminary answers to these questions as summarized below, we want to emphasize our belief that *discussion of these questions* will provide a necessary framework for regulators, consumer advocates, and industry to resolve the current issues concerning illustrations of index-linked products, including the more specific issues that have been raised by the Subgroup.

(A) What is the purpose of illustrations?

Although illustrations can be used for many purposes, the following seem primary to us:

1. To help consumers understand the mechanics of products, that is, their features and how they will operate, as opposed to how they will perform, which can't be predicted or estimated;
2. To help consumers understand the tradeoffs between higher potential index-linked returns versus the higher product charges that will be incurred to support them;
3. To help consumers make informed choices between products available within the marketplace, recognizing that in the final analysis only consumers themselves can make such choices.
4. To help consumers set intelligent expectations as to potential prices and benefits of available products, including premium funding requirements, cash value accumulation, ability to take income, length of coverage, death benefits, and any supplemental benefits.
5. To help policy owners manage their policies effectively after purchase, primarily through the use of inforce illustrations as a crucial tool for making timely adjustments to planned premium payments or other planned policy transactions when actual index performance inevitably has varied from what was initially illustrated.

(**B) With respect to illustrations of index-linked products, how is AG 49 possibly falling short today?**

In our view, AG 49 is currently falling short in the following ways:

1. In not requiring adequate and uniform disclosure of the tradeoffs between potential higher index-linked returns versus higher product charges that will be incurred to support them, in terms of illustrated prices and benefits. We refer to this as the risk/return profile of the product, and we mean this only in the sense of scenario testing, as opposed to any attempt to estimate future probability distributions.
2. In failing to provide consumers with useful metrics (other than illustrated policy values and lengths of coverage) that they can use to evaluate and compare risk/return profiles for different products and product designs that have become available within the marketplace.
3. In its lack of clarity as to how its requirements should be interpreted with respect to recent and emerging product designs featuring new kinds of index-linked enhancements;
4. In creating a non-level playing field that favors some types of product designs (e.g., those featuring multipliers, high participation rates, or other index-linked enhancements) over other designs, by allowing the former to illustrate more favorably than the latter, even in situations where both designs possess the same or similar risk/return profiles

Based upon the above framework and our own preliminary conclusions as summarized above, we offer the following brief commentary on questions 1, 2 and 2a from the exposed list:

1. How should products with different attributes be illustrated to demonstrate the differences in product features, potential returns, and downside risk?

Products should be illustrated at index-linked crediting rates that they are potentially able to achieve, including index-linked enhancements, so long as they are self-supporting and non-lapse supported, clearly explained, and not deceptive.

2. Should a higher risk / higher reward IUL product be illustrated with higher credited rates than a vanilla IUL product would be?

Higher credited rates, including reflection of any index-linked enhancements, should be allowed to be illustrated based on the historical "look-back" structure of AG 49, subject to the conditions stated in 1.

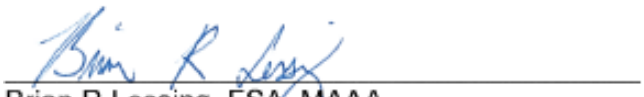
2a. If "yes", how should the downside of the product be communicated with applicants?

Illustrations and/or metrics based upon credited rates that are significantly lower than the maximum illustrated crediting rate should be required, to reveal differences in risk/return profiles among currently available and future product designs.

Useful metrics for consumers might include (1) premium funding sensitivities (to show how sensitive the "price" of the coverage is to changes in assumed index-linked crediting rates and enhancements), (2) internal rates of return on cash value (if such returns are higher than the illustrated crediting rate or other threshold value, this could signal potentially higher risk), or (3) percentage reductions in yearly cash value growth that would result from stipulated reductions in assumed index-linked crediting rate (such reductions could be magnified for designs with multipliers or high participation rates, achieved by hedging notional amounts far in excess of policy accounts).

Illustrations and/or metrics based upon credited rates that vary from one year to the next might also be helpful to consumers, but we believe that volatility risk is more difficult to address in new business illustrations than is the risk of sustained low index-linked returns. There are technical reasons for this, including illustration reg and AG 49 limitations on maximum illustrated crediting rates, difficulties in choosing representative historical time periods or realistic hypothetical patterns of returns, etc. Therefore, it seems to us that enhanced use of inforce illustrations should be strongly encouraged or even mandated for this purpose, as well as for managing the risk of sustained low index returns.

We hope the above comments are helpful, and we look forward to participating on future calls.



Brian R Lessing, FSA, MAAA
Senior Director and Actuary
AXA Equitable Life Insurance Company
1290 Avenue of the Americas
New York, NY 10104

Cc: Reggie Mazyck, NAIC

CENTER for ECONOMIC JUSTICE | FAIR ACCESS FAIR TREATMENT

Comments for the Center for Economic Justice

To the Indexed Universal Life Subgroup of the NAIC Life Actuarial Task Force

Needed Reforms for IUL Illustrations and AG 49

March 8, 2019

CEJ submits the following comments to the IUL subgroup.

The current state of IUL Illustrations violates the spirit and intent of the NAIC Life Illustration Model Regulation and AG49. Insurers have developed products specifically to game the Regulation and AG 49 to

- produce unrealistic accumulation amounts;
- mask massive fees;
- present policy loans as a perpetual cash machine;
- increase the risks to consumers without consumers understanding the increased risk;
- generate great potential for reputational risk for insurers and the insurance industry for the sale of misleading and deceptive products; and
- likely create future solvency and systemic risk from defective products.

It is important to point out that while an IUL can be a sound product with good value for the consumer, some IUL product designs can be defective from the standpoints of consumer benefit, market conduct and/or financial solvency. While CEJ is critical of the current state of IUL illustrations and some IUL products, an IUL can be designed to be a sound and beneficial product for consumers.

There is no question that recent product design has been guided by illustrating high accumulation values and illustration rates with the result that several new products – those with multipliers, new hybrid indices, high fees and unrealistic loan rate arbitrage – illustrate higher accumulation amounts despite lower crediting rates and significantly higher policy fees than prior to AG49. If the purpose of AG 49 was to rein in unrealistic illustrations, AG 49 is a failure.

The fundamental structure of life illustrations is flawed. There is nothing in the Life Illustration Model or AG49 that requires the presentation to the consumer of substantive market risks – particularly risks associated with different patterns of market gains and losses or risk associated with future premium payment requirements not anticipated or otherwise shown in illustrations.

There should be an effort at convergence of indexed annuity and indexed life insurance illustrations. The fundamental structure of indexed annuity illustrations – a scale representing the outcome assuming the worst historical period, a scale representing the outcome assuming the best historical period and a scale representing average historical experience – communicates risk to the consumer far better than the scales permitted by the life illustration model. The annuity disclosure model also needs to be improved to address the spate of new indices for new products based on data mining favorable near-term historical returns. This can be addressed by lengthening the time periods for evaluating such scales to a period sufficiently long to prevent the type of data mining to create indices showing extremely favorable results over the very recent past.

IUL illustrations violate the requirements of the Life Illustration model constantly. The model prohibits "represent(ing) the policy as anything other than life insurance" and "use(ing) or describe(ing) non-guaranteed elements in a manner that is misleading or has the capacity or tendency to mislead." AG49 has not only failed to rein in these abuses, it has prompted insurers to double down on the life-insurance-as-riskless-high-yield-investment in a manner that misleads consumers to believe riskless high returns are available through life insurance. These prohibitions in the illustration model occur hundreds or thousands of times a day.

IUL products are marketed as a better investment than the mutual funds or other security upon which the indexed product's index is based. In other words, an indexed IUL is presented as a better investment – safer and with a higher accumulation – than a direct investment in the index security itself. Again, the fault is with the basic structural requirements for life insurance illustrations.

A better approach would be to show the cost of the value provided by the insurance -- what is the cost of the guarantees given to the consumer by the insurance company? Instead of illustrations purporting to obliterate the risk-return tradeoff in investments – illustrations should show the cost and the value of insurance. Just as consumers see the cost of their auto, home or term life insurance relative to the benefits they can expect, so should investment type insurance product marketing information show the cost of the product versus the benefits relative to a direct investment by the consumer in the security that is used for the index.

This would mean, using a IUL based on the S&P 500 index as an example, comparing the cost of the IUL policy – all premium, fees and charges and the difference in accumulation between the IUL accumulation and the accumulation a consumer would otherwise achieve from a direct investment in the S&P 500, including dividends – to the benefits of the IUL which are the guarantees that an insurance product provides. From our perspective, consumers value insurance because of protection – the guarantees – that insurance coverage provides to the consumer. We believe illustrations should be organized to present a product to consumers in the manner in which consumers have come to understand the value of insurance – for a certain cost, the insurer promises certain guarantees if certain events occur.

Based upon the above, we ask the IUL Subgroup to recommend to both LATF and the A Committee that:

- The problems with IUL illustrations require greater attention than revisions to AG49. Revising AG49 will surely lead to new and different product designs that game the revised AG49. Structural change to life illustrations is needed.

- The Life Insurance Illustration Model should be reviewed with the goals of
    - Presenting the true cost of guarantees in life insurance policies to the benefits of those guarantees
    - Presenting true risk-return tradeoffs to consumers, including and especially risks associated with variation in returns over time and the resulting likelihood of consumers being forced to pay additional premium in future years;
    - Pursing convergence, to the degree possible given the differences between life insurance and annuities, with annuity illustration requirements, with particular emphasis on replacing the life illustration model scales with the worst, best and average scales in the annuity disclosure model; and
    - Stopping the abuses with illustrations of loans made to appear as if the IUL is perpetual cash machine;

- The effort should be undertaken by regulators and consultants with expertise in addition to actuarial science, including experts in consumer disclosure, biases and cognition. A working group of the A Committee would be better situated to address the broader problems with life insurance illustrations than LATF or a LATF subgroup.

- The effort should involve consumer testing to ensure that intended and expected disclosure outcomes are actually realized. If regulators can field test capital models for private mortgage insurance and group capital, there is no reason to fail to field test the disclosures to consumers that form the basis of consumers' decision to invest lifetime savings.

March 28, 2019

Fred Andersen
Deputy Commissioner of Insurance
Minnesota Department of Commerce
Chair, NAIC IUL Illustration (A) Subgroup
Via email to Tiffany Lewis (tnlewis@naic.org)

Re: NAIC Illustration (A) Subgroup – Preliminary Responses to Questions 3 - 8

Fred:

This letter addresses questions 3- through 8 of the 8 questions posed by the NAIC Illustration (A) Subgroup, and is submitted on behalf of the following companies:

Lincoln Financial Group
National Life Group
Nationwide
Pacific Life
Transamerica

The following responses should be considered preliminary and we look forward to further deliberations that will enable us to provide more specific and concrete responses.

3. In 2015, there was a decision by the Subgroup to not have a hard ceiling on the credited rate, e.g., no rate above 6.75%. Should that decision be revisited?

Applying a hard ceiling on the IUL credited rate would not be appropriate.

We believe that one important goal of the illustration is to accurately reflect product mechanics. Any hard ceiling applied to the credited rate of any life insurance policy illustration, including IUL policies, would be arbitrary, and would not allow the mechanics of certain product features to be reflected appropriately.

In the specific case of IUL Index credit multiplier illustrations with a hard ceiling would capture the full impact of product charges but would not illustrate the full range of credits for which the charges have been assessed. Such illustrations would lead consumers to an incomplete understanding of a product's upside and downside potential.

4. Is the interaction of the loan charges and loan credits being illustrated as expected?

We understand that regulatory concerns have been expressed on the interaction between Index credit multiplier and the current ability to illustrate 100 bps difference between the illustrated rate credited to the loan balance and the illustrated loan charge. We look forward to working with the Subgroup to clarify regulatory expectations regarding this interaction.

5. Are there known concerns regarding illustration of volatility-controlled funds?

Although we acknowledge that AG49 requires actuarial judgment in applying the guardrail around index returns to volatility-controlled funds, we are not aware of specific concerns raised by regulators or consumers. We look forward to working with the Subgroup to better understand any potential concerns.

6. Is there a concern that extreme variations of the index credit multiplier could lead to a risk-return profile similar to that of variable life even though return-of-premium (net charges and withdrawals) remains a floor? If so, is that something our subgroup, focused on illustrations, would address?

We are unaware of any IUL product with a risk return profile similar to that of variable life. Variable life products have both an uncertain upside and downside return. IUL products typically have a floor or minimum interest crediting rate that applies even where the indexed return is negative. Additionally, many current IUL products offer return-of-premium benefits and minimum interest guarantees not normally found in variable products.

7. Should it be recommended that LATF address the issue of whether assumptions underlying IUL illustrations should be consistent with assumptions underlying PBR and asset-adequacy testing?

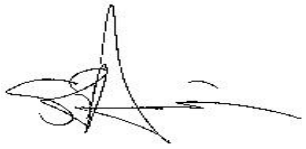
We do not support linking the assumptions underlying illustrations with the assumptions underlying reserves because statutory valuations and illustrations have very different purposes. Statutory valuations are intended to protect company solvency, so policy reserves are established and tested under moderately adverse conditions (i.e., focus on the downside risk). In contrast, illustrations are intended to provide consumer education, so policy illustrations show different scenarios (i.e., both the downside risk and the upside potential).

In addition, we note that consistency between illustrations and statutory valuations may not be possible without opening the Life Insurance Illustrations Model Regulation. If this were pursued, it would be important to apply any such rules to all products covered by the Model.

8. Are there issues relevant to IUL that are part of a broader concern related to non-IUL life illustrations, where engagement with A Committee may be necessary?

We believe that the Subgroup's focus on the effectiveness of AG 49 is appropriate at this time. That said, should certain AG 49-specific matters raised by the Subgroup implicate changes to the Model – including impacts that may be common across product types – we will look forward to discussing them with the Subgroup as they arise.

Respectfully Submitted,



Scott R. Harrison
Harrison Law Office, P.C.

On behalf of the following companies:

Lincoln Financial Group
National Life Group
Nationwide
Pacific Life
Transamerica

March 29, 2019

Fred Andersen
Deputy Commissioner of Insurance
Minnesota Department of Commerce
Chair, NAIC IUL Illustration (A) Subgroup
via email to Reggie Mazyck (RMazyck@naic.org)

Re: IUL Illustration questions for consideration

Dear Mr. Andersen,

On behalf of Transamerica, I welcome the opportunity to provide comments on the questions posed by the IUL Illustration (A) Subgroup.

Transamerica has offered IUL products since 1997. IUL products have become an attractive and versatile tool for meeting the insurance needs of middle-class Americans. Because illustrations are an important and valuable part of the sales process, Transamerica supports a regulatory framework that provides clarity and consistency around illustration practices.

Transamerica believes that prospective purchasers of IUL and other products should be provided illustrations that facilitate understanding of how IUL products work, that show the risk/reward profile, and that facilitate comparisons across products. We appreciate the Subgroup's interest in considering fundamental issues regarding current IUL illustration guidance as it pertains to different product designs. Transamerica supports the comprehensive responses of the American Council of Life Insurers (ACLI) and of a separate coalition of companies. In this letter we wish to share some thoughts on selected questions posed by the Subgroup.

2. Should a higher risk / higher reward IUL product be illustrated with higher credited rates than a vanilla IUL product would be?

2a. If "yes", how should the downside of the product be communicated with applicants? One example is a side-by-side alternate scale showing lower returns for the higher risk product than would be shown for a "regular" IUL product. Another example is a separate demonstration of how returns could develop in an adverse scenario (potentially impacted by the sequence of returns).

Transamerica believes that a higher risk / higher reward product should be illustrated by showing both the potential for higher returns (upside) and the potential for higher risk (downside). We suggest that a possible way of communicating this with applicants would be a single page summary table such as the following:

Illustration Summary Table (Proposed)

Net Cash Surrender Value	Illustration Bases			Scales of Credited Interest Rates			
	Guaranteed basis[1]	Midpoint basis[2]	Current basis[3]	Minimum scale[4]	Alternate scale[5]	Non-level scale[6]	Current scale[7]
Year 10							
Year 20							
Year 30							
Age 100							

[1] The guaranteed basis employs guaranteed charges and a defined minimum scale for both interest rates and equity returns.
[2] The midpoint basis employs the average of the guaranteed and current scales for both charges and returns.
[3] The current basis applies both current charges and the permitted illustrated maximum interest rates. The "current basis" is the same as the "current scale."
[4] The minimum scale of returns would apply the guaranteed minimum interest rate for fixed returns and equity market index returns. Current charges would apply.
[5] The alternate scale of returns would apply the AG49 defined rate. Current charges would apply.
[6] The non-level scale of returns could annually alternate between the minimum scale and the current scale. Another possibility may be for a random set of returns between the permitted illustrated maximum and minimum interest rates to be generated annually. Current charges would apply.
[7] The current scale employs current charges and the permitted illustrated maximum interest rates. The "current scale" is the same as the "current basis."

The benefits of this summary table include the following:

1. It builds on existing illustration practices, adding a Non-level Scale (which would need to be developed) and a one-page summary table
2. It conveys to the consumer that outcomes are uncertain and will not be uniform from year to year
3. It allows the consumer to see a plausible yet conservative range of outcomes, facilitating product comparisons
4. It displays the impact of variability in (a) both charges and credited rates, and (b) credited rates alone.

4. Is the interaction of the loan charges and loan credits being illustrated as expected?

We understand that potential regulatory concerns exist based on the interaction between index multipliers and the current ability to illustrate a 100 bps difference between the illustrated rate credited to the loan balance and the illustrate loan charge. We acknowledge these concerns and could support either of the following:

1. No illustration of leveraged loans on all products (not just IUL), or
2. A 100 bps upside limit on loan leverage, provided that:
    a. All forms of non-guaranteed elements—including index-based interest credits and bonuses—are treated equitably, and
    b. A commensurate downside illustration is also provided

8. Are there issues relevant to IUL that are part of a broader concern related to non-IUL life illustrations, where engagement with A Committee may be necessary?

We support the current Life Illustrations Model Regulation for new business or products continuing to be sold, but the model regulation unduly restricts the ability of companies to provide relevant in-force illustrations, negatively impacting consumers.

If an inforce policy does not pass the required lapse-support and self-support tests, the current scale of non-guaranteed charges cannot be illustrated. This is frequently the case if a product has significantly underperformed pricing expectations. In such circumstances, the company can only provide a quote at the guaranteed scale or illustrate using a hypothetical scale that would allow the product to pass the two tests. An illustration using a scale other than a current best estimate reduces the consumer's ability to understand how policy performance and any policy changes impact the long-term funding for the policy.

This deficiency could be rectified by changing the way that the lapse-support and self-support tests apply to inforce illustrations within the model regulation.

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Again, we appreciate the opportunity to provide comments and stand ready to assist the Subgroup in its work.

Sincerely,

Michael J. Brown

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