The First Step Toward Revising Life Insurance Illustration Requirements

June 17, 2015

On June 4, 2015, the Life Insurance and Annuities (A) Committee of the National Association of Insurance Commissioners (NAIC) took its first step in revising life illustration requirements by adopting proposed Actuarial Guideline 49 (AG 49). AG 49 sets forth parameters to be used in index universal life illustrations for calculating the credited rate for the "illustrated scale," the earned interest rate for the "disciplined current scale," and the illustrated rate credited to policy loans. The general purpose of AG 49 is to facilitate uniformity in the methodology for determining the interest rates for index-based life insurance product illustrations. The methodology does not address all index account variations, but is intended to help consumers better understand how index-based life insurance policies function. AG 49 was developed as an "interim guidance" to address the varying practices in application of the Life Insurance Illustration Model Regulation (Model 582). A working group of the Life Actuarial Task Force is expected to provide further refinement to AG 49. In addition, chairwoman Julie McPeak, Commissioner of the Tennessee Department of Commerce and Insurance, acknowledged the need to reopen Model 582 to ensure a level playing field for all products, and to examine the disclosures in illustrations. New York's representative was the only committee member that did not support AG 49, stating that New York is in the process of developing its own proposal in this area. **What does AG 49**

Require?
It requires insurers illustrating policies that credit interest based on an index to:

1. Compute the maximum crediting rate for the illustrated scale based on the arithmetic mean of the geometric average annual credited rates of the "Benchmark Index Account."
2. Limit the earned interest rate for the disciplined scale to either: (a) if the insurer hedges its obligations to credit interest based on an index, 145 percent of the annual net earnings rate of the general account assets allocated to support the illustrated policy; or (b) the annual net investment earnings rate of the general account allocated to support the illustrated policy.
3. Include a new ledger based on a newly-adopted "Alternative Scale."
4. Limit the interest rate credited on policy loans (a) in an illustrated scale ledger to no more than 1 percent greater that the loan interest charged and (b) in the Alternative Scale ledger to no more than the loan interest charged.
5. Include a table showing the highest and lowest of the geometric average annual crediting rates.
6. Include a table showing actual historical index changes and corresponding hypothetical rates using current index parameters for the most recent 20-year period.

What is the Illustrated Scale?
Model 582 prohibits insurers from illustrating non-guaranteed policy values (or other non-guaranteed elements of a policy) on a basis more favorable to the policy owner than provided under the policy's "illustrated scale." "Illustrated scale" is defined as the policy's "currently payable scale" or, if less favorable to the owner, its "disciplined current scale." AG 49 limits the illustrated scale's assumed annual credited interest rate to a maximum of the rate calculated for the Benchmark Index Account. **What is the Benchmark Index Account?**
Actuarial Guideline 49 defines a "Benchmark Index Account" as an account that:

1. credits returns based on the S&P 500® Index using an annual point to point crediting method, subject to a zero percent "floor" and an applicable "cap,"
2. credits such returns on the basis of a 100 percent "participation rate,"
3. does not entail any account charges that exceed those for any other accounts within the policy, and
4. does not limit how much of the policy's account value may be allocated to the Benchmark Index Account.

How is the Crediting Rate Based on the Benchmark Index Account Computed?
Hypothetical interest rates would be computed based on the current cap used by the insurer for the

index account similar to the Benchmark Index Account. That cap would be applied to the S&P 500's historical performance for the one-year period starting on December 31 of the calendar year that is 66 years prior to the current calendar year and each trading day thereafter. For the 2015 illustrations, the first one-year period would start on January 3, 1950. Once the hypothetical crediting rate for each one-year period has been computed, then the geometric average of the crediting rates for the 25-year period starting on January 3, 1950 and for the 25-year period commencing on each trading day thereafter would be computed. Finally, an arithmetic mean of those geometric averages would be computed as the crediting rate for the illustrated scale. **What if a Policy Does Not Offer a Benchmark Index Account?**

If an insurer's policy does not offer an S&P 500 based index account similar to the Benchmark, then AG 49 requires that "actuarial judgment" be used to determine a hypothetical annual cap to be used in computing the crediting rate based on the Benchmark Index Account. **How are the Crediting Rates for Other Index Account Options Computed?**

For index accounts using other indices or crediting methods, actuarial judgment is to be used to determine their maximum annual credited interest rate. The actuarial judgment must take into account the "fundamental characteristics" of the index account and the "parameters shall have the appropriate relationship to the expected risk and return of the Benchmark Index Account." This language suggests that in computing the maximum crediting rate for other index accounts, the insurer may use the same methodology that is used for computing the interest rate for the Benchmark Index Account. However, in so doing, if a different index is then used, the insurer should consider whether (i) the index has sufficient historical data; and (ii) the historical changes in index are reflective of the expected changes that are similar to the Benchmark Index Account. The maximum crediting rate for other index accounts may not exceed the crediting rate for the Benchmark Index Account. **What is the Disciplined Current Scale?**

Under Model 582, the "disciplined current scale" limits the amount of non-guaranteed elements used in computing non-guaranteed policy values. The non-guaranteed elements may not be illustrated on a basis more favorable to the policy owner than what is reasonably based on actual recent historical experience. AG 49 sets forth limits on the earned interest rate used in determining the disciplined current scale. Specifically, if the insurer engages in a hedging program with respect to the index-based interest, the assumed earned interest rate ***may not exceed*** 145 percent of the annual net investment earnings rate of the general account assets allocated to support the policy. If the insurer does not engage in such a hedging program, AG 49 limits the earned interest rate to the annual net investment earnings rate of the general account assets allocated to support the policy. These experience limitations are also to be used when testing for self-support and lapse-support under Model 582, accounting for all benefits, including illustrated bonuses. **What is the Alternate Scale?**

AG 49 also requires that the basic illustration for an indexed account include a new "Alternate Scale" illustration alongside the illustrated scale. The interest rate to be used for each index account in the Alternate Scale illustration may not exceed the credited rate for the policy's "fixed account" option or, if the policy in question does not offer a fixed account option, the average of (a) the credited

interest rate assumed for the illustrated scale, and (b) the guaranteed minimum rate of credited interest for the account in question. The Alternate Scale illustration also limits the interest rate credited to the loan balance. **When Do IUL Issuers Need to Comply With AG 49?**
Assuming it is approved during the executive and plenary call on June 18, AG 49 has a bifurcated effective date:

- **September 1, 2015** – AG 49's limits on the illustrated scale for index account's interest rate and limits on the earned interest rate for the disciplined current scale apply.
- **March 1, 2016 –** AG 49's limits on loan interest rates and requirements to show the Alternate Scale ledger, table showing highest and lowest geometric average rates, and table showing historical index changes and corresponding hypothetical rates for the most recent 20-year period apply.

The date on which the policy was sold dictates whether the illustration must comply with AG 49. Both new business and in-force illustrations for policies sold on or after an effective date must comply with the requirements that take effect on that date. If a policy has been sold before the effective date, however, the requirements taking effect on that date do not apply. **Why is AG 49 Viewed as Interim Guidance?**
NAIC's Life Actuarial Task Force acknowledges that there remain open questions on certain aspects of AG 49. In recognition of the need to implement the limits on crediting rates, LATF and the (A) Committee nevertheless approved the proposed AG 49 in its current form. LATF established a sub-group, led by Fred Anderson of Minnesota, to consider the open questions. Moreover, as noted above, Model 582 is likely to be reopened to ensure a level playing field for all products. Additional questions raised by various regulators and commenters include:

> *How do Carriers Illustrate IUL Products with Higher Purchased Caps and Purchased Participation Rates?* As currently drafted, AG 49 does not appear to allow insurers to illustrate a higher crediting rate for index accounts that allow an owner the option to pay an additional account charge in exchange for a higher cap or participation rate. In its current form, AG 49 would limit the index interest rate to that for the Benchmark Index Account but at the same time would require the additional charge to be reflected in the policy values. Similarly, the proposed actuarial guideline does not specify how actuaries should reflect higher account charges charged in exchange for a higher cap and/or participation rate in the required table showing hypothetical interest rates using current index parameters for the most recent 20-year period. *How do Carriers Illustrate IUL Products with Multiple Fixed Accounts?* In computing the interest rate for the Alternate Scale, AG 49 does not address a product that may offer multiple fixed accounts with differing crediting rates, as AG 49 currently provides that the assumed credited interest rate cannot "exceed the credited rate for the fixed account."

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