



March 11, 2015

Mike Boerner
Chair, Life Actuarial (A) Task Force
National Association of Insurance Commissioners

Dear Mr. Boerner:

The American Academy of Actuaries¹ Life Illustrations Work Group (“Work Group”) appreciates the opportunity to comment on the proposed Actuarial Guideline YY that was discussed on the Feb. 19 Life Actuarial (A) Task Force conference call.

While formulating our comments, we were mindful of the goals stated in the Life Insurance Illustration Model Regulation (“the Model”) and in the February 2007 revision of actuarial standard of practice No. 24 (“ASOP 24”):

- “...to ensure that illustrations do not mislead purchasers of life insurance and to make illustrations more understandable” (the Model)
- “...to update and reflect current, generally accepted actuarial practices with respect to illustrations prepared in compliance with the Model [due to continued product innovation]” (ASOP 24)

Our comments are organized to follow the sections of the proposed Actuarial Guideline.

GENERAL COMMENTS

- 1) The Background section states: “in the absence of uniform guidance, two illustrations that use the same index and crediting method often illustrated different crediting rates.” We note that this disparity could continue to be the case after this guideline becomes effective due to the following factors:
 - a. Products with the same the same index and crediting method—and the same index parameters—may have different “annual net investment earnings rates” described in 5 (A) and 5 (B), which could result in different illustrated rates.
 - b. Companies and agents may illustrate a lower credited rate at their option.

¹ The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists 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.

We also note that uniformity of illustrated rates is not a goal of the Model. Therefore, we recommend the Background section of this document be modified to either remove this reference or clarify the perceived problem.

- 2) We believe it is incorrect to prescribe a credited rate for the Currently Payable Scale for an indexed universal life (IUL) policy. The Currently Payable Scale is defined in the Model as a scale of non-guaranteed elements that are determined by the company; these non-guaranteed elements are not intended to be prescribed by regulation. We recommend a change to the language to remove this reference.
- 3) We recommend additional clarity as to how the proposed Actuarial Guideline applies to in-force policies. The Work Group has not had time to fully consider the potential impacts to in-force policies, but there are some concerns that common practices under ASOP 24 Section 3.7 (“Illustrations on Policies In Force One Year or More”) may be affected in an unintended manner. In addition, we believe there may be consumer confusion if an in-force illustration fell within the scope of the Actuarial Guideline but the new business illustration did not (or vice versa).
- 4) We continue to have concerns that the proposed Actuarial Guideline reaches beyond the responsibilities of the Illustration Actuary. For example, under the Model, the Illustration Actuary certifies that the illustration meets the requirements of a disciplined current scale (DCS); however, it is the Responsible Officer who certifies compliance for items such as the requirements in sections 6 and 7 of the proposed Actuarial Guideline.
- 5) We recommend that the Scope section be modified or expanded to include policies that utilize an external index to determine non-guaranteed elements other than index credits (e.g., participating whole life policy with index-linked dividends).

SECTION 3: DEFINITIONS

- 6) The Alternate Scale definition references a fixed account in 3 (A) (i). It is possible that a product could offer multiple fixed accounts (e.g., one fixed account may offer a higher credited rate in exchange for a longer duration). Clarification is needed as to what would be intended in that situation. We also note that there could be a significant inconsistency between illustrations of policies with a fixed account and those without.
- 7) The Annual Point to Point definition references an annual cap in 3 (B) (ii). We believe the intent is to use the annual cap associated with the currently payable scale for the calculations in 4 (B). In any case, we recommend additional language to make that clear.
- 8) The Annual Point to Point definition references account charges in 3 (B) (vi). We recommend additional language to define account charges and to clarify what should be done in the event that account charges vary between more than one account (e.g., should the Illustration Actuary use the account with the lowest percent charges?).

SECTION 4: CURRENTLY PAYABLE SCALE METHODOLOGY

- 9) As mentioned above in our general comments, we believe this section is intended to limit the illustrated rate, and not to specify the actual credited rate to the policy. We recommend all such references to the currently payable scale be removed.
- 10) We continue to note that the use of the current indexing parameters combined with historic index experience creates a mismatch of assumptions. (The same type of mismatch is true in the indexed annuity illustration regulation; however, the impact is less severe due to the shorter historical horizon used and commonly lower option budgets.)
- 11) We question whether it is appropriate to give certain time periods significantly more weight than others. The rolling 25-year periods apply extra weight to years in the middle of the 65-year period vs. years at the beginning and end of the period, so more recent index performance will have relatively low impact. Furthermore, the rolling 25-year periods may make the look-back rate more difficult to explain to the consumer. A simple look-back method without rolling periods may be sufficient without adding complexity for the consumer (e.g., one could use the average annual rate from a simple [50]-year look back). Additionally, it may be sufficient to use fewer data points than those that are required in a daily calculation.
- 12) We note that the calculations in 4 (A) are open to interpretation (e.g., how to handle dates that do not fall on a trading day). We recommend more clarification of this calculation.
- 13) We believe the annual cap that is used in the look-back calculation in 4 (A) is intended to be the declared current cap offered in a company's actual available Benchmark Index Account. We recommend better clarification of such throughout the document.
- 14) We recommend combining 4 (E) with 3 (C) to help improve clarity, and recommend deleting the last phrase of 4 (E) ("but in no event shall the credited rate for the currently payable scale exceed the rate calculated in 4 (B)") because it is already included elsewhere in the Actuarial Guideline.
- 15) We believe the intent of 4 (E) is to require construction of a hypothetical, supportable S&P 500 Annual Point to Point index account, but believe it could be misinterpreted to allow any hypothetical Benchmark Index Account (e.g., Nasdaq-100 Monthly Average). We recommend adding clarifying language to this effect and providing guidance to help actuaries create a hypothetical Benchmark Index Account.

SECTION 5: DISCIPLINED CURRENT SCALE METHODOLOGY

- 16) We recommend changing the "credited rate" reference in this section to "earned interest rate" to align with terminology used in the Model.
- 17) The 45 percent limit in 5 (A) seems to be an arbitrary number, and we question if it should be a static number. We suggest that if the look-back methodology is sound, then an arbitrary limit should not be needed.
- 18) We interpret the limit in 5 (A) to apply when the Illustration Actuary is performing self-support and lapse-support testing for the DCS; however, the formula seems to ignore certain sources for

the amount invested in a hedging program. For example, it is widely accepted practice for cost of insurance charges (COIs) or other policy charges to both offset mortality and expense costs and also support a higher option budget. The formula in 5 (A) eliminates these potential additional components and results in inconsistencies between IUL and traditional universal life DCS testing. We recommend modifying the language to eliminate the limitation on the amount invested in the hedging program.

- 19) We believe there would be value in defining “net investment earnings rate.” We believe a common interpretation would be to subtract default costs and investment expenses, but note that ASOP 24 specifically states that investment expenses are sometimes treated separately.
- 20) The amount assumed to be invested in a hedging program described in 5 (A) is to be expressed as a percent. We recommend clarifying that the account value is the denominator in that percentage calculation.
- 21) We do not understand the intent of 5 (C). ASOP 24 already requires inclusion of all policy features, including crediting bonuses, to be considered as a part of DCS testing. What, if anything, is this language intending to add? Is a bonus intended to be capped by the Benchmark Index Account limit as well?

SECTION 6: POLICY LOANS

- 22) Policy loan leverage is a feature of many product designs, not just IUL products. The 100-basis-point limitation to loan leverage could confuse consumers when comparing different types of products subject to the Model. We recommend this provision be removed from the IUL Actuarial Guideline and addressed in a manner that affects all products with similar features.
- 23) The 100-basis-point limitation appears arbitrary to us.

SECTION 7: ADDITIONAL STANDARDS

- 24) In view of the Model’s goals of not confusing purchasers and making illustrations more understandable, we question whether percentiles are understandable to the average consumer.
- 25) We believe it is important to convey how the crediting rate can vary year-to-year and note that the original ACLI proposal included a chart to show possible yearly movements.

We hope these comments are helpful. Please contact Brian Widuch, the Academy’s life policy analyst (widuch@actuary.org; 202-223-8196) if you have any questions or would like any further assistance.

Sincerely,

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Cc: Fred Andersen