

The IUL Illustration Debate

Where it has been, where it is now, and who should care

Tom Doruska

February 25, 2015

Life Insurance in the News

“The life insurance industry continues to be deeply divided over the content of illustrations agents use in selling indexed universal life insurance (IUL).”

LifeHealthPro, October 2014

“In Washington, D.C., LATF continued to debate the path it would take in developing actuarial guidelines for applying the Life Insurance Illustrations Model Regulation (Model 582). The key issue that remains unresolved is how to calculate the disciplined current scale rate of return in Indexed Universal Life (IUL) illustrations.”

Sutherland Legal Alerts, November 2014

“Closer regulatory oversight on illustrations is another trend expected to affect another index product, universal life.”

Insurancenewsnet, December 2014

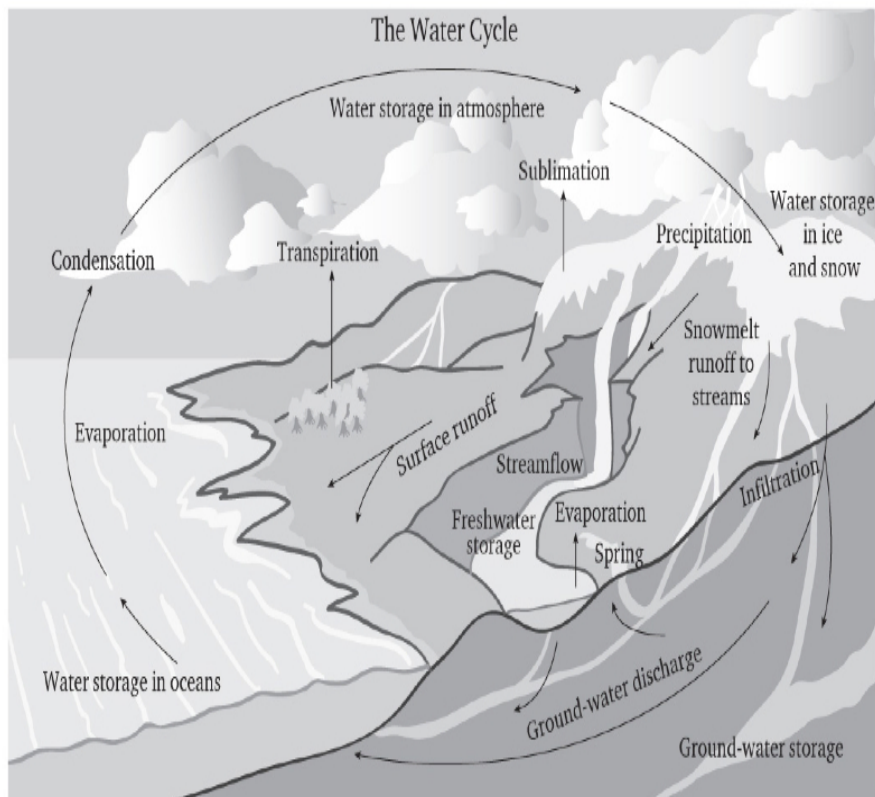
Agenda

1. Overview
 - Current Regulatory Environment
 - Illustrations & Illustration Actuary
2. Indexed Life Design/Illustrations
3. Industry Activity
 - ACLI
 - Regulators
4. Next Steps/Who Should Care

Current Illustration Regulations

Regulation	Description
Life Insurance Illustrations Model Regulation (Model 582)	<p>Developed in mid 1990's by NAIC and enacted by states.</p> <p>Purpose is to “provide rules for illustrations that will protect consumers and foster consumer education”</p> <p>Requires annual company certification, by board appointed “illustration actuary” that illustrated values comply with requirements</p>
Actuarial Standard of Practice No. 24	<p>First adopted in 1995; current version effective since 2007. Promulgated by Actuarial Standards Board.</p> <p>Provides guidance to actuaries in work done to demonstrate compliance with Model 582</p> <p>Illustrated values cannot be more favorable than “currently payable scale” with this scale meeting supportability requirements</p>

Illustration? Illustration Actuary?



3% 71% 21% 5%

A + B + C + D

In which of these fields is an actuary most likely to work?

- A: Education
- B: Insurance
- C: Agriculture
- D: Optics

Detailed description: A woman with dark hair and bangs is shown on a game show set. To her right is a bar chart with four bars of different heights. The bars are labeled A, B, C, and D. Above the bars are the percentages 3%, 71%, 21%, and 5% respectively. Below the bars is the text 'A + B + C + D'. In front of her is a large question: 'In which of these fields is an actuary most likely to work?'. Below the question are four options: '•A: Education', '•B: Insurance', '•C: Agriculture', and '•D: Optics'. The woman appears to be looking at the question with a thoughtful expression.

Life Insurance Illustration

Issue State: IA

Designed for: Valued Client

Issue Age: 45

Male, Preferred Non-Tobacco

\$220,370 Selected Face Amount

Initial Annual Premium: \$10,000.00

Initial Death Benefit Option: Increasing

LEDGER

Policy Year	EOY Age	Key	Gross Premium Outlay	Total Cash from Policy* (BOY)	Net Outlay	Guaranteed at 2% (1)			Non-Guaranteed Assumed (1)		
						Account Value	Net Cash Value	Net Death Benefit	Account Value	Net Cash Value	Net Death Benefit
1	46	A	10,000	0	10,000	8,109	2,016	228,479	9,008	2,915	229,378
2	47	A	10,000	0	10,000	16,433	10,746	236,803	18,880	13,194	239,250
3	48	A	10,000	0	10,000	24,874	19,593	245,244	29,592	24,311	249,962
4	49	A	10,000	0	10,000	33,454	28,580	253,824	41,211	36,337	261,581
5	50	A	10,000	0	10,000	42,173	37,705	262,543	53,818	49,350	274,188
6	51	A	10,000	0	10,000	51,017	46,955	271,387	67,499	63,437	287,869
7	52	A	10,000	0	10,000	59,981	56,325	280,351	82,347	78,691	302,717
8	53	A	10,000	0	10,000	69,046	65,796	289,416	98,464	95,215	318,834
9	54	A	10,000	0	10,000	78,206	75,363	298,576	115,962	113,118	336,332
10	55	A	10,000	0	10,000	87,966	85,529	308,336	135,713	133,276	356,083
			100,000	0	100,000						

Illustration Actuary

- Member in good standing of the American Academy of Actuaries
- Appointed by the insurance company board of directors
- Responsible for certifying that the disciplined current scale used in illustrations complies with applicable Actuarial Standard of Practice and the applicable Illustration Regulation
- Responsible for notifying the insurance company board of directors and the state insurance commissioner promptly if he/she is unable to certify compliance

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Disciplined Current Scale

Definition, per ASOP 24:

“A scale on non-guaranteed elements, certified annually by the illustration actuary, constituting a limit on illustrations currently being illustrated by an insurer that is reasonably based on actual recent historical experience and that satisfies the requirements in the Model.”

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Non-guaranteed element:

“Any element within an insurance policy that affects policy costs or values that is not guaranteed or not determined at issue...Examples of non-guaranteed elements include...participation rates and maximum rates of return for indexed life insurance products.”

Life Insurance Illustration

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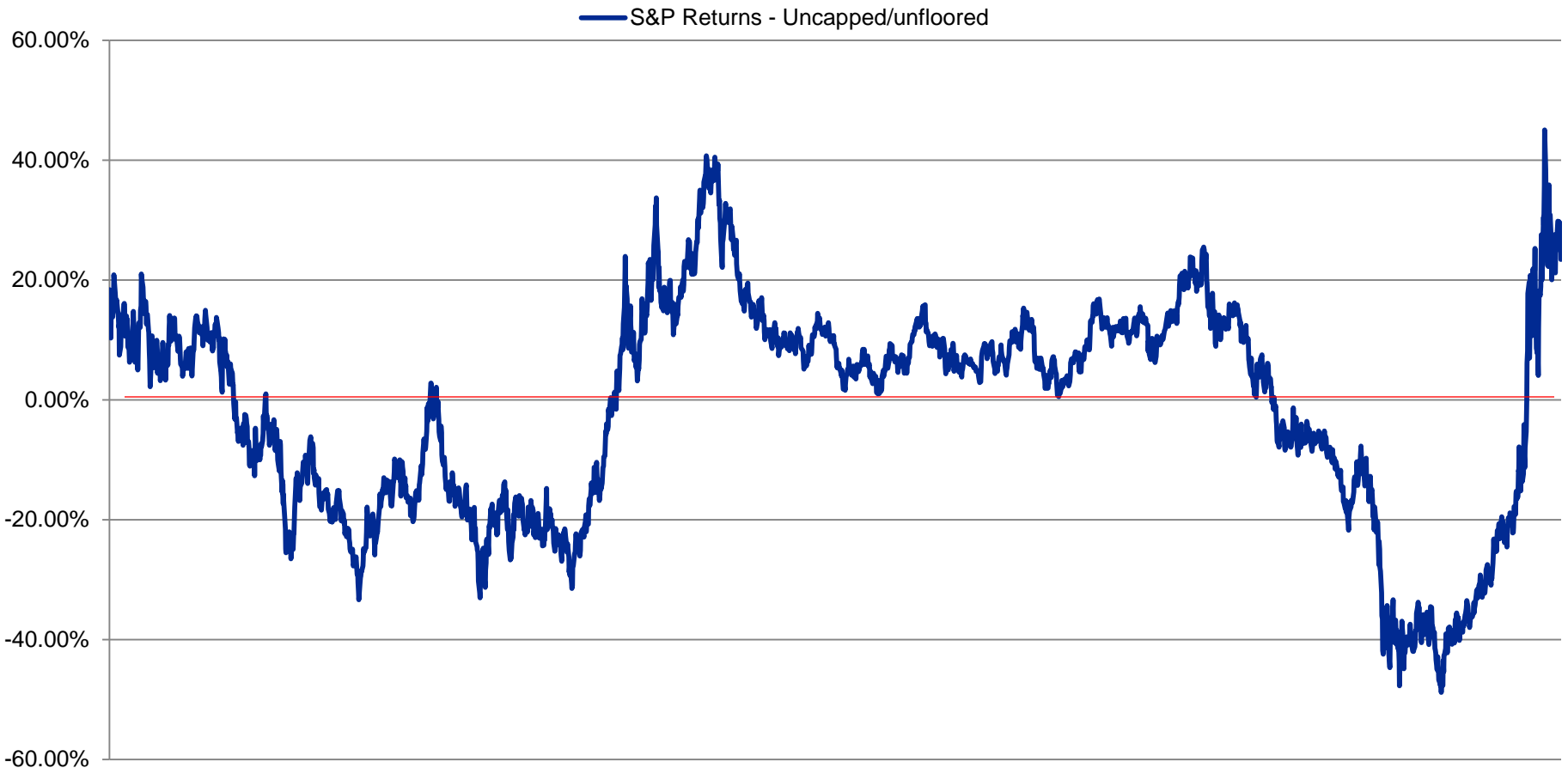
LEDGER

For an indexed life product, the index parameter of the product, such as the cap, is the non-guaranteed element that is unique to IUL.

Policy Year	EOY Age	Key	Gross Premium Outlay	Total Cash from Policy* (BOY)	Net Outlay	Guaranteed at 2% (1)			Non-Guaranteed Assumed (1)		
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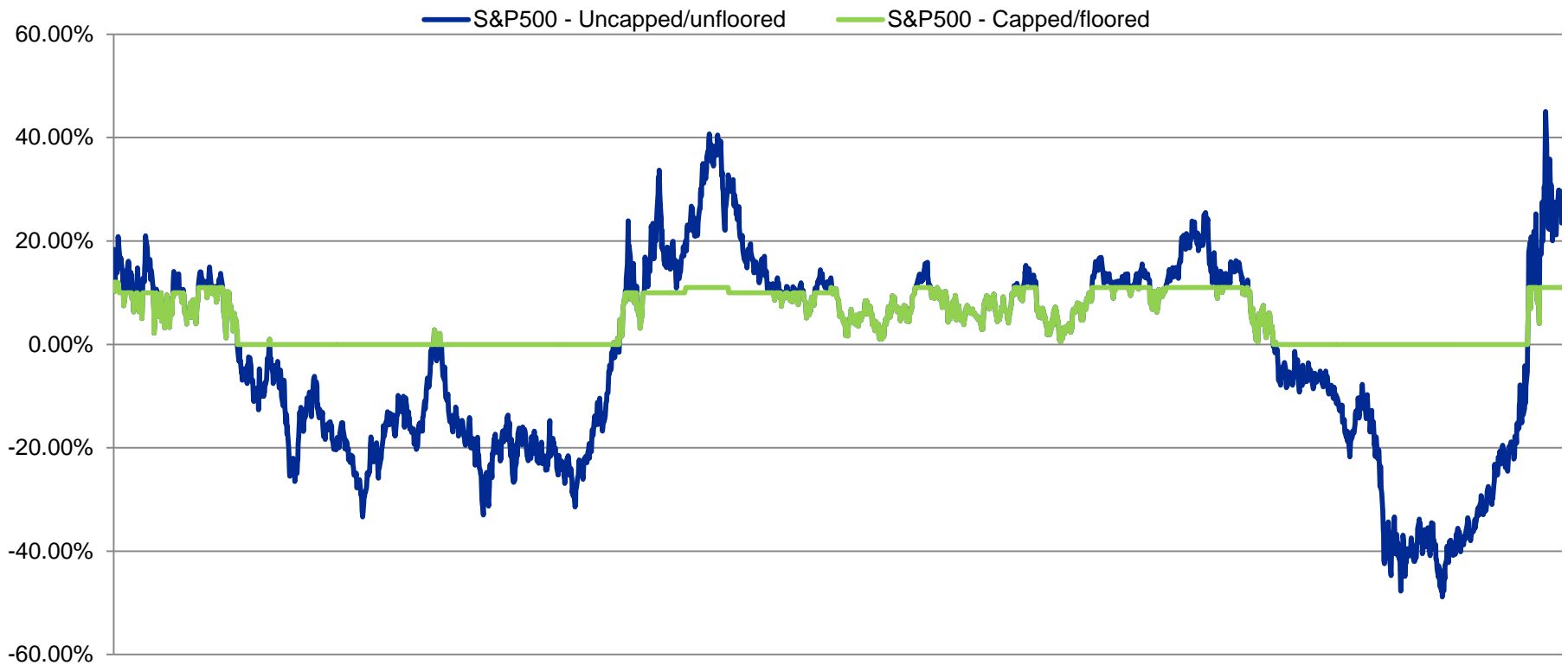
Historical Returns

S&P500 – Uncapped One-Year Point-to-Point
1/1/2000 – 12/31/2009



Historical Returns

S&P500 –One-Year Point-to-Point
1/1/2000 – 12/31/2009



What Rate to Use in an Illustration?

Product	Non-Guaranteed Interest Rate
Whole Life	Declared interest rate within the current dividend scale
Traditional Universal Life	Declared current credited rate
Indexed Universal Life	If the cap is 12%, what do you illustrate at? <ul style="list-style-type: none">• Know the minimum is 0%• Know the maximum is 12%• Don't know what rate will be credited

Industry Activity: IUL Illustrations

ACLI IUL Illustration Task Force

Began work in 2010

Chair: Tom Doruska, Global Atlantic

Charged with recommending improvements to life insurance illustrations for indexed products

Task Force Goals:

- Increase consistency in illustrated rates on IUL
- Improve consumer understanding of IUL interest crediting/its variability

ACLI IUL Task Force Recommendations

NAIC Actuarial Guideline for IUL Illustrations

Consistency in IUL Illustrated Rates

- 25-year back-testing using current cap/par/etc.
- Calendar year data, all data points

Understanding of index crediting/variability

- Table of year by year index credits
- Assume current cap/par/etc and 1/1-12/31 historical index results

IUL Lookback Calculator

Years in Lookback Period	Average Credited Interest Rate for Lookback Period
25	8.10%

ACLI IUL Task Force Recommendations

NAIC Actuarial Guideline for IUL Illustrations

Consistency in IUL Illustrated Rates

- 25-year back-testing using current cap/par/etc.
- Calendar year data, all data points

Understanding of index crediting/volatility

- Table of year by year index credits within illustration
- Assume current cap/par/etc and 1/1-12/31 historical index results
- Table to include applicable historical loan rates

Hypothetical Strategy Results by Year				
Date	S&P 500® Index	Hang Seng Index	1-Yr PIP Increased Part. (200%)	1-Year Point-to-Point
1/1/1988				
1/1/1990	27.25%	5.55%	10.00%	13.00%
1/1/1991	-6.56%	6.61%	0.00%	0.00%
1/1/1992	26.31%	42.11%	10.00%	13.00%
1/1/1993	4.46%	28.28%	8.93%	4.46%
1/1/1994	7.06%	115.67%	10.00%	7.06%
1/1/1996	-1.54%	-31.10%	0.00%	0.00%
1/1/1998	34.11%	22.98%	10.00%	13.00%
1/1/1997	20.26%	33.53%	10.00%	13.00%
1/1/1998	31.01%	-20.29%	10.00%	13.00%
1/1/1999	26.67%	-6.29%	10.00%	13.00%
1/1/2000	19.06%	68.80%	10.00%	13.00%
1/1/2001	-9.78%	-11.00%	0.00%	0.00%
1/1/2002	-13.04%	-24.50%	0.00%	0.00%
1/1/2003	-23.37%	-18.21%	0.00%	0.00%
1/1/2004	26.38%	34.92%	10.00%	13.00%
1/1/2006	8.99%	13.15%	10.00%	8.99%
1/1/2008	3.00%	4.54%	6.00%	3.00%
1/1/2007	13.62%	34.20%	10.00%	13.00%
1/1/2008	3.53%	39.31%	7.06%	3.53%
1/1/2009	-38.49%	-48.27%	0.00%	0.00%

NAIC Life Actuarial Task Force (LATF)

Proposed Actuarial Guideline YY

Posted	February 23, 2015
Comments Due	March 11, 2015
Effective Date	Illustrations signed on/after September 15, 2015
Note	LATF willing to consider suggested revisions; commentary that follows based on wording as exposed

Proposed Actuarial Guideline YY

Key Elements

Alternate Scale

1. A scale on non-guaranteed elements equal to the currently payable scale except for the credited rate.
2. Credited rate equals $\text{Min}(\text{Fixed Account rate, illustrated loan charge})$
3. Illustration required to include ledger using Alternate Scale to be showed alongside ledger using illustrated scale with equal prominence

Proposed Actuarial Guideline YY

Key Elements

Currently Payable Scale

1. Defines the credited rate for the currently payable scale for each Index Account
2. Defined as an average of 25 year lookback period averages over the past 65 years
3. Always uses a specific external index and a specific index crediting design
4. Updated towards the beginning of the year (or when non-guaranteed parameters changed)

Proposed Actuarial Guideline YY

Key Elements

Disciplined Current Scale

Indicates limits for the credited rate of the disciplined current scale

1. Different limits depending on how company invests in support of index-based interest
2. Each limit defines a maximum assumed investment return

Proposed Actuarial Guideline YY

Key Elements

Policy Loans	If the illustration includes a loan, the illustrated rate credited to the loan balance shall not exceed the illustrated loan charge by more than 100bps
Additional Standard	The credited rate of the currently payable scale was defined as the arithmetic mean of the lookbacks. A table of different percentiles of the lookbacks is to be included in the illustration.

Proposed Actuarial Guideline YY

Implications?

Alternate Scale

1. Does the loan charge limit only apply if loans are being illustrated?
2. Does the loan charge limit apply only to the outstanding loan balance?
3. The depiction of values at the Alternate Scale is unique to IUL.
 - Is this a level-playing field?
 - Would consumers of other products with similar risks benefit from similar disclosure?

Proposed Actuarial Guideline YY

Implications?

Currently Payable Scale

1. Defines the credited rate for the currently payable scale. Is this better listed as the maximum illustrated rate?
2. ASOP #24 compliance is determined for the “scale of non-guaranteed elements.” Does this limit on a single element result in a non-level playing field?
3. If the product does not offer the benchmark index, would they be required to pay a license fee to that index provider?

Proposed Actuarial Guideline YY

Implications?

Disciplined Current Scale

1. Defines a limit for the assumed investment return. This return is a company experience factor. Is this a non-level playing field for IUL?
2. If the company hedges, the guideline limits the hedged budget to earned interest. Is this a non-level playing field for IUL by limiting the source of a hedge budget?

Proposed Actuarial Guideline YY

Implications?

Policy Loans	<ol style="list-style-type: none">1. Is this a non-level playing field for IUL as other products have similar potential?2. Theoretically, what if the product guarantees more than a 100bp differential? Is the illustration not allowed to show the guaranteed provision of the policy?
Additional Standard	Will these be valuable to provide insight into potential credited rate variability?

Who Should Care?

Indexed Life Carriers?

Certainly, as Actuarial Guideline YY applies to illustrations of those products

Index Annuity Carriers?

Perhaps, as concerns over index selection and current market conditions are similar

All Life Carriers?

Perhaps, as some product features are similar and guideline is setting precedent