NAIC IUL Illustration Guideline Debate: ACLI Recommendation vs. Minority Alternative

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Index Universal Life (IUL) is regulated as a general account product. As such, the National Association of Insurance Commissioners (NAIC) is seeking to establish IUL Illustration Guidelines (Guidelines) consistent with the rules for general account products covered by the NAIC Model Illustration Regulation.

The NAIC asked the American Council of Life Insurers (ACLI) to provide industry input for the development of the Guidelines. In response, ACLI established a task force to develop an industry supported recommendation. After extensive deliberations, and a vote by ACLI Member Companies, ACLI delivered a recommendation for IUL Illustration Guidelines to the NAIC that was supported by a super-majority of the ACLI Life Committee, the CEO Steering Committee, and the ACLI Board of Directors.

A minority group of Member Companies objected to the ACLI recommendation, claiming it does not go far enough to protect consumers because the use of a historical look back method for setting the maximum crediting rate is not consistent with illustration guidelines for other general account products (Whole Life (WL) and Universal Life (UL), which are based on current returns). This minority group—comprised of Member Companies that do not offer IUL (including New York Life, MetLife, and Northwestern Mutual)—delivered an Alternative Proposal to the NAIC that would place significant limitations on the maximum allowable crediting rate for IUL illustrations.

M Financial Group agrees there is a need for IUL illustration guidelines to provide consistency from carrier to carrier. The IUL products offered by M Carriers have a range of maximum illustrated crediting rates that vary between 7% and 10%. While some of this variation is due to different index terms and time periods, each company takes a different approach to establishing rates. We acknowledge there is risk in the variability of sales illustrations and believe these risks should be communicated to clients.

M Financial Group supports ACLI's efforts to develop a proposal that provides reasonable limits and disclosures and preserves a client's access to illustrations that meet their specific situation. M Financial believes the ACLI recommendation achieves this objective with meaningful limits on the illustration crediting rate and additional disclosures designed to help consumers better understand the mechanics of IUL and its increased variability relative to UL. M Financial also believes consumers should have access to the appropriate tools that allow them to make informed decisions based on their respective risk return profiles.

The ACLI recommendation seeks to provide:

- consistency in illustrated crediting rates between carriers when using the same index and index parameters (e.g. cap and floor),

- uniform guidance to companies and illustration actuaries on how to determine the maximum IUL illustrated credited rates,
- additional disclosure of interest crediting rate variability to consumers, and
- flexibility, so guidelines can be adaptable to future product differentiation, product development, and economic conditions.

To achieve these goals, the following rules were recommended:

The Maximum Illustration Crediting Rate is the lessor of (1) and (2):

1. The 25-Year Historical Look Back rate calculated using a standardized methodology. The proposal standardizes both the look back time period of 25 years and the calculation for the look back rate. This recommendation is consistent with the method the NAIC has adopted for other indexed product types (e.g., Annuity Disclosure Model Regulation). Consumer understanding is enhanced with products having the same index parameters and crediting method illustrating the same maximum crediting rate across all carriers; and helping consumers compare different index choices within the same product.
2. The Regulatory Cap of 10%, which is similar to the 12% maximum applicable to Variable Universal Life (VUL) illustrations. This Regulatory Cap was established to provide an effective and meaningful limitation for current and future IUL designs, including various indexing time periods (e.g., 2 year, 5 year), while creating flexibility should economic environments change (thus avoiding the challenge of requiring all States to revise the Guideline again in the future).

Requirement for Additional Disclosures Unique for IUL

1. A reduced return "midpoint" illustration using current non-guaranteed charges and a crediting rate that is halfway between the Maximum Illustration Crediting Rate and the minimum crediting rate floor.
2. A table of annual year-by-year historical look back returns that highlights the annual volatility in the index return.
3. A table showing the 25-year Historical Look Back rate at current and reduced index parameter levels (e.g. cap rates between the current and guaranteed level).

The ACLI recommendation is supported by the principle that a regulatory structure should not disadvantage one product type in favor of another. Regulations without this critical balance ultimately impair the ability of consumers to choose the best product that meets their needs.

The Alternative Proposal

The minority group of Member Companies has delivered an alternative recommendation for the illustration guideline. The minority group states the following objections to the ACLI recommendation:

- IUL is a general account product; illustration rates should be tied to general account yields.
- The look back methodology is flawed as it does not reflect, and overstates, current market expectations of future option returns.
- Their stochastic analysis suggests historical look back returns have a low probability to occur based on current market conditions.

The alternative recommendation sets the maximum illustrated crediting rate based on the general account yield for the portfolio of general assets backing a carrier's IUL product. The rate would vary from carrier to carrier, and could vary between products from the same carrier if different portfolios support different products.

Example of Application of Alternative Proposal

For a 0% floor:

> **Maximum Illustration Crediting Rate = General Account Yield x 112%**
> (the 112% would be adjusted down if the guaranteed floor is greater than 0%)

For a company with a 5% General Account Yield, the maximum illustrated crediting rate would be limited to 5.6%.

M Financial Group's Position

M Financial is supportive of the majority industry position and does not support the alternative proposal because:

- It does not enhance consumer understanding of IUL mechanics.
- It could either result in inconsistent and confusing illustration crediting rates when comparing carriers with the same index and parameters, or (the inverse) two carriers could use the same crediting rate when the index parameters are different.
- It sets an overly conservative limit on the illustrated crediting rate. IUL, by its nature, is more volatile than UL, and thus has a broader range of outcomes. Consumers should have the opportunity to review illustrations that show the broad range of outcomes.
- In-force IUL policyholders have been receiving returns higher than the alternative maximum. This proposal would limit the usefulness of in-force illustrations that can provide valuable guidance to consumers.

- The analysis supporting the alternative proposal's theoretical argument for derivative returns and stochastic analysis is based on subjective assumptions.
- Other general account products (UL and WL) are not required to disclose the General Account Yield supporting the crediting rate.

Next Steps at the NAIC

The NAIC has exposed both proposals for comment. M Financial is engaged with ACLI and Member Companies in providing comments on the proposals. The deadline for comments is October 20, 2014. M Financial will continue to provide updates on NAIC deliberations.