Actuarial Guideline 49 Post Standards Update

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Actuarial Guideline 49 (AG49) emerged on the Indexed Universal Life (IUL) scene in 2015. It provided the first uniform standards covering important aspects of illustrating IUL contracts. Certain requirements of AG49 have been effective since September 1, 2015. These requirements included: (1) the determination of maximum illustrated crediting rates for indexed accounts inside IUL contracts (using a concept known as the Benchmark Index Account), and (2) guidance for life insurers' illustration actuaries to certify that an IUL policy form meets standards that allows the policy to be illustrated in the first place. Several other AG49 standards became effective on March 1, 2016. These include requirements for illustrating participating policy loans and mandates for certain additional disclosures on IUL illustrations.

Initial Impact of AG49

The good news is that the adoption of AG49 did not result in life insurers exiting the IUL market. In fact, the existence of standards has led to additional carriers entering the IUL market, and sales are still very strong. AG49 has largely achieved its goal of strengthening uniformity of maximum illustrated credited rates in IUL illustrations.

The standards have also raised the level of dialogue around the proper credited interest rate to illustrate and the importance of policy components other than credited interest, such as mortality and expense loads. This has been accomplished without making the illustration actuary's job of certifying compliance with the NAIC Life Insurance Illustration Model Regulations significantly more difficult.

At the same time, AG49's adoption has resulted in a greater focus on explicit persistency bonus features, whether guaranteed or non-guaranteed. These bonuses are intended to improve long-term illustrated performance. Such bonuses may be expressed as an additional interest credit after a specific policy year or a refund of expense or mortality charges.

Additionally, AG49 has had the gradual effect of reducing the number of indexed subaccounts offered, especially brand new indexes or those without significant performance history. Some insurers no longer offer a 0% floor, 100% participation rate S&P 500 index account in their IUL. For example, they may instead offer only a 1% floor S&P account, which under AG49 provides more latitude in crafting a maximum illustrated credited rate. Finally, AG49 has led a number of insurers to adjust the contours of their loads, fees, and charges in order to fine-tune the competitive profile of their products.

March 1, 2016 Standards

The first of the two major requirements, effective on March 1, 2016, is related to participating loans or policy loans in which policy loan collateral stays invested in the indexed accounts, while loan interest is charged on the basis of either a fixed loan rate or linked to a Moody's Index. Regulators were especially concerned about previous illustrations in which high credited rates were shown as applying to the loan collateral, while loan rates charged were much lower. This created a loan leverage (or arbitrage) effect that could be overly optimistic. Effective March 1, 2016, AG49 requires that, for the purposes of IUL policy illustrations, the differential between the rate credited to loan collateral and the rate charged on the loan cannot exceed 100 basis points (1%) annually. Note that this is an illustration requirement, and the actual policy performance could result in a differential higher than 100 basis points annually. AG49 does not specify how the differential is to be narrowed. Specifically, is the credited rate in the illustration reduced, or is the loan rate charged increased? It seems likely that more carriers will reduce the credited rate illustrated on loan collateral to satisfy the requirement. Importantly though, AG49's participating loan standard is unlikely to materially change the presence of such features in IUL products.

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The second of the two major requirements for IUL illustrations, effective on March 1, 2016, is the necessity for additional disclosures, namely:

- A ledger of Alternate Scale values alongside the ledger using the Illustrated Scale. The Alternative Scale limits the index account credited rate to the credited rate for the Fixed Account, and if a participating loan is depicted, the credited rate on loan collateral must equal the rate charged on the loan.
- A separate table showing the highest and lowest geometric average returns over the twenty-five year segments used in calculating the Benchmark Index Account maximum illustrated rate.
- A table for each index illustrated showing actual index performance and corresponding account crediting rates for the most recent twenty-year period. This disclosure aims to help make consumers aware of potential volatility in an index's returns, and also to realize that the index crediting rate may differ from the actual percentage change in the index.

Although this second category of AG49 changes is systems- and technology-intensive for insurers, it will not result in any seismic changes to IUL product design or features.

Future of AG49

As expected, the version of AG49 adopted in 2015 will not be the final word. Modifications to the Guideline are already underway, and interested parties have petitioned for even more widespread changes that are unlikely to be adopted anytime soon. The two areas of proposed change to AG49 that are moving quickly through the process are:

- Recognizing that some IUL contracts allow the policyholder to pay a policy charge in exchange for a higher crediting cap (so-called Dual Account products). This AG49 modification will allow multiple Benchmark Index Accounts (and multiple maximum illustrated credited rates) within the same contract.
- Refining the Alternate Scale requirements to limit potential areas of abuse. These changes are logical, but should not have a major impact.

As regulators consider an array of changes to AG49 going forward, natural questions arise about illustrations of non-indexed life insurance products and whether consistency should exist between illustration standards for indexed life versus non-indexed life. Accordingly, the NAIC is starting to consider the need to open up the entire Model Regulation for life insurance illustrations for a fresh review.

For further commentary on AG49, see the full-length article: "Actuarial Guideline 49 – A Closer Look," by Tim Pfeifer, President - Pfeifer Advisory (pfeiferadvisory.com).