ACTUARIAL GUIDELINE YY

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THE APPLICATION OF THE LIFE ILLUSTRATIONS MODEL REGULATION TO POLICIES WITH INDEX-BASED INTEREST

Background

The Life Insurance Illustrations Model Regulation (Model Regulation #582) was adopted by the NAIC in 1995. Since that time there has been continued evolution in product design, including the introduction of benefits that are tied to an external index or indices. Although these policies are subject to Model Regulation #582, not all of their features are explicitly referenced in the model, resulting in a lack of uniform practice in its implementation. In the absence of uniform guidance, two illustrations that use the same index and crediting method often illustrated different credited rates. The lack of uniformity can be confusing to potential buyers and can cause uncertainty among illustration actuaries when certifying compliance with Model Regulation #582.

This guideline provides uniform guidance for policies with index-based interest. In particular, this guideline:

1. Provides guidance in determining the maximum crediting rate for the illustrated scale and the earned interest rate for the disciplined current scale.
2. Limits the policy loan leverage shown in an illustration.
3. Requires additional consumer information (side-by-side illustration and additional disclosures) that will aid in consumer understanding.

Text

1. Effective Date

This Actuarial Guideline shall be effective as follows:

i. Sections 4 and 5 shall be effective for all new business and in force life insurance illustrations on policies sold on or after September 1, 2015.

ii. Sections 6 and 7 shall be effective for all new business and in force life insurance illustrations on policies sold on or after March 1, 2016.

2. Scope

This Actuarial Guideline shall apply to any life insurance illustration that meets both (i) and (ii), below:

i. The policy is subject to Model Regulation #582.

ii. Interest credits are linked to an external index or indices.

3. Definitions

A. Alternate Scale: A scale of non-guaranteed elements currently being illustrated such that:

i. The credited rate for each account does not exceed the credited rate for the Fixed Account, or, if the insurer does not offer a Fixed Account with the illustrated policy, the average of the credited rate for the illustrated scale and the guaranteed credited rate for that account.

ii. If the illustration includes a loan, the illustrated rate credited to the loan balance does not exceed the illustrated loan charge.
iii. All other non-guaranteed elements are equal to the non-guaranteed elements for the illustrated scale.

B. **Benchmark Index Account**: An Index Account with the following features:

   i. The interest calculation is based on the percent change in S&P 500® Index value only, over a one-year period using only the beginning and ending index values. (S&P 500® Index ticker: SPX)

   ii. An annual cap is used in the interest calculation.

   iii. The annual floor used in the interest calculation shall be 0%.

   iv. The participation rate used in the interest calculation shall be 100%.

   v. Interest is credited once per year.

   vi. Account charges, if applicable, do not exceed the account charges for any other accounts within the policy.

   vii. There are no limitations on the portion of account value allocated to the account.

C. **Fixed Account**: An account where the credited rate is not tied to an external index or indices.

D. **Index Account**: An account where the credited rate is tied to an external index or indices.

4. **Illustrated Scale**

   The credited rate for the illustrated scale for each Index Account shall be limited as follows:

   A. Calculate the geometric average annual credited rate for the Benchmark Index Account for the 25-year period starting on 12/31 of the calendar year that is 66 years prior to the current calendar year (e.g., 12/31/1949 for 2015 illustrations) and for each 25-year period starting on each subsequent trading day thereafter, ending with the 25-year period that ends on 12/31 of the prior calendar year.

      i. If the insurer offers a Benchmark Index Account with the illustrated policy, the illustration actuary shall use the current annual cap for the Benchmark Index Account in 4 (A).

      ii. If the insurer does not offer a Benchmark Index Account with the illustrated policy, the illustration actuary shall use actuarial judgment to determine a hypothetical, supportable current annual cap for a hypothetical, supportable Index Account that meets the definition of a Benchmark Index Account, and shall use that cap in 4 (A).

   B. The arithmetic mean of the geometric average annual credited rates calculated in 4 (A) shall be the maximum credited rate for the illustrated scale.

   C. For other Index Accounts using other equity, bond, and/or commodity indexes, and/or using other crediting methods, the illustration actuary shall use actuarial judgment to determine the maximum credited rate for the illustrated scale. The determination shall reflect 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. In no event shall the credited rate for the illustrated scale exceed the rate calculated in 4 (B).

   D. At the beginning of each calendar year, the insurer shall be allowed up to three (3) months to update the credited rate for each Index Account in accordance with 4 (B) and 4 (C).

5. **Disciplined Current Scale**

   The earned interest rate for the disciplined current scale shall be limited as follows.

   A. If an insurer engages in a hedging program for index-based interest, the assumed earned interest rate underlying the disciplined current scale shall not exceed 145% of the annual net investment earnings rate
(gross portfolio earnings less provisions for investment expenses and default costs) of the general account assets (excluding hedges for index-based credits) allocated to support the policy.

B. If an insurer does not engage in a hedging program for index-based interest, the assumed earned interest rate underlying the disciplined current scale shall not exceed the annual net investment earnings rate of the general account assets allocated to support the policy.

C. These experience limitations shall be included when testing for self-support and lapse-support under Model Regulation #582, accounting for all benefits including illustrated bonuses.

6. 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 100 basis points.

7. Additional Standards

The basic illustration shall also include the following:

A. A ledger using the Alternate Scale shall be shown alongside the ledger using the illustrated scale with equal prominence.

B. A table showing the minimum and maximum of the geometric average annual credited rates calculated in 4 (A).

C. For each Index Account illustrated, a table showing actual historical index changes and corresponding hypothetical interest rates using current index parameters for the most recent 20-year period.