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 1993. 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 index-based crediting rate for the currently payable scale and 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 for all life insurance illustrations signed and dated on or after September 1, 2015.

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. The credited rate is tied 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. Annual Point to Point: A method used to determine index-based interest with the following features:

i. Interest calculation is based on the percent change in index value over a one-year period using only the beginning and ending index values.
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, are consistent with the account charges for all other accounts.

C. **Benchmark Index Account**: An actual Index Account available for the illustrated policy with the Annual Point to Point method based solely on changes in the S&P 500® Index (Ticker: SPX).

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

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

4. **Currently Payable Scale Methodology**

   The credited rate for the currently payable scale for each Index Account shall be determined 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 65 years prior to the current calendar year (e.g., 12/31/1950 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.

   B. For the Benchmark Index Account, the arithmetic mean of the geometric average annual credited rates calculated in 4 (A) shall be the credited rate for the currently payable 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 credited rate for the currently payable 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 currently payable 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).

   E. If the insurer does not offer a Benchmark Index Account with the illustrated policy, the illustration actuary shall use actuarial judgment to create a hypothetical, supportable Benchmark Index Account for the purposes of this section, but in no event shall the credited rate for the currently payable scale exceed the rate calculated in 4 (B).

5. **Disciplined Current Scale Methodology**

   The credited rate for the disciplined current scale for each Index Account shall be limited as follows.

   A. If an insurer engages in a hedging program for index-based interest, the assumed investment return from that hedging program shall not exceed 45%. The amount assumed to be invested in a hedging program, expressed as a percent, shall not exceed the annual net investment earnings rate of the portion of the general account supporting the policy.

   B. If an insurer does not engage in a hedging program for index-based interest, the assumed investment return rate shall not exceed the annual net investment earnings rate of the portion of the general account supporting the policy.

   C. Any illustrated bonus or other policy benefit shall be considered in the determination of the disciplined current scale.
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, 20th percentile, 80th percentile, and maximum of the geometric average annual credited rates calculated in 4 (A).