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Actuarial Guideline 49 (aka Actuarial Guideline YY)

By Donna Megregian

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After a lot of hours, hard work, and compromise, April 16, 2015, brought about a new actuarial guideline that was approved by the Life Actuarial Task Force (LATF). This guideline officially will be known as "Actuarial Guideline 49 (AG 49), The Application of the Life Illustrations Model Regulation to Policies with Indexed-Based Interest." The goal of the guideline is to help bring consistency to the determination of the maximum illustrated index crediting rate on indexed universal life policies (IUL), moderate what some perceived as the potential for IUL products to meet with consumer dissatisfaction, and provide guidance to the illustration actuary.

By Sept. 1, 2015, for all new business and in-force policies issued on or after Sept. 1, 2015, sections 4 and 5 of the guideline must be reflected in illustrations. By March 1, 2016, Sections 6 and 7 of the guideline are effective. This article will highlight the provisions of each section of the guideline.

BENCHMARK INDEX ACCOUNT

The guideline establishes new definitions that were not contemplated in the Life Illustration Model Regulation (Model Regulation #582 or the Model Reg) or Actuarial Standard of Practice 24 (ASOP 24). One new term is Benchmark Index Account.

Section 3B of AG49 defines a Benchmark Index Account as 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 (annual point-to-point approach). (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 percent.
iv. The participation rate used in the interest calculation shall be 100 percent.
v. Index 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.

The S&P 500® along with the other parameters defined were chosen because of its widespread recognition, history, and popularity among IUL products today.

Section 4 of AG49 describes the calculation for what the maximum illustrated credited rate can be using the Benchmark Index Account parameters. The basic calculation is a rolling 25-year average starting on 12/31 of the calendar year that is 66 years prior to the current calendar year, ending 12/31 of the prior calendar year. Illustrations in 2015 would use a starting point of 12/31/1949. This longer term rolling average will prevent wide swings in the maximum illustrated rate year to year on the Benchmark Index Account.

Actuarial judgment is used when parameters do not line up exactly with the Benchmark Index Account. For starters, create a hypothetical supportable index that meets the definition of Benchmark Index Account and reflect the fundamental characteristics of the index account with the appropriate relationship to the expected risk and return of the Benchmark Index Account (Sections 4A and 4C). Regardless of what index or index parameters a company uses (higher floors, different participation rates, different index, etc.), the maximum illustrated rate cannot exceed that which is based on what is defined as the Benchmark Index Account.

Section 5 of AG49 imposes a limitation on how much a disciplined current scale can assume as an underlying earned interest rate. If the insurer engages in a hedging program, the

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assumed earned interest rate underlying the disciplined current scale (DCS) cannot exceed 145 percent of the annual net investment earnings rate of the general account assets allocated to support the policy. If a company has a 5 percent net investment earnings rate, the earned interest rate cannot exceed 145 percent x 5 percent = 7.25 percent. Without a hedging program, the earned rate is limited to the net investment earned rate (in this case 5 percent).

Pop quiz: You have an indexed account with a 1 percent floor and a current cap of 11 percent. How would you apply AG 49 to determine your maximum illustrated credited rate? (Answer in the next edition of *Product Matters!*)

POLICY LOANS AND ALTERNATE SCALE

Section 6 of AG 49 limits the arbitrage between the loan charged rate and the credited rate on loaned funds under participating loans to 100 bps. Many IUL policies have a participating loan, meaning the loaned amount is credited whatever the other non-loaned funds are credited. The charged rate on the loaned fund may be fixed by the company or variable, but until AG 49, the difference between the charge and credit in some circumstances created a loan arbitrage, or borrow for less than interest credited. Section 6 mitigates the differential, but does not eliminate the arbitrage completely.

Section 3A of AG 49 defines the Alternate Scale as 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.

This Alternate Scale eliminates any excess interest above the current fixed account and any loan arbitrage. Section 7 of AG 49 requires the Alternate Scale and the illustrated scale developed under Section 4 and 5 be shown side by side. Section 7 also requires additional tables to be shown related to the minimum and maximum annual credited rates from Section 4 and 20-year historical results for the actual index account using current index parameters. Modifications to illustration systems can take time to put into the correct format which is why this section has an effective date for next year. Because guaranteed scales are also supposed to be shown next to current illustrated scales based on the Model Reg, companies may need to move to a landscape format or create a new page to display the current and the Alternate Scale together.

Pop quiz: I have a variable loan rate that is currently projecting 5 percent, and my benchmark index account is calculated to credit 7 percent. What values can I show in my illustration? (Answer in the next edition of *Product Matters!*)

OVERALL IMPACT

Some may lobby for an update to the Model Reg, as broader issues related to a nearly20-year-old regulation (effective in 1997) may need to be addressed more directly than through an actuarial guideline. Loan arbitrage can exist on other products, not just IUL, and companies with potential for arbitrage may want to consider AG 49 and the precedent it sets related to this topic. Bringing consistency and consumer information is in the spirit of the guideline and the Model Reg, however all products and markets may benefit from a refresh of the Model Reg, although that takes time and state approval.

The guideline will not necessarily require products with the same index parameters to have the same maximum illustrated rate. What is supportable is up to the illustration actuary and involves all aspects of the product, not just the credited rate. The guideline does provide more direction on how companies calculate certain aspects of the parameters that feed into the testing.

At the time of this writing, the American Academy of Actuaries Life Illustrations Workgroup has been working on a supplement to the practice notes to help with some questions companies have related to the guideline. By the time this is published, the supplement should be available through the American Academy of Actuaries website[1]. An update to the practice notes is likely on deck after that.

What about New York you ask? New York has been open to the fact that they intend to create their own guidance related to this topic. At the time of this writing, nothing is known to this author to have been made available for comment. ■

ENDNOTE

1 The American Academy of Actuaries has now published the addendum. Available at *https://www.actuary.org/files/IWGPracticeNoteAdd_08282015.pdf.*

Donna Megregian, FSA, MAAA, is vice president and actuary for RGA. She can be contacted at *dmegregian@rgare.com.*