Illustration Regulation

LifeTrends®

By Janet Gossage, FSA, MAAA

Some experts believe life insurance has been the industry most affected by the sustained low interest-rate environment. Indeed, we have seen this impact especially on the no-lapse guaranteed universal life market, where many carriers have exited, pricing has generally increased, and new products have been launched with much lower guaranteed interest rates.

One impacted area that rarely receives attention is the regulation regarding in-force illustrations. Intended to "provide rules for life insurance policy illustrations that will protect consumers and foster consumer education,"[1] the NAIC (National Association of Insurance Commissioners) Illustration Regulation took effect in January 1997 and applies to all policies sold after that effective date.[2] This regulation has shaped illustrations for 20 years, standardizing the basic and supplemental illustration formats, the midpoint scales that must be shown, and requiring each company to appoint an illustration actuary and an illustration officer.[3]

Though still uncommon, recently we have witnessed clashes between the NAIC Illustration Regulation and the pressures of the low interest-rate environment. Because the regulation was designed to ensure realistic illustrations for in-force business, carriers must continually assess whether a product's underlying actuarial assumptions remain viable. When the answer to that question is no, the resulting unexpected in-force illustration may have an unanticipated effect on everyone involved with the policy, from the brokerage agency down to the client.

The following should help you understand what is happening when a carrier is forced to change the nonguaranteed assumptions behind a product's in-force illustrations and how your agency can get out in front of any illustrative surprises.

How do companies demonstrate compliance with the regulation?

Year after year, the company-appointed illustration actuary certifies that each scale used for sales illustrations remains a disciplined current scale. Effectively, the carrier must determine annually if the product's actuarial foundations continue to be sustainable moving forward. To remain a disciplined current scale, the scale's non-guaranteed assumptions must be reasonably based on the company's recent actual experience and must not project improvement in the experience beyond the illustration date.

How does the annual certification impact in-force illustrations?

If the illustration actuary does not certify that each in-force illustrated scale remains a disciplined current scale, the carrier will either choose to declare the product non-illustratable (meaning that the product can only be illustrated on a guaranteed scale) or create a new scale that passes the tests required to be considered a disciplined current scale.

How does this impact me as an agent trying to service my client?

For a multitude of reasons, you should be running or requesting in-force illustrations on your cases annually. As it relates to illustration regulation, having those available should help you avoid being completely blindsided if the carrier declares the product non-illustratable or creates a new current disciplined scale.

When you request an in-force illustration, you may either:

a) get exactly what you requested and feel confident that—at least for the next year—the policy will perform as shown,

b) be told the product is no longer illustratable and be given an illustration using guaranteed interest rates and monthly deductions, or

c) be given an illustration using a new scale that is a disciplined current scale, illustrating lower values than what would be illustrated with the currently payable scale but higher values than what would be illustrated using only guarantees.

What should I do if I'm told the product is no longer illustratable?

If the carrier declares the product non-illustratable, your client needs to understand that what their in-force illustration is showing is a worst-case scenario. As a result, you may consider requesting additional illustrations tinkering with the death benefit or premiums in order to provide your client options under these worst-case assumptions.

Ask the carrier the following questions:

1) Would they be willing to develop a scale that passes the illustration requirements and gives you a more hopeful alternative to show the client?

2) An increase in monthly deductions would make the product more sustainable for the carrier and could even make a new disciplined current scale a viable possibility. However, a monthly deduction increase could also have an impact on your client's ability to sustain the policy with the current premiums and death benefit. With that in mind, is the carrier planning or considering increasing monthly deductions on this product?

3) Are they actively working with the ACLI (American Council of Life Insurers) to get this regulation changed for in-force illustrations, as it only causes confusion and handcuffs your ability to help the consumer make the right decisions on their policy going forward?

What should I do if I'm given an illustration using a new scale somewhere between current and guaranteed?

If you have a prior in-force illustration, you should compare the growth rate in the account values between the projected end of year account value for this year and the next year on each of the illustrations. Assuming the interest rate assumption has not changed, this will give you an estimate for the percent increase they are assuming in the monthly deductions between current and this new scale.

Ask the carrier the following questions:

1) Should the client expect the monthly deductions to be increased at a similar level the next year? Again, an increase in monthly deductions would help make the product more sustainable for the carrier but could also impact your client's ability to afford the policy as is.

2) How was the illustrated scale derived? Is it a simple percent increase to the current scale or something else?

3) Do they have plans to change the scale again next year, or are they confident that it can pass as a disciplined current scale going forward?

4) Why did they choose to create this scale instead of making the product non-illustratable? (This is especially important if they made other products non-illustratable that year.)

5) Do they have compliance-approved language that you can share with your client to help explain this scale?

6) Are they actively working with the ACLI to get this regulation changed for in-force illustrations, as it only causes confusion and handcuffs your ability to help the consumer make the right decisions on their policy going forward?

Final Thoughts

Hopefully your carriers are still running in-force illustrations at currently payable scales, and you have not encountered either of the above scenarios. However, as you steward your in-force business, it would still be worthwhile to understand how carriers plan to interpret and apply the regulation going forward.

Designate someone within your BGA—likely someone who actively manages in-force business—to handle the relationship with each carrier's illustration actuary and illustration officer,[4] maintaining an active understanding of carriers' positions on in-force illustrations. Smaller BGA's and BGA's who have exhausted their internal resources in pursuing these relationships should lean on their IMO for help in understanding carriers' positions.

For those of you who have ever been given a different in-force illustration than the one you expected, it is important to make sure the ACLI and NAIC understand the difficult position this puts you in as an advisor to your client. Lean on your IMO to help make your voice heard. As with any well-meaning regulation gone awry, both distribution and carriers need to have a strong voice in sparking the changes that reinforce life insurance as a reliable asset class for consumers.

1 Life Insurance Illustrations Model Regulation, Section 1. Purpose.

2 Some states may have adopted the regulation after January 1, 1997, so effective date can vary by state.

3 The only change to this regulation occurred in September 2015, when AG49 standardized certain illustrative limits and introduced additional requirements for IUL illustrations.

4 For some companies, the illustration officer is a sales or marketing leader.

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