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Attachment B
Life Disclosure Working Group
Life Insurance (A) Committee
12/6/92

Preliminary Report American Academy of Actuaries Task Force on Life Illustrations

The AAA Task Force on Life Insurance Illustrations has reviewed the recommendations from the research paper on illustration practices prepared by the SOA. Our primary goal is to focus on changes that will benefit consumers and third-party users of illustrations. A secondary goal is to improve illustration methodology for those involved in developing illustrations and setting the underlying assumptions: actuaries, agents, and company management.

Changes to illustrations can be considered in three categories:

- (1) Those that should occur immediately due to perceived problems at the consumer level. Action by the NAIC will be required for these changes to have a widespread and immediate impact.
- (2) Those that require broader exposure within, and input from, the industry. It is expected that these changes can be implemented over the next few years, although work within the industry would begin immediately. Regulatory action may be needed to allow for changes in practice.
- (3) Educational efforts that require broad-based support within the industry. While some of these efforts can be implemented in the short-term, changes in consumer and industry perceptions of illustrations will evolve over time.

The Task Force recognizes that as educational efforts have an impact on the use of illustrations, some of the short-term changes may no longer be required. However, such changes are necessary on an interim basis to assist the consumer.

- Immediate Changes

These changes are very specific and deal with product structures and premium financing.

Vanishing Premium Illustrations

- (1) Require adequate disclosure of the vanish concept, either through a footnote, additional columns or illustration of an alternative scenario.
- (2) Require illustrations of guaranteed and non-guaranteed values to be based on consistent premium and death benefit patterns.
- (3) Require an illustration showing the premiums necessary to maintain the original death benefit for all years under guaranteed assumptions.

- (4) Change the name from "guaranteed values" to "policy values based on guaranteed assumptions".

Second-to-Die Policies

- (1) Require a statement regarding whether policy values change at the first death, and how they change.
- (2) If values do change, describe when the first death is illustrated to occur and why this assumption was selected (policyholder request, life expectancy of that insured, etc.). To be complete, the illustration must demonstrate the operation of the contract when both insureds are alive and after the first death.

Modular Policies

These are policies that allow for blends of term riders, PUA riders and dividend options to provide an integrated package of benefits.

- (1) Disclose the modular structure (both initial premiums and initial death benefits) clearly in the illustration. The illustrated values based on guaranteed assumptions should be consistent with the premium pattern.
- (2) Disclose the current and guaranteed premium for any applicable term coverage (whether provided by riders or dividends).
- (3) Require an illustration showing the cost for the total death benefit in all years under guaranteed assumptions.

Two-Tier Policies

- (1) Life insurance and annuity components should be illustrated separately.
- (2) If current annuitization values are shown, guaranteed values must also be shown (both with respect to annuitization fund and monthly income).

Cost Comparisons

- (1) Require the illustration to include a footnote similar to the following:

Sales illustrations should not be used for comparative policy performance purposes. Life insurance policies are complex financial instruments, which generally contain both guaranteed and non-guaranteed elements. A sales illustration may be helpful in understanding how a particular policy performs under specified circumstances. It is generally not feasible, however, to use sales illustrations to determine whether one policy is a better buy than another.

- (2) Delete the interest-adjusted cost indexes from point-of-sale illustrations, recognizing that these indexes are generally used to compare policy costs.

- Short Term Changes

Factions within the industry have considered or recommended changes. To be effective, rather than offering more and possibly conflicting recommendations, our Task Force suggests industry-wide consideration of the following:

- ✓ (1) Disclosure of the underlying assumptions which could reasonably be understood and evaluated by the consumer.
- (2) Use of standardized earned rate assumptions, that are linked to short-term and long-term indexes, to illustrate sensitivity to different interest rate environments.
- (3) Consideration of other sensitivity analyses that may be helpful to the consumer.
- (4) Development of standardized definitions of the terms generally displayed in the illustration.
- (5) Consideration of standardized notes as appropriate.
- (6) Optional use of different print (bolder or bigger) to be permitted for specific notes.

The result of this industry-wide review should be a package of recommended changes that can generally be supported by companies, agents, actuaries, regulators and other insurance professionals.

There is one short-term action that could be undertaken by the actuarial profession. The recommended change would be to develop appropriate definitions of such terms as "current experience", "best estimate" and "supportability", that underlie the Actuarial Standards of Practice. This would be a project recommended to the Actuarial Standards Board. This action might help actuaries, but would have limited impact on the perceived problem with illustrations.

- Long-Term Changes

These are strategies that are largely educational. The goal of these efforts is to make the creators and users of illustrations aware of the limitations on, and the appropriate uses of, illustrations. The Task Force believes that most of these strategies will require industry-wide support and cooperation. Among the items to be considered are:

- (1) Development of a consumer brochure that is presented at point-of-sale.
- (2) Educational strategies for agents, actuaries, and company personnel.
- (3) Research into appropriate methodologies/measures to compare companies and products.

The third item was identified as a research project for the SOA, although a task force has not yet been formed.