

Industry Responses to AG49

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Part 1: Carrier Trends

Under New Limits, Carriers Lean on Familiar Methods to Distinguish IUL Offerings

On September 1, 2015, the National Association of Insurance Commissioners implemented the first phase of Actuarial Guideline 49 (AG49). Several trends have emerged from the regulatory wake, each of which existed in some form or fashion prior to that time. However, in order to differentiate themselves under AG49's new speed limit, more carriers are now expanding their use of old methods to add new strength to their illustrative performance.

The key features carriers are using to enhance the perceived value of indexed universal life (IUL) products are: interest bonuses, spread death benefit options, alternative crediting approaches, and volatility control accounts.

Interest Bonuses

The most prevalent accompaniment to IUL products has been interest bonuses, which were not addressed within AG49 regulations. Interest bonuses help rejuvenate the optimism of the IUL sale by bulking the returns on an illustration without violating any rules set forth by AG49. Many interest bonuses have guaranteed components, which have proven to be a differentiator for many who are selling IUL products. Ultimately, though, IUL products are designed to shine on the performance of their non-guaranteed elements.

Interest bonuses go by a variety of names (e.g. persistency credits, account value enhancements) and take a number of forms. The most common is a flat percentage, typically less than 1%, added to the indexed return beginning in either year six or eleven. For instance, once the interest bonus has kicked in, during a year with a 5% indexed return, an IUL product with a 0.5% interest bonus would illustrate 5.5% growth on the policy. Other versions include multipliers and charge reimbursements.

LifeTrends evaluates the competitive positioning and offering of over 40 IUL products. Nearly all of these products sport some variety of interest bonus, making this one of the most widespread trends among IUL products. Following AG49's standardization of maximum illustrated rates, carriers clearly view interest bonuses as a reliable manner of boosting their IUL performance.

Index Multipliers

Functionally, index multipliers can be considered interest bonuses, as they also serve to bolster the return on the crediting rate. This approach earns its own distinction here because several carriers now offer this bonus at policy issue, as opposed to being packaged as a persistency credit. Index multipliers fulfill their purpose by multiplying the indexed return instead of adding to it. For instance, in a year with a 6% indexed return, an IUL product with a 10% index multiplier would earn 6.6% growth on the policy.

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By giving the cash value a boost from day one instead of waiting five to ten years into the policy, index multipliers effectively create a new, enhanced crediting rate for the policy, even while capping the maximum illustrated rate according to regulation. This standout effective rate results in improved performance, especially when comparing products at the same illustrated rate.

In March 2015, before AG49 was implemented, Nationwide was first to debut an index multiplier beginning in year one. In the post-AG49 world, Prudential and Penn Mutual have followed suit, adding this unique design to PruLife® Index Advantage UL (2016) and Accumulation Builder Select IUL, respectively, in October 2016.

Dynamic Multipliers

In February 2017, Minnesota Life and Pacific Life ushered in potentially the next version of interest bonus—the dynamic multiplier—with Orion IUL’s Annual Policy Credit and Pacific Discovery Xelerator IUL’s Performance Factor. What makes these multipliers unique is their completely fluid nature. Not only are the bonuses non-guaranteed, the two carriers do not multiply the indexed return by a fixed percentage. Instead, each carrier subjectively multiplies the account value or indexed return based on its own valuation of policy structure, client, and market performance. Though both carriers have shunned the interest bonus nomenclature when discussing these credits, each product’s spectacular performance is largely due to its dynamic multiplier.

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Spread Death Benefit Options

The emergence of spread death benefit options is particularly unique, as this trend is comprised of a clear, upfront actuarial tradeoff. In exchange for the consumer spreading some or all of the death benefit over a predetermined number of years upon the insured’s death, the carrier will either add to the policy’s account value or reduce cost of insurance (COI) rates while the policy is in force, expanding the policy’s ability to grow its cash value.

Accordingly, this trend is mainly geared toward the accumulation sale. Though the death benefit is still important for accumulation-oriented products, consumers have

shown a far greater tolerance for deferring some or all of the death benefit when the policy is designed to maximize the available cash while still alive.

Minnesota Life pioneered this unique spread death benefit concept with the development of Omega Builder, which was originally created as a proprietary product for a select marketing organization and then introduced to the open market in August 2014. Omega Builder features a mandatory rider that spreads at least half of the death benefit payout over a minimum of ten years. The more death benefit that is spread (up to 100%) and the longer it is spread (up to 30 years), the greater the discount on the COIs will be. Since AG49 went into effect, Pacific Life, American General, and National Life have each unveiled similarly structured riders that may be elected with each of their IUL offerings.

Utilizing a carrier’s maximum possible spread can result in distributions roughly 5% to 10% greater than what

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would be illustrated without the spread. Though not directly correlated with any portion of AG49 regulations, spread death benefit options have come to be seen as a sensible, mutually beneficial method for carriers to distinguish their income-oriented IUL offerings in the aftermath of AG49.

Alternative Crediting Approaches with the S&P 500

High Cap Accounts

Within AG49, the S&P 500 must be used to determine a product’s maximum illustrated rate. As a result, carriers seem to be moving away from alternative indices and toward different crediting approaches with the S&P 500, such as high cap accounts. In exchange for the higher cap, a carrier will either charge the indexed return or reduce the interest bonus by a fixed percentage.

The high cap is definitely an optimist’s account, as AXA indicated when introducing BrightLife Grow in April 2014: “The Plus options offer greater upside potential, but will not perform as well as the Core options when the markets perform negatively to moderately because the

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Core options do not have a segment charge.” In 2016, similar accounts were introduced with American General’s Max Accumulator+ IUL and Pacific Life’s full IUL product suite, while Minnesota Life’s new Orion IUL joined the high cap crowd in February 2017.

Uncapped Accounts

Uncapped accounts preceded AG49 but have since become more prominent. In exchange for an uncapped return of the S&P 500, a carrier will charge the indexed return before crediting the policy. This is most commonly done by subtracting a flat, non-guaranteed percentage from the uncapped return (usually referred to as a spread, between 4% and 6%), such as with American National’s Signature Plus IUL. Other products, such as Mutual of Omaha’s Income Advantage, simply credit the policy with a non-guaranteed percentage of the indexed return (referred to as the participation rate, between 50% and 65%).

Illustrations with uncapped accounts are still subject to a maximum illustrated rate determined by AG49, using the cap of the product’s regularly capped S&P 500 index account. This rate tends to be lower than what the uncapped account could otherwise justify, under current assumptions using AG49’s historical lookback calculation, even after charging the indexed return.

Volatility Control Accounts

Though carriers have increasingly abandoned non-S&P 500 indices, the market has still shown some appetite for an S&P 500 alternative. Filling this void are volatility control accounts. Instead of merely placing faith in a different index, these accounts are distinguished by controls that shift away from volatility within an underlying set of indices in order to stabilize the interest returns. Allianz has long been highlighting the Barclays US Dynamic Balance Index (BUDBI) in the Allianz LifePro+ product line, while American General released the Merrill Lynch Strategic Balanced Index on its Max Accumulator+ IUL in May 2016. Most recently, Minnesota Life released two S&P 500 Low Volatility accounts on its Orion IUL in February 2017.

Volatility control accounts have gained traction in the annuity space. Historically, that has been a staging ground for the life insurance market; however, these accounts have not caught on quite as quickly as some had predicted with IUL products.

Conclusions

Perhaps nothing is more indicative of the advent of these trends than Minnesota Life’s Orion IUL, released in February 2017, which offers each of the above features. Though these regulatory responses have not been adapted universally—even interest bonuses, increasingly ubiquitous as they are, have taken on many unique shapes and forms—carriers are clearly directing significant creative effort toward distinguishing themselves within the boundaries of AG49. As an industry leader in competitive and marketing intelligence, LifeTrends will continue to monitor market trends and appropriately enhance our commentary relative to this subject.

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Part 2: Distribution Perspectives

As Options Grow in Complexity, Distribution Longs for Simplicity

At the beginning of 2017, LifeTrends engaged with over 30 of their independent brokerage general agency (BGA) clients in an effort to understand how indexed universal life policies are currently being positioned and sold, particularly with retirement income in mind. In these detailed conversations, the primary focus centered around whether carrier trends were fulfilling their intended purpose of increasing enthusiasm for IUL products.

Undoubtedly, the IUL market has grown substantially over the past decade. However, it quickly became apparent that, of those who are selling IUL, more than a few respondents struggled to navigate and recognize the importance of the many bells and whistles carriers had hoped would distinguish their products. Many other respondents were still trying to convince producers of the reliability of IUL because the products appeared too foreign or complex. The remainder represented those who were more comfortable with IUL and had a fairly solid, usually simple framework for selecting and selling a product.

In any case, a consistent theme ran through each of our conversations: trust. That may sound overly simplistic, but by and large our brokerage clients are wondering two questions:

- What is the carrier promising?
- Is the carrier good on their promise?

Trust was the consistent theme that ran through each of our conversations.

Of course, each respondent answered those questions differently, but their interpretations boiled down to these common factors:

- A carrier's perceived reliability, as indicated by:
 - Financial ratings and overall reputation,
 - BGA's relationship with the carrier, and
 - Respondents' past experiences with the carrier in underwriting and in-force policy management/tracking.
- The perceived reliability of a product's illustration, with a preference for:
 - Conservative illustrations (more at 6% than 5%) and
 - Guaranteed interest bonuses or any offering of a guaranteed component.

For each respondent, the carriers that met those expectations and still illustrated relatively well were the winners of the IUL sweepstakes. In short, respondents always gravitated to a carrier that was easy to work with and had a simple, straightforward product that illustrates well, doesn't require excessive scrutiny, and does what the illustration software says it will do. It seems the market has changed so much that many respondents, instead of trying to be a product guru, would rather have a product that is easy to explain and just plain works.

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Indexed Returns

Regardless of the fact that each carrier has a non-guaranteed cap (effectively neutralizing a product's other guaranteed elements), the more non-guaranteed variables that a product hinged on, the less comfortable a respondent was likely to feel selling it. Non-guaranteed interest bonuses were the primary target of this criticism; respondents showed a clear preference for guaranteed interest bonuses. Case in point: Nationwide's IUL Accumulator was respondents' overwhelming favorite, in no small part due to the guaranteed bonus provided by its index multiplier beginning in the policy's first year. In the same vein, the guaranteed 1% floor offered by Lincoln and Penn Mutual also stood out.

In general, the more math that was required to determine the ultimate indexed return, the less comfortable the respondent became—for example, alternative indexed approaches that trade a percentage of the indexed return in exchange for either a higher cap or no cap at all. This could be traced to one or more causes:

- The additional effort required to understand the benefits of each crediting approach, particularly with the illustrative limits of AG49, for each and every product on the market;
- The additional effort required to equip a producer to explain the pros and cons of these different approaches to clients;
- The additional barrier to a client's comfort and familiarity before choosing to pursue an IUL policy.

The overwhelming majority of respondents preferred the normally capped crediting approach with the S&P 500, though this could also be the result of being the default account on most illustration software.

Increasingly discarded by carriers since AG49, alternative indices will likely not be missed, as they were perceived to be merely another option requiring explanation but lacking a strong alternative value proposition. In contrast, a few BGAs had built a strong narrative around volatility control accounts, such as the Barclays US Dynamic Balanced Index that Allianz provides, because of their clear value as a hedge against market volatility.

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Policy Design

Most respondents expressed a desire to illustrate products conservatively, though that usually only meant they illustrate products below the maximum illustrated rate. Many illustrate products at 6%, though some tinker with the illustrated rate in order to account for varying caps and non-guaranteed interest bonuses. Some expressed a desire to illustrate at 5% but feared IULs would no longer be competitive.

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The “typical IUL sale” for most respondents involved clients paying to retirement (usually considered to be age 65; otherwise, age 70) and taking distributions for 20 years. A common structural guideline was a minimum 15-year investment horizon, meaning distributions should not begin before the policy had been in force for at least 15 years, in order to increase the likelihood that the policy will have endured the highs and lows of the market and perform at a more moderate level.

Riders and Features

Despite the preference for simple, straightforward products, we did notice a tension in many of these conversations between respondents wanting a straightforward product but also being enticed by the possibilities presented by features and riders to win competitive situations.

Within the sweet spot of this dichotomy was the spread death benefit option. Several respondents already employed products with these options, but only in strictly life insurance retirement plan (LIRP)-oriented sales. These respondents typically placed Minnesota Life or American General among those they commonly sold. Of those respondents who were not regularly using spread death benefit products, most agreed that the spread death benefit option makes a lot of sense in accomplishing the core function of the policy, is very straightforward and easy to understand, and therefore worthy of greater consideration with LIRP cases.

Beyond this, the only other type of rider to regularly be mentioned was built-in chronic illness riders. This had more to do with these rider's lack of initial upfront cost than any thorough evaluation of their ultimate effect on an accumulation-minded policy. Again, though, the common theme was that riders will merit consideration if they add clear value to the sale, don't interfere with the function of the policy, and don't require a ton of additional explanation to the producer and client.

Automatic triggers of overloan protection riders, as seen with Protective, were highly praised. Respondents viewed this as an incredibly sensible structure to build into IULs, as it takes an enormous burden off the client's shoulders—a burden they may or may not remember exists when it really matters.

Carrier Relationship

One of the biggest factors for respondents was the relationship with the carrier, particularly on the administrative side of the policy. Essentially, the more respondents enjoyed doing business with a carrier, the more likely they were to keep that carrier's product in the conversation. Respondents felt it was especially appropriate to place weight on the carrier relationship where LIRP is involved, as distributions create substantially more opportunities to shape a living client's experience and also reflect back on the producer and BGA.

The easier carriers can make things for the people buying and selling their product, the more likely it will be that the carrier's product gets bought and sold.

Underwriting was frequently cited as the primary carrier-specific hurdle that greatly impacted their willingness to recommend a product to a producer. Respondents also indicated policy goal-tracking solutions—a regular report tracking the progress of an IUL policy and making recommendations to keep it on target—to be an extremely helpful feature. Though it tended to be further down the line in terms of overall importance, most respondents simply seemed perplexed that more carriers could not do this well, if at all.

A noteworthy example of this sentiment is Principal, a carrier often cited by respondents—unsolicited—as one they would love to sell based solely on their experiences with the carrier, but in the case of accumulation-oriented IUL, could not justify selling based on the illustration's projected distributions. However, were Principal to make this product more competitive, it was clear they would earn the business of many BGAs looking to make things easier on themselves, producers, and their clients.

Conclusions

IULs as LIRPs will always have a non-guaranteed component, so carriers will never be able to guarantee overwhelmingly positive returns on an IUL policy any more than an advisor can guarantee overwhelmingly positive returns on the stock market. But they also don't have to.

Carriers may believe they are providing more solutions and thus more certainty for producers and consumers, but the only thing carriers have definitively provided is more options. Instead of leading to greater confidence in specific products or IUL in general, more options have led to the exact opposite—anxiety and even paralysis, particularly as the options become more complex.¹

Thus, when designing a product, carriers should recognize the long food chain from carrier to consumer, and then consider how much confidence filters down to the end of the line. BGAs must win producers by providing an appropriate life insurance solution, while producers must then win consumers by conveying this value amongst a vast array of investment vehicles. So many moving parts on so many products have not increased the capacity of those who sell life insurance to make more targeted recommendations and, by extension, more sales. Instead, BGAs and producers are increasingly giving up on understanding all their options and selling only a select few carriers, primarily on the basis of relationship and trust and not much else.

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Bells and whistles are nice in theory, but thinking beyond the life insurance market alone, a carrier would likely win a lot of fans by designing a simple, competitive product that is easy to explain to producers and clients and whose performance is straightforwardly justified. This would allow BGAs and producers to present a much stronger narrative of IULs as a stable cash asset, not as a gimmick from a niche—or worse, unproven—investment vehicle. On the administrative side, the easier carriers can make things for the people buying and selling their product, the more likely it will be that the carrier's product gets bought and sold.

¹ As it applies broadly to the modern-day intersection of psychology and economics, this idea has been advanced most notably by Barry Schwartz in his book "The Paradox of Choice." Schwartz is the Dorwin Cartright Professor of Social Theory and Social Action at Swarthmore College.