Equity Indexed Universal Life Insurance- A Call to Action and the Need for Further Consumer Intervention

NAIC AG49 Does Not Resolve the Misleading and Deceptive Practices Issue

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Equity Indexed Universal Life (EIUL) has been the subject of misleading and deceptive marketing practices[1]. Following are just a few of the examples:

- Inconsistent look-back periods for policy illustrations –using whatever period the issuer found that maximizes the illustrated crediting rate of their indexed methodology.
- Crediting rates tied to the price movement of different indices – no disclosure of the correlation to the total return.
- Since EIUL is not a security, <u>non-securities</u> licensed agents are not only restricted from discussing / disclosing market correlations but also on how the product "fits" with the consumers personal financial planning objectives.
- Because EIUL is not a security, <u>securities</u> licensed agents are not provided the market correlations and equivalent total returns to (1) adjust policy illustration rates consistent with the consumers personal financial planning objectives and (2) to ensure they are compliant with FINRA's 10% gross hypothetical illustration rate cap.

This is an urgent issue because this 'hybrid'[2] has become the 'product du jour' and subject to 'win the illustration beauty contest' exercises with clients.

In response to this illustration abuse and issuer inconsistency, the NAIC (National Association of Insurance Commissioners) Actuarial Guideline 49 (AG49) became effective September 1, 2015. As a result, one small step has been taken to curb illustration abuse issues. AG49 does not and cannot, however, resolve the basic misleading and deceptive marketing practices discussion issues inherent to this product in today's environment. Further EIUL intervention is still needed for the reasons explained in this article[3].

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[1]New York State Financial Services Superintendent Benjamin Lawsky investigation of EIUL sales practices, described as deceptive and misleading.

[2] This term is used by the authors simply to differentiate EIUL from universal life marketed by life insurance licensed sales agents as well as variable universal, corporate variable universal life (aka institutional life insurance), and private placement universal life marketed by securities licensed registered reps.

[3] This article is a follow-up 'companion article' to our article, "Equity Indexed Universal Life Insurance – A Call to Action", in the *Society of Financial Service Professionals'* April 2015 Risk Management Newsletter. These two articles do not question the attractive financial and estate planning purposes of this product. Rather, they identify the hurdles to credibly identify, communicate, and

AG49's purpose is to control the maximum interest rates permitted in new illustrations as well as re-illustrations to inforce EIUL policies by specifying a 65-year look-back period and a series of 25-year measurement periods that all EIUL illustrations must use. By extension, AG49 also provides the differentials the Society of Actuaries consider appropriate between different types of Universal Life Insurance products. It is important to understand that AG49 simply establishes a 'maximum' permitted EIUL illustration rate but the 'maximum' has ***no relevance*** to the crediting rate (investment return) a purchaser considers realistic for longer-term planning purposes. Although state regulations do not permit a non-registered licensed life insurance sales agent to provide investment advice or discuss investment-related issues specific to this product:

- A non-securities licensed agent can sell the policy.
- Only a securities licensed agent can discuss EIUL's fit in the investment driven marketplace and ongoing investment driven decisions the policy owner must make.

These are the core misleading and deceptive practices discussion issues that must be addressed in order for the agent to demonstrate a suitability determination. If they are not addressed, a 'dispute defensible[4]' suitability determination cannot be made and the policy purchaser is likely exposed to illustrated policy values that cannot be achieved.

Intervention and the Form it should take for a Buy-Fund-Manage Life Insurance Product

For reader awareness of the misleading marketing practices issue, we applied the S&P 500® Total Return to the 2015 AG49 (1) data period and (2) 25-year returns:

- 12.44% average of 1-year periods.
- 10.90% average return of the 25-year blocks of 1-year periods.

Without intervention, consumers may be shown an illustration having a 6.65% AG49 compliant illustration rate that is calculated assuming a 10.90% average Total Return of the 25-year blocks. However, is this 10.90% Total Return assumption based upon past market performance consistent with a consumer's 6%-8% Personal Financial Planning Total Return objective? Assuming an 8% Total Return planning objective, this EIUL policy should be illustrated at 4.88%

"Intervention" is defined[5] as "coming between so as to prevent or alter a result or course of events". Intervention is important on behalf of the purchasers of **flexible** premium **non-guaranteed** life insurance products – Universal Life (UL), Variable Universal Life (VUL) and Equity Indexed Universal Life (EIUL) - because there are buy-fund-manage issues with each of these products.

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manage its risks. Further, given the known issues that have lead to allegations of misleading and deceptive practices, these articles address basic product suitability considerations so that legal, tax and financial advisors are aware of the product selection trade-offs.
[4]'Dispute defensible' is a term used by E. Randolph Whitelaw to describe best practices in the evaluation and risk management of life insurance. For example, it is known that carrier illustrations for flexible premium non-guaranteed death benefit products disclaim predictive value and are considered by the Society of Actuaries and FINRA as inappropriate for predictive value determinations and policy comparisons.
[5]New Oxford American Dictionary.

- The ‘buy’ function usually is based upon an issuer illustration that (1) disclaims predictive value and (2) assumes a crediting interest rate selected by the sales agent.
- The ‘fund’ function refers to annual premium payments that require periodic adjustment based upon the actual policy crediting rate and charges controlled by the issuer.
- The ‘manage’ function is not provided by the issuer nor the sales agent who typically does not have contractual post-sales responsibilities. Rather, the ‘manage’ function is solely the responsibility of the policy owner.

Since most purchasers have no idea they have assumed performance risk, intervention is needed to ‘credibly’ monitor policy performance and determine on an annual basis if the scheduled ‘fund’ premium amount will sustain death benefit coverage to insured life expectancy and avoid unexpected policy lapse without value.

AG49 is important to consumers because its interpretation now provides the NAIC and the Society of Actuaries illustration differentials between Universal Life (UL), Equity Indexed Universal Life (EIUL) and Variable Universal Life (VUL / CVUL). Intervention is no longer an agent opinion, but is based on industry best practices.

Intervention, however, should also incorporate Monte Carlo Simulations based on the consumer’s future market expectations. Life insurance illustrations typically utilize a level rate-of-return based on current market returns, or in the case of EIUL, how the market has performed over the past 65 years. The combination of AG49 and Parameterized Return Monte Carlo Simulations will allow the consumer to assess the risk / return of different policy forms utilizing a common starting point – the consumers S&P 500® total return planning assumption.

Intervention should also include FINRA comparative analysis best practices - FINRA Rule 2210(d)(4)(C) governing “hypothetical illustrations of financial principles” provides the methodology for illustrating different structural and tax alternatives.

Due to the fact that EIUL is not a security, two problems still exist:

- Non-securities licensed agents have been free to devise whatever comparisons to other planning and investment management structures (401(k), IRA, Taxable Brokerage Account, 409A, Annuity, etc.) that best demonstrate the benefit of purchasing the EIUL policy.
- Securities licensed agents have not been provided the total return equivalences to prepare FINRA compliant comparisons to other market influenced alternatives.

AG49 now provides the differentials to prepare comparatives to other life insurance and investment alternatives based on FINRA best practices.

Given the assumption of performance risk and the missing management function, EIUL or other flexible premium non-guaranteed death benefit policies should not be purchased unless a third-party provider[6] of

[6]Since the mid-1980s, corporations have purchased flexible premium non-guaranteed death benefit products to fund, formally or informally, corporate benefit plans (COLI). Further, financial institutions have done the same to meet their Tier One capital reserve requirements (BOLI). The purchase decision is ultimately the responsibility of the Chief Financial Officer who is accountable to the CEO and Board of Directors - Finance Committee. The CFO’s purchase decision includes the screening and selection of a credible

'credible' policy risk management services is selected prior to policy acceptance. For owners of inforce flexible premium non-guaranteed policies, 'credible' third-party provider intervention should be a priority.

Summary

NAIC AG49 has brought consistency to the look-back methodology for issuers in calculating the maximum permitted EIUL illustration rate. Extension of the AG49 calculation to the S&P 500® total return now provides the differentials needed to:

- Adjust EIUL illustrations consistent with consumer personal financial planning assumptions.
- Provide best practices "hypothetical illustrations" to other forms of life insurance and market linked alternatives.

NAIC AG49 did not directly address the consumer disclosure issues of a market linked non-security, but indirectly provided the information for:

- A non-security licensed agent to introduce third-party intervention and analysis for their clients.
- A securities licensed agent to introduce third-party intervention and analysis to ensure their life insurance services properly fit with their investment management services.

NAIC AG49 did not just limit the EIUL "win the illustration" contest, but provides the differentials that are essential to prudent personal financial planning and "dispute defensible" suitability determinations. Most important to the prospective or existing EIUL policy owner, NAIC AG49 combined with the intervention services described in this article to safeguard planning objectives by providing policy design and plan management services unavailable from the issuing carrier and sales agent.

In light of this, is there a 'call to action' readers should consider? Yes. All EIUL policies purchased before AG49's September 1st effective date should be re-illustrated based upon the policy owner's total return objective using Monte Carlo Simulation. Why?

- Illustration returns are likely inconsistent with personal financial planning best practices.
- Premium outlays, based upon unrealistic crediting rate assumptions, are likely inadequate to sustain the policy beyond average life expectancy.
- If the policy was purchased as a LIRP (Life Insurance Retirement Plan), future policy cash accumulation values are likely inadequate to meet retirement objectives.

The probability that originally illustrated policy values, often the basis for the purchase decision, will be realized is minimal at best. Fortunately, the tools and guidance are available for EIUL consumers to reset policy expectations consistent with their overall financial planning objectives.

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third-party plan/policy management so that management of performance risk and the form it will take are determinations made before policy purchase. All purchasers of these products are well advised to do the same.

Authors Comment: The number of inforce EIUL policies warranting reillustration is overwhelming, to say the least. For the reasons explained in this article, reillustration for corrective action purposes can be problematic given the limited investment information that can be requested and/or discussed by a non-securities licensed sales agent. We offer an intervention program. Additional information can be obtained by contacting the co-authors at RWhitelaw@TrustAssetConsultants.com or Mark@ValleyViewConsultants.com.