FROM THE DESK OF MARTIN H. RUBY, FSA

THE IMPACT OF AG-49B

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Effective May 1, 2023, Indexed Universal Life (IUL) insurance sales illustrations have to adhere to a revised set of standards. These standards, termed AG-49B, expand the illustration standards laid out in AG-49 (2015), and AG-49A (2020).

It is important to remember that all AG-49 regulations impact sales illustrations only. These new standards do not impact the actual performance of IUL policies, only the way agents can show projections through a carrier illustration.

I see two big takeaways for agents from AG-49B:

1. IUL illustrations under AG-49B are very conservative, and in many cases illustrated rates will be significantly lower than past performance. This means illustrations are no longer a projection of likely performance.

2. Because of this, it will be harder to compare potential income from IUL to potential income from other products, since other products (like IRAs) are not handicapped in their projections with similar regulations. This will no longer be an apples-to-apples comparison.

WHAT'S CHANGED?

Let's look at the regulation and the new provisions.

The updated standards under AG-49B will affect IUL illustrated values in three key ways:

1. Maximum Illustrated Rates | One key goal of AG-49B was to limit illustrated projections when a controlled or target volatility index is used. The reforms make the assumed credited rate lower when using one of these indices. Under the new regulation, the maximum illustrated rate that can be used with the S&P 500® point-to-point crediting options stays the same.

2. Bonuses | AG-49B maintains the prohibition passed in AG-49A regarding illustrating the impact of most interest-crediting bonuses. Currently, bonuses that are expressed as a percentage of the underlying

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interest credit, even if such percentages are guaranteed in the policy, cannot be projected in the illustration itself. One exception to this rule: flat bonuses added to the annual credited rate may be illustrated.

3. **Participating Loan Spread** | AG-49B continues restricting the maximum spread in participating loans that was part of AG-49A. This restriction limits the illustrated spread to 0.5%, even if historical data shows it to be much higher.

> In all cases, these restrictions **only apply to the illustrated values** at the time of sales. **They do not impact actual value** to a policyholder as experience plays out. In other words, if an IUL product was attractively priced prior to AG-49B, then **nothing changes in terms of likely IUL policy performance.**

ILLUSTRATED RATES VS. HISTORICAL EXPERIENCE

So how do the new illustrated values compare to historical experience for IUL policies? I believe after AG-49B, policy projections are no longer representative of likely policy performance. IUL illustrations are now held to very conservative standards, especially compared to real-world performance.

Why do I believe this? Let's look at each of the areas impacted by AG-49B, and compare illustrated standards to historical experience.

1. **Maximum Illustrated Rates:** Most carriers are seeing their maximum illustrated rates fall below 6%. This is simply the result of the "math" embedded in the AG-49B regulation. So how realistic is this? Let's look at historical performance this century (2000-2022). The annual return of an S&P 500® annual point-to-point index with an 11% cap and a floor of 0% is 6.23%. This is actually a historically low number resulting from two severe bear markets in the first decade of the century (2000-2002 and 2008) as well as the poor market performance of 2022. In other words, during a period of stock market under-performance, policyholders still experienced a credited rate above 6%. However, under the revised AG-49B standards, most IUL products are forced to use an assumed credited rate below 6%. This results in a fairly high degree of conservatism, even by regulatory standards.

2. **Bonuses:** AG-49B maintains provisions passed as part of AG-49A in 2020, effectively prohibiting the ability of illustrations to show the impact of bonuses that are structured as a percentage of interest credited - even when guaranteed in the policy. This continues to impact a very popular bonus feature in IUL policies, and remains puzzling as it prohibits showing a guaranteed projection. Most carriers have come out with a flat bonus option that can be applied to the annual interest credit, which at least gives some value to bonuses. But even with this option, IUL illustrations will not capture the full value of the indexed bonuses, which will credit interest to policyholders in real world experience.

3. **Loan Spread:** The AG-49 updates over the past few years have also brought conservative restrictions to the spread assumption on participating loans. The original AG-49 allowed a 1%

positive spread, which was lower but more closely aligned with historic experience of the loan spreads, which averaged about 1.5%-2% for most carriers. As part of AG-49A, the spread assumption was reduced to 0.5% and remains at that lower rate under AG-49B. This is another area where IUL illustrated values could be significantly lower than actual performance.

THE PROS AND CONS OF CONSERVATIVE PROJECTIONS

There is benefit to showing a client conservative projections of IUL policy performance. As many of us know, it is better to under promise and over deliver on results to our clients.

However, AG-49B represents a level of conservatism that may require changing how we view illustrated values, and how we compare them to other options.

Post AG-49B, IUL illustrations are now subject to what I call "conservatism cubed." All three elements addressed in the regulation (projected credited rate, indexed related bonuses, and participating loan spreads) are now subject to very conservative projections that likely underperform real-world experience. This is especially true for the projected credited rate assumption. AG-49B has the effect of taking projected policy values further away from what a policy holder could reasonably expect to experience. It shows the downside of the range of returns but gives no information as to other possible upsides based on historical evidence.

WHAT'S NEXT?

It should bring your client comfort knowing that the cash value projections they are being shown in an illustration are quite conservative and less than historically likely.

Most carrier illustrations include historical results from their various index options. You may consider comparing a product's current maximum illustrated rate to the real rates produced by a given index over a variety of time periods. While these results do not account for interest earned from bonuses and participating loan spreads, it does add some insight to the conservative nature of the policy projections.

Finally, some advisors like to compare IUL projected values to alternative strategies such as annuities or stock/bond portfolios. This will be more difficult to do effectively with the changes under AG-49B. An advisor would need to apply the same stringent set of conservative standards to growth in an IRA or other account, and those conservative standards could seem unrealistic to a client (in fact they may be, just as the IUL illustrated values may underperform historical results).

> **In short, AG-49B has made it more difficult to compare IUL and other approaches on an apples-to-apples basis. IUL illustrations must now contend with "conservatism cubed" whereas other account projections do not.**

However, that doesn't mean it's impossible to compare the value of IUL with the value of other approaches, and show clients how IUL can be an important part of their overall retirement approach.

After all, illustrated projections are just one way to consider IUL. If we evaluate the benefits a client can access with each strategy, IUL continues to shine. After all, no other single product can package as many desirable benefits into one approach: protection from rising taxes; tax-free supplemental income for retirement; a tax-free legacy; mitigation of market risk through indexing; hedging against sequence of return risk through loan structure; and protection from the legislative risk of changes from Washington.

In time, carriers may develop product features that bring illustrated values more inline with real-world experience, even under the AG-49B restrictions. Until then, it's important to remember savers will still access the full performance of their policies (untouched by the AG-49 illustration reforms) going forward.

ABOUT THE AUTHOR

Martin H. Ruby, FSA, has made his career helping people save smarter. As Founder and Chairman of Stonewood Financial as well as a nationally-recognized public speaker, his ideas help savers achieve greater financial wealth and independence. A former insurance-industry executive, Martin is an actuary- a mathematics specialist focused on identifying and eliminating risk. In founding Stonewood, Martin realized his vision of using actuarial insights to structure strategies that address new and emerging risks for American savers.