Northwestern Mutual®

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Via U.S. Mail,
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Lisa Larson
Assistant Director, Regulatory Affairs
Maryland Insurance Administration
200 St. Paul Place, Ste. 2700
Baltimore, MD 21202

Re: Proposed New Regulations under a New Chapter, COMAR 31.15.15 Annuity Disclosure

Dear Assistant Director Larson:

I am Assistant General Counsel at The Northwestern Mutual Life Insurance Company and submit the following comments regarding the changes to the proposed regulation, COMAR 31.15.15 Annuity Disclosure, which were published in the Maryland Register on July 8, 2016 (Vol. 43:14). The original language of COMAR 31.15.15 was part of a new set of regulations, proposed on January 8, 2016 (Maryland Register, Vol. 43:1), that would have adopted , with only minor changes, the most recent amendments to the Annuity Disclosure Model Regulation (NAIC 245).

In particular, my comments relate to the following highlighted language that is being added to subsection (F)(8) and included in a new subsection (M) of COMAR 31.15.15.05:

> *(8)* [[*The*]] ***Except as provided in §M of this regulation, the*** *non-guaranteed elements underlying the non-guaranteed illustrated values shall be no more favorable than current non-guaranteed elements and shall not include any assumed future improvement of such elements;*
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> * * * *
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> ***M. An insurer is not required to consider actuarial assumptions[1] in the dividend scale formula as a nonguaranteed element for the illustrations required by this regulation for:***
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> ***(1) Immediate annuities, if the insurer offers both participating and nonparticipating immediate annuities to applicants; or***
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> ***(2) Deferred annuities, if the insurer offers both participating and nonparticipating deferred annuities to applicants.***

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[1] The proposed new language does not define the term "actuarial assumptions". Thus, it is unclear exactly what assumptions should be considered actuarial assumptions.

BACKGROUND:

In 2011, the National Association of Insurance Commissioners amended the Annuity Disclosure Model Regulation to include, for the first time, standards for annuity illustrations. Those standards are now set forth at NAIC 245, Section 6.

For the most part, the standards for annuity illustrations mirror the standards for life insurance illustrations contained in the Life Insurance Illustrations Model Regulation (NAIC 582). For example, the two illustration standards contain similar requirements for labeling, numbering, and dating illustrations (compare NAIC 245, Sections 6(A)(1) and 6(F)(1)-(2) to NAIC 582, Sections 6(A) and 7(A)(1)-(2)) and for clearly identifying and labeling both the guaranteed and nonguaranteed elements being depicted (compare NAIC 245, Sections 6(F)(7), (10), and (14)-(15) to NAIC 582, Sections 7(A)(6)-(8) and (12)).

More significantly, both of the illustration standards contain similar restrictions and limitations on the benefits, values, and dividends an illustration can depict as well as the underlying assumptions and formulas used to calculate those benefits, values, and dividends. The primary impact of such restrictions and limitations is to prevent insurers from routinely projecting a "bright future" economic environment and depicting unsupportable "rosy scenarios" of future policy performance.

In this regard, the standards for life insurance illustrations contain two basic prohibitions. First, a life insurance illustration cannot, at any policy duration, depict policy performance more favorable to the policy owner than that produced by the insurer's current "illustrated scale". NAIC 582, Sections 6(B)(5) and 7(A)(7). In turn, the insurer's illustrated scale is limited by the concept of a "disciplined current scale", which must be "reasonably based on [the insurer's] actual recent historical experience[2]", must "reflect only actions that have already been taken or events that have already occurred", and "[does] not ... include any projected trends of improvements in experience or any assumed improvements in experience beyond the illustration date". NAIC 582, Sections 4(D) and 4(G). Thus, for example, an insurer's illustrated scale cannot be founded on an assumption that investment returns will increase by even a small amount in the future, thereby allowing the insurer to assume greater future investment income and illustrate higher dividend payments. Rather, the insurer must base its actuarial assumptions and its illustrated scale on "actual recent historical experience" and refrain from "assum[ing] improvements in experience beyond the illustration date."

The standards for annuity illustrations impose essentially the same restrictions and limitations, using somewhat different language. To start, the standards provide:

> The non-guaranteed elements underlying the non-guaranteed illustrated values shall be no more favorable than current non-guaranteed elements and shall not include any assumed future improvement of such elements.

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[2] "Experience" is generally understood to refer to the insurer's experience in terms of mortality, expenses, and investment returns, all of which are taken into account in determining policy dividends.

NAIC 245, Section 6(F)(8). While the annuity illustration standards never use the terms "scale" or "illustrated scale", it is clear the drafters had the concept of an illustrated scale in mind when they used the term "non-guaranteed elements underlying the non-guaranteed illustrated values" in Section 6(F)(8). This is made even clearer in the definition of "non-guaranteed elements":

> "Non-guaranteed elements" means the premiums, credited interest rates (including any bonus), benefits, values, dividends, non-interest based credits, charges or elements of formulas used to determine any of these that are subject to company discretion and are not guaranteed at issue. An element is considered non-guaranteed if any of the underlying non-guaranteed elements are used in its calculation.

NAIC 245, Section 4(J) (emphasis added). After all, an "illustrated scale" is little more than a set of "elements" comprising a "formula" that is "used to determine" the other non-guaranteed elements depicted in an illustration, such as the "benefits, values, [and] dividends". Accordingly, as adopted by the NAIC, the annuity illustration standards do the same things as the life insurance illustration standards: (1) they prohibit an illustration from depicting policy performance better than the insurer's current scale and (2) they prohibit the insurer's current scale from projecting or assuming future improvements in experience.

COMMENTS:

With that as background, adding the highlighted language discussed above to COMAR 31.15.15.05 would be inappropriate for the following reasons:

1. **The Additional Language Would Nullify COMAR 31.15.15.05(F)(8) in Its Entirety.**

According to the Notice of Proposed Action published on July 8, 2016, the purpose of the language being added to COMAR 31.15.15.05 is to provide an "exception" that excludes the "actuarial assumptions in the illustrated scale formula" from being considered as a "nonguaranteed element" under the rule in subsection (F)(8) prohibiting illustrations from assuming "future improvements" in nonguaranteed elements.[3] If, however, the purpose of NAIC 245, Section 6(F)(8) (upon which COMAR 31.15.15.05(F)(8) is based) is to (1) prohibit an illustration from depicting policy performance better than the insurer's current scale and (2) prohibit the insurer's current scale from projecting or assuming future improvements in experience, then the additional language proposed for COMAR 31.15.15.05 will have the effect of completely nullifying subsection (F)(8). It will create the proverbial "exception that swallows the rule".

To start, subsection (F)(8)'s prohibition against assuming "future improvements" cannot be reasonably interpreted as applying to any nonguaranteed elements other than the actuarial assumptions in the illustrated scale formula. For example, Northwestern Mutual routinely uses annuity illustrations to show

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[3] Thus, for example, if the insurer's illustrated scale is based on an assumption that market interest rates will triple in the next five years, under the new language, the insurer would be free to illustrate much better policy performance than it otherwise could have, based on actual recent experience.

future increases in several "nonguaranteed elements", including death benefits, cash values, and/or income payments, based on illustrated payments of nonguaranteed credited interest or the use of illustrated nonguaranteed dividends to purchase paid-up additions. In turn, the ability to use nonguaranteed dividends to purchase paid-up additions also allows Northwestern Mutual to illustrate increasing dividend payments, year-to-year. If Northwestern Mutual could not show such "future improvements" in death benefits, cash values, income payments, and dividends, it would have no reason to use illustrations for annuities. On the other hand, if the prohibition against "future improvements" did not apply to the actuarial assumptions underlying its dividend scale, Northwestern Mutual would be free to make virtually any assumptions it wants about the future and illustrate just about any values it desires for future death benefits, cash values, income payments, and dividends.

Further, imagine if a similar exception were applied to the language of the Life Insurance Illustrations Model Regulation. Such an exception might involve adding language to NAIC 582, Section 6(B)(5) and including a new subsection (D), as follows:

> B. When using an illustration in the sale of a life insurance policy, an insurer or its producers or other authorized representatives shall not:
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> * * * *
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> (5) <u>Except as provided in subsection (D) of this Section,</u> ~~Use~~ <u>use</u> an illustration that at any policy duration depicts policy performance more favorable to the policy owner than that produced by the illustrated scale of the insurer whose policy is being illustrated;
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> * * * *
>
> <u>(D) An insurer is not required to consider actuarial assumptions in the dividend scale formula as a component of the illustrated scale for the illustrations required by this regulation.</u>

Obviously, such an amendment would be absurd. The new language would exempt the very thing Section 6(B)(5) was intended to limit and allow the very result Section 6(B)(5) was intended to prohibit.

In the end, if the prohibition in COMAR 31.15.15.05(F)(8) against illustrating "future improvements" in "nonguaranteed elements" is to have any meaning, it must be read to place limits on the actuarial assumptions in the insurer's illustrated scale formula. Adding language that exempts such actuarial assumptions from the reach of subsection (F)(8) would only render that provision meaningless.

2. <u>The Additional Language Appears to Violate the Actuarial Principles of ASOP 15</u>.

Actuarial Standard of Practice No. 15, promulgated by the Actuarial Standards Board, states that it "applies to actuaries when performing professional services in connection with the establishment or modification of the dividend framework and the determination and illustration of dividends for individual

participating ... annuities...." However, it "does not apply to actuaries when performing professional services with respect to illustrations of dividends subject to ASOP No. 24, Compliance with the NAIC Life Insurance Illustrations Model Regulation." ASOP 15, Section 1.2 (2006).
Section 3.13 of ASOP 15 states:

> 3.13 Illustrated Dividends Not Subject to ASOP No. 24—The actuary should determine dividends to be used in illustrations not subject to ASOP No. 24 so that they reasonably relate to actual dividends recently determined for payment on policies in force.
>
> The actuary should consider whether illustrated dividends can be supported by recent experience. If not, the actuary should disclose this and consider the appropriateness of recommending a reduced scale for illustrations.

This provision of ASOP 15 appears to fall squarely on the side of requiring an insurer's illustration scale for annuities to be reasonably based on the insurer's actual recent historical experience. Accordingly, the additional language proposed for COMAR 31.15.15.05—which rejects actual recent historical experience as a limitation on the insurer's illustrated scale—appears to conflict with this key provision of ASOP 15.

3. <u>The Additional Language Would Defeat the Goal of Greater Uniformity in Insurance Laws</u>.

Presumably, one of the primary reasons for adopting the most recent amendments to the Annuity Disclosure Model Regulation (including the new annuity illustration standards) is to promote greater uniformity in state insurance laws. However, the additional language proposed for COMAR 31.15.15.05 would place Maryland out of step with other states. Maryland's annuity disclosure regulation will be the only one exempting actuarial assumptions from the prohibition against assuming "future improvements" in the "non-guaranteed elements underlying the non-guaranteed illustrated values". Therefore, insurers would be free to illustrate annuities one way in Maryland but prohibited from using the same kind of illustrations for annuities in other states.

Further, the additional language proposed for COMAR 31.15.15.05 would put Maryland's annuity illustration standards at odds with its own life insurance illustration standards. Maryland's life insurance illustration regulation (COMAR 31.09.09.01 through 31.09.09.13) contains the same language as the NAIC model regulation concerning "illustrated scale" and "disciplined current scale" as well as the same prohibitions against depicting policy performance better than the insurer's current scale and against assuming future improvements in experience. *See* COMAR 31.09.09.03(B)(5) and (8), COMAR 31.09.09.06(B)(5), and COMAR 31.09.09.07(A)(8). Accordingly, for no good reason, insurers would be free to assume future improvements in experience for their annuity illustrations but would be prohibited from doing so for their life insurance illustrations.

4. <u>The Additional Language Would Create an Unlevel Playing Field for Insurers</u>.

On its face, the additional language proposed for COMAR 31.15.15.05 would apply to immediate annuities, but only if the insurer offers both participating and nonparticipating immediate annuities. Similarly, the new language would apply to deferred annuities, but only if the insurer offers both participating and nonparticipating deferred annuities. Because not all insurers can legally comply with these requirements, the additional language would create an unlevel (and unfair) playing field for insurers.

As a Wisconsin domiciled mutual insurance company, Northwestern Mutual is subject to Wis. Stat. § 632.62(1)(b), which provides:

> (b) *Fraternals and mutual insurers.* A fraternal or mutual insurer issuing life insurance policies may issue only participating policies, except for the following situations in which it may issue nonparticipating policies:
>
> 1. Paid-up, temporary, pure endowment insurance and annuity settlements provided in exchange for lapsed, surrendered or matured policies;
>
> 2. Annuities beginning within one year of the making of the contract; and
>
> 3. Such term insurance policies as the commissioner may exempt by rule.

As such, Northwestern Mutual can issue both participating and nonparticipating immediate annuities, but it is legally prohibited from issuing anything other than participating deferred annuities. In turn, even if Northwestern Mutual wanted to utilize the exemption created by the additional language proposed for COMAR 31.15.15.05, it could not do so for its deferred annuities. Having a rule that arbitrarily confers benefits to some insurers, but not others, based solely on their state of incorporation would be patently unfair.

CONCLUSION:

For the reasons stated above, Northwestern Mutual urges the Maryland Insurance Administration to remove the additional language for COMAR 31.15.15.05, proposed on July 8, 2016, from the final version of the regulation.

Sincerely,

Christopher W. Brownell

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