May 5, 2023

Interstate Insurance Product Regulation Committee
444 North Capitol Street, NW
Hall of the States, Suite 700
Washington, DC 20001

RE: Draft Uniform Standards for Index-Linked Variable Annuities (ILVAs)

Members of the ILVA Subgroup of the Product Standards Committee:

The American Council of Life Insurers (ACLI)[1] and the Committee of Annuity Insurers (CAI)[2] appreciate the opportunity to submit comments to the Product Standards Committee's ILVA Subgroup on the discussion draft of the *Uniform Standards for Index-Linked Variable Annuities (ILVAs)* (ILVA Compact Standards or Discussion Draft).

We applaud and strongly support the efforts of the Interstate Insurance Product Regulation Commission (Compact), its Product Standards Committee and ILVA Subgroup to develop workable Compact product standards for ILVAs.

Introduction: ILVAs and the ILVA Marketplace

As you know, the ILVA market has seen substantial growth over the past several years. ILVAs fill an important midpoint on the risk/reward spectrum – between conventional fixed index annuities and conventional unit-linked variable annuities – that is consistent with the investment objectives and risk tolerances of many retirement savers. The growth of this market has been fostered by the diversity of ILVA product designs that offer consumers a wide variety of linked indexes/benchmarks, different index crediting terms, and perhaps most importantly a wide variety of crediting strategies that incorporate different crediting and protection features. This diversity has also been aided by the increasing number of carriers offering these products, and the fact that ILVAs are being distributed and offered through a variety of different distribution channels affording meaningful ILVA choices to consumers.

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[1] The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States.

[2] The Committee of Annuity Insurers is a coalition of life insurance companies that issue annuities. It was formed in 1981 to address legislative and regulatory issues relevant to the annuity industry and to participate in the development of public policy with respect to securities, state regulatory and tax issues affecting annuities. The CAI's current 32 member companies represent approximately 80% of the annuity business in the United States.

Accordingly, it is essential that the ILVA Compact Standards be broadly drafted to continue to foster this diversity and innovation, as the Compact's member states have done. As currently structured, it is questionable whether the Discussion Draft would permit current features offered in the ILVA marketplace, much less innovative emerging and future features. Examples of overly prescriptive terms that would call into question the permissibility of existing product designs abound in the Discussion Draft – a Buffer definition that would not allow for designs where the contract owner bears the entire loss if the buffer is exceeded (sometimes referred to as a barrier protection feature); a scope provision that does not anticipate the use of a participation rate as a downside protection; an Index definition that does not clearly contemplate the use of ETFs or non-securities benchmarks; and a Trigger Rate definition that does not allow for a specified crediting rate triggered off of a negative index return. The level of prescription would also call into question the permissibility of now-common features not reflected in the Discussion Draft, such as a performance lock.

We believe that the ambiguity around the permissibility of existing designs created by these prescriptive terms is likely inadvertent, but such ambiguity is inevitable if the ILVA Compact Standards retain the level of prescription in the Discussion Draft. Instead, we urge the Subgroup to follow the precedent of the *Individual Deferred Non-Variable Annuity Contract Standard* (IIPRC-A-02-1) and the *Additional Standards for Index-Linked Crediting Feature for Deferred Non-Variable Annuities and the General Account Portion of Individual Deferred Variable Annuity Contracts* (IIPRC-A-07-1-1), which eschew overly prescriptive definitions and requirements and have allowed for the development of innovative products and robust competition in the fixed index annuity marketplace. This approach would follow that taken by the Compact's member states, which has led to the development of robust competition in the ILVA marketplace, to the benefit of consumers. Our comments and suggestions that follow are offered in that spirit.

<u>Comments and Suggestions</u>

We have separated our comments into three sections. First, we provide our views on the specific issues on which the Subgroup has requested comment. Next, we address inconsistencies with the Actuarial Guideline for ILVAs (AG 54) recently promulgated by the NAIC. Finally, we address other concerns with the Discussion Draft, including the level of prescription discussed above.

(1) <u>Specific Issues on which the Subgroup has Requested Comments</u>

The Subgroup has requested comment on two specific issues in the agenda for the public call scheduled for May 8, 2023.

1. ***The definition of "floor" in the draft standard does not include a zero floor and therefore a product with a floor of zero is not within the scope of the standard and instead would be subject to the non-variable standards.***

While there are similarities between an ILVA strategy with a zero floor and a conventional fixed indexed annuity (FIA) strategy, there are also important differences. Consequently, we believe that the ILVA Compact standards should allow for ILVA strategies with a zero floor.

- Primary among these differences is that an ILVA strategy with a floor of zero is subject to the same Interim Value calculations that apply to other ILVA strategies, which allows gains or losses within the index strategy term. In contrast, a conventional FIA strategy does not recognize any indexed interest until the end of the index strategy term.

- In addition, for contract owners who want to dynamically manage their risk at and after issue of the product, the availability of an ILVA strategy with a zero floor provides an important component of this portfolio. The availability of an ILVA zero floor enables greater flexibility and diversification.

- Risk management may vary depending on whether or not a strategy is subject to non-variable standards and the associated nonforfeiture requirements. The insurer may wish to allow the contract owner to lock in performance prior to the index term end date. Consistent Interim Value requirements across ILVA strategies better enable insurers to offer such features.

2. *The purpose of the new provision in the application standard is to help assure that consumers that purchase Compact-approved products are aware and hopefully better understand the differences between an ILVA and non-variable indexed annuities and variable annuities*.

While we agree that contract owners should understand how the ILVA product works, we note that because ILVAs are registered as securities, there is ample prospectus disclosure provided to prospective contract owners prior to the time of sale. Additionally, as both a security and an annuity, all sales are subject to the "best interest" standard applicable under Federal securities law and state insurance laws. We are concerned that the Product Comparisons as outlined in both the proposed Application standard and the Discussion Draft would confuse consumers. We note that similar comparisons are not required for fixed index annuities, fixed rate annuities and variable annuities.

We urge the Subgroup to avoid creating additional disclosure requirements considering the already voluminous prospectus and other disclosures provided in connection with ILVA sales, and the substantial guardrails provided by the best interest standard.

(2) Inconsistencies with AG 54

The Discussion Draft contains several inconsistencies with AG 54 that was recently promulgated by the NAIC. Some of these inconsistencies are significant enough that they could lessen the utilization of the Compact and also influence individual state views of ILVA product filings, which could adversely affect consumer choice. These inconsistencies between AG 54 and the Discussion Draft include the Trading Cost restriction, the apparent requirement to include an Interest Rate MVA with prescribed calculations, and the disallowing of zero floors.

We urge the Subgroup to adjust the proposed standards in the following areas to align more closely with AG 54.

Trading Costs

Like AG 54, the Discussion Draft rightly includes a provision for frictional costs of unwinding derivative positions when calculating the Hypothetical Portfolio. AG 54 requires an actuarial certification that "any Trading Costs represent reasonably expected or actual costs at the time the Interim Value is calculated". However, the Discussion Draft limits the Trading Cost to 10 basis points. Trading Costs can greatly exceed 10 basis points for longer-dated options, less liquid indices, and during periods of increased market volatility.

Incorporating AG 54's actuarial certification that "any trading costs represent reasonably expected or actual trading costs at the time the Interim Value is calculated" is the ideal solution. A low, arbitrary

restriction on Trading Costs would force insurers to limit their offerings to short index terms and certain highly liquid indices, and/or reduce other crediting parameters to compensate for inability to manage Trading Cost risk.

Interest Rate Market Value Adjustments (MVAs)

When reviewing the Discussion Draft, many of our member companies expressed confusion about how to interpret MVA requirements. Areas of concern include, but are not limited to:

- The Discussion Draft can be construed to require an interest rate MVA.
- Having the MVA tied to the duration of the fixed income assets requires a changing maturity throughout the life of the Contract (examples include the maturity duration during and after the surrender charge period and the existence of a living benefit feature).
- Whether the MVA calculation is intended to be prescriptive or principles-based.
- Whether the MVA is considered part of the net investment return for the purposes of demonstrating compliance with Section 7 of the NAIC's Variable Annuity Model Regulation (Model #250).

Consumers may or may not wish to bear interest rate risk when purchasing an ILVA contract. Granting insurers flexibility as to whether to include an MVA, and how to structure it, will enable a more diverse, competitive ILVA marketplace. Some insurers prefer to manage interest rate risk without including an MVA to create a simpler experience for the consumer. These insurers would be penalized by the requirement of an interest rate MVA.

Some insurers also have different asset management strategies. Some insurers manage assets at a contractual level, while others have investment strategies specific to unique index-linked strategies. A prescriptive MVA requirement could favor the approach of some insurers at the expense of others. In addition, for contract owner simplicity, some insurers are managing their risk to the index strategy terms, rather than directly tying it to either a hypothetical or fixed maturity of assets.

We believe AG 54's principles-based approach regarding MVAs will foster a competitive ILVA marketplace without favoring one design over another design. Thus, we encourage the Subgroup to structure MVA language consistent with AG 54 which would include, but not be limited to, the removal of the following language: "An MVA is applied in determining the Fixed Income Asset Proxy, not to Strategy Values or Interim Values.".

Certification of "Material Consistency"

Like AG 54, the Discussion Draft would require an actuary to certify that the product's Interim Values are materially consistent with the Hypothetical Portfolio benchmark. AG 54 requires testing "under a reasonable number of realistic economic scenarios." The Discussion Draft would require that "Testing must be performed for a sufficient range of positive and negative index changes to establish that equity between the contract holder and the company exists under any reasonable scenario." Use of the phrase "any reasonable scenario" suggests that a single scenario could be disqualifying at the discretion of a reviewer. We are concerned that this may result in inconsistency in product approvals.

We propose that equity be established by assessing consistency of values across a range of economic scenarios rather than "any" single deterministic scenario. The Discussion Draft already contains language stating an actuary must describe how the Interim Value applies for both upward and downward adjustments.

Therefore, we encourage the Subgroup to structure Material Consistency language consistent with AG 54 by removing the phrase "under any reasonable scenario". The industry is interested in partnering to refine the determination of material consistency and equity.

Section 7 of Model #250

In requiring compliance with Section 7 of Model #250, AG 54 excludes Section 7.B. The Discussion Draft does not explicitly exclude Section 7.B, which creates ambiguity. We request the proposed standards be revised to exclude Section 7.B.

As previously mentioned, some members were also unsure whether the MVA was intended to be part of the net investment return for the purposes of demonstrating compliance. Our position is that it is appropriate to include the MVA as part of the net investment return. Otherwise, it could unduly constrain product design.

(3) <u>Other Concerns with the Discussion Draft</u>

The following is a bullet point list of high-level comments and concerns that we offer to assist the Subgroup in developing the next draft of the ILVA Compact Standards. We have identified these areas below by referencing the specific section in the Discussion Draft, where applicable.

General, Scope and Definitions

- Although the Discussion Draft uses broad language (for example, under "Scope") contemplating the use of crediting elements beyond those that are expressly identified and defined in the standards, it would be advisable to include an additional drafting note indicating that the standards should not be interpreted as limiting the design of crediting elements or innovative features available for approval, at least in the absence of an express prohibition.

- The standards should not include specific definitions for crediting elements, such as buffer, cap, floor, margin or spread, participation rate, and trigger rate or step-up rate. Specific definitions for crediting elements could be interpreted as restricting product design (and the draft definitions are inconsistent with several designs in the market today). As discussed above, the Compact standards for fixed index annuities do not include such definitions, and we note that AG 54 did not set forth specific definitions for ILVA crediting elements. If the standards are to include specific definitions, it is essential that companies have the opportunity to provide alternative definitions.

- Terminology should be refined as necessary to better differentiate between traditional variable annuity, ILVA, and fixed interest concepts. For example, the term "subaccounts" is a traditional variable product concept and would not always be an accurate way to characterize ILVA or fixed interest options given that assets may be held in the general account as well as the separate account.

- It is unnecessary to include standards and definitions related to traditional variable investment options and fixed interest options in these standards, as such options are already covered by other existing standards. Therefore, for example, Appendix A would not be needed.

Actuarial Requirements

- The required certification that "The values of the elements used in determining an index credit provide higher potential positive credits and higher potential contract benefits in comparison to any non-variable annuity offered by the Company at issue" assumes that all other aspects of the products are alike which may not be the case. For example:

  - An ILVA with a high buffer, shorter surrender charge period, and higher expenses/commission may produce lower crediting parameters than a FIA with a longer surrender charge period and lower expenses/commission.

  - The certification would require the timing of rate setting to align across products to avoid potential for short-term differences.

  Based upon the considerations outlined above, we recommend removing this certification requirement.

- The Discussion Draft does not appear to view contracts that meet the definition of a Hypothetical Portfolio to be considered as a safe harbor and not subject to certain testing requirements, which differs from AG 54. We recommend that contracts meeting the definition of a Hypothetical Portfolio align with AG 54 and be considered as a safe harbor.

- There is an inconsistency within the Discussion Draft where the draft allows different valuation techniques in Section B(1)(g)(v), but also states that "the derivative structure must be designed and calibrated such that it closely matches the value of standard put and call options under most conditions and assumptions" in Section B(1)(d)(vi)(4). These statements conflict with each other and we feel the draft should be aligned to the AG 54 framework.

Product Flexibility and Compact Approval Procedures

- Variability of Information (Section 1.C)

  - Consistent with virtually all product designs in the market today, there should be a provision or drafting note clearly stating that the rates associated with "upside" crediting elements are non-guaranteed elements, and that those rates may be changed for new Index Strategy Terms under both new contracts and in-force contracts without prior Compact approval.

  - We recommend a provision comparable to subsection (6) allowing for indexes to be identified as a variable item and be added or removed for new Index Strategy Terms under new and in-force contracts without prior Compact approval.

  - In subsection (5), the Discussion Draft states that "A zero entry in a range of values on the specifications page for tiering levels, expense charges, or other fees applicable under the contract is unacceptable." Limiting flexibility for zero fees impacts current product designs and restricts future innovation.

- General clarification is needed on guaranteed vs. non-guaranteed elements. For example, if buffers may be filed with a reasonable range, the Discussion Draft would limit the offer of additional buffers to an approved Index to new business only. Such new buffers should be available to in-force contract owners.

- Amendments (Section 3.A) - The ILVA Compact Standards should include a provision or drafting note making clear that insurers can close Index Strategies to new money at any time, subject to any guarantees that a contract may include regarding the availability of specific Index Strategies.

- Contract Guarantees (Section 3.G) - The Contract Guarantees section should include a provision or drafting note that expressly allows for the values of non-guaranteed elements for the initial Index Strategy Term, such as, but not necessarily limited to, the rate for upside crediting elements, to be included on the specifications page of the contract. That provision or drafting note should permit the values of non-guaranteed elements to be changed for future Index Strategy Terms without prior Compact approval.

- Contract Values (Section 3.H) - Subsection (5) provides "The contract shall identify or describe each index available under the contract, either within the contract itself or on the specifications page." Not every distributor offers every Index Strategy, so while we agree that all Indices should be listed in the spec page for new business, offering different Index Strategies by rider should be an option. AG 54 allows index-linked features to be added by rider, endorsement or amendment. In addition, it is unclear whether the Discussion Draft would require that companies issue new spec pages with the addition of a new index or Index Strategy.

- Discontinuation of or Substantial Change to an Index (Section 3.K) -Consistent with existing product designs, an insurer should be able to replace an index during an Index Strategy Term for a broader range of reasons than index discontinuation or a substantial change in the calculation of the index. We recommend language that the insurer may discontinue or replace an index if the index is discontinued, index values are not available for any reason, the insurer is no longer licensed or otherwise permitted to use the index, if the index's calculation changes substantially, or if hedging instruments become difficult to acquire or the cost of hedging becomes excessive in the insurer's judgment.

Consistency with SEC Regulations

- It is important that the Section 3.C. Assignment section include a provision or drafting note that expressly allows a company to restrict assignments if relying on Rule 12h-7 under the Securities Exchange Act of 1934 (1934 Act) that exempts insurers issuing registered insurance products from SEC public company reporting requirements that otherwise would be triggered by federal securities registration (or any other provision of the federal securities laws that requires or is dependent upon the ability to restrict assignments). Rule 12h-7 is premised on there being no trading market for the securities. Therefore, one of the conditions of Rule 12h-7 is that insurers include a provision in their policy form requiring written notice to, and acceptance by, the insurer prior to any assignment or other transfer of the securities, and reserving the right to refuse any assignment or other transfers at any time on a non-discriminatory basis. Most insurers issuing ILVAs rely on Rule 12h-7, and we expect that when the SEC adopts a new registration form in 2024 one of the conditions for use of that form may be reliance on Rule 12h-7.

- The Section 3.U. Ownership section (as with the Assignment section, above) also should include a provision or drafting note that expressly allows a company to restrict changes of ownership if relying

on Rule 12h-7 under the 1934 Act (or any other provision of the federal securities laws that requires or is dependent upon the ability to restrict changes in ownership).

Guaranteed Living Benefits (GLB)

- GLB requirements need to be reconsidered for ILVAs. The ILVA Compact Standards should also allow for GLB riders without a benefit base to maximize growth potential for consumer retirement income. The ILVA market has trended towards cost-efficient options with higher growth potential during accumulation, which alleviates the need for a guaranteed benefit base.

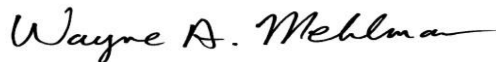
In-Force Contracts

- There should be greater clarity around the treatment of product enhancements for in-force contracts. If Compact approval is received for new indices, and/or enhancements to previously approved contracts, such as new crediting features or new benefits, companies should be able to make these indices, features and/or benefits available on in force contracts and not only newly issued contracts.

The ACLI and the CAI appreciate the opportunity to comment on the Discussion Draft of the *Uniform Standards for Index-Linked Variable Annuities (ILVAs).* We look forward to continued discussion and collaboration with the Subgroup and the Product Standards Committee to finalize a standard that will allow ILVA products to be approved through the Compact while fostering innovation and competition.

Respectfully submitted,

AMERICAN COUNCIL OF LIFE INSURERS (ACLI)



Wayne Mehlman
Senior Counsel, Insurance Regulation
waynemehlman@acli.com

Brian Bayerle
Chief Life Actuary
brianbayerle@acli.com

COMMITTEE OF ANNUITY INSURERS (CAI)
For the Committee of Annuity Insurers, By:

Eversheds Sutherland (US) LLP
steveroth@eversheds-sutherland.com
maureenadolf@eversheds-sutherland.com