ACLI
Financial Security for Life

THE Committee OF Annuity Insurers
www.annuity-insurers.org

September 8, 2023

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

RE: Revised 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 its revised draft of the *Uniform Standards for Index-Linked Variable Annuities (ILVAs)* (ILVA Compact Standards or Discussion Draft).

We strongly support the efforts of the Interstate Insurance Product Regulation Commission (Compact), its Product Standards Committee and the ILVA Subgroup to develop workable Compact product standards for ILVAs. We appreciate the significant efforts of the Subgroup to address many of our comments on the initial draft of the ILVA Compact Standards. We offer the following comments on the revised ILVA Compact Standards, including the following responses to questions raised by the Subgroup in its response to prior comments, to assist the Subgroup in developing ILVA Compact Standards that will allow for widespread use of the Compact for ILVA product filings as well as continued innovation and competition in the ILVA marketplace.

To facilitate the Subgroup's review of our comments, we have ordered the sections of our comment letter generally in the order that the provisions in question appear in the revised draft of the ILVA Compact Standards and therefore not in the order of importance to the industry.

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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.

I. Scope and Definitions

a. ***The definition of "account value" needs to be broadened to include fixed accounts with market value adjustment (MVAs) and fixed accounts supported by separate accounts***

The definition of "account value" should be broadened to encompass additional types of non-variable investment options that have been included in ILVA contracts to date and/or that may be built into ILVA contracts that insurers may offer in the future. Specifically, in addition to fixed account options supported by a general account that accumulate interest at a guaranteed minimum interest rate greater than or equal to 0%, the definition should also contemplate: (i) fixed account MVA options supported by a separate account that do not comply with Model #805 (subject to IIPRC-A-07-I-3, *Additional Standards for Market Value Adjustment Feature Provided Through a Separate Account*), revised as we propose below, and (ii) fixed account options supported by a separate account that comply with Model #805. Without these revisions, it is unclear whether the above-referenced options may be offered as part of an ILVA contract approved through the Compact.

The requested revisions could be made by either (i) revising the definition of "non-variable account value" to expressly list the above-referenced investment options; (ii) redefining "non-variable account value" as any portion of the account value that isn't variable account value or index-linked variable account value; or (iii) adding a fourth sub-definition for "other account value." Alternatively, an appropriate drafting note could suffice. We have not provided a suggested mark-up at this time, as the approach may be dependent on how the Subgroup revises the ILVA Compact Standards in response to other comments, and we wish to be sensitive to how a revised definition could impact other parts of the ILVA Compact Standards. Nonetheless, we believe this is an important issue, and we stand ready to work closely with the Subgroup on a revised definition.

b. ***The definition of "Index" is inconsistent with FIA standards and may not be broad enough to accommodate some of the benchmarks already permitted by member states***

In the revised Discussion Draft, "Index" has been re-defined to mean "a benchmark used to determine index credits that is well-established, publicly available, and where the source of the benchmark is external to the company." As discussed further below, the revised definition is an unnecessary departure from the Compact standards for fixed indexed annuities (FIAs) (which do not define the term "Index"), is too restrictive from a product design standpoint, and is inconsistent with indices used in existing product designs of both ILVAs and FIAs. The Subgroup should follow the approach in the FIA standards by deleting the revised definition and leaving the term "Index" undefined.

The original draft ILVA Compact Standards defined "Index" to mean "a benchmark designed to track the performance of a defined portfolio of securities." As part of our first comment letter, in support of our general view that the ILVA Compact Standards should not include overly prescriptive terminology, we commented that the original definition of "index" was too restrictive because it failed to contemplate the use of ETFs or non-securities benchmarks. In response to comments, the Subgroup revised the definition of index, but the revised definition is even more restrictive than the original. The Subgroup's response document states that the definition was revised "based on the Compact MVA standard definition, MD and OR definitions of index."

The revised definition is problematic and should be deleted from the ILVA standards. In this regard, we highlight the following three items for the Subgroup's consideration:

- First, the revised definition would call into question the permissibility of existing product designs. For instance, many ILVAs in the market today use custom indices and blended indices, and those indices are often defining features of the products. We are concerned that if the revised definition is adopted, companies would be discouraged from filing their ILVAs with the Compact. We would view any such result as detrimental to customers, companies, and the general development of the ILVA market.

- Second, to achieve logical parity between Compact standards for ILVAs and FIAs—which are more alike than ILVAs and MVAs—the Subgroup should follow the approach in the Compact standards for FIAs,[3] not the approach in the Compact standards for MVAs.[4] The Compact standards for FIAs do not contain any definition of "index." The FIA standards require the actuarial memorandum to describe the indices used as the basis for interest credited to the contract, but do not otherwise prescribe or restrict which indices may be used.

- Third, while we appreciate the Subgroup's consideration of our original comment by providing for a definition that doesn't clearly prohibit index options linked to ETFs or non-securities indices, the revised definition is too restrictive from a product design standpoint, as the terms "well-established," "publicly available," and "external to the company" could result in significant and undue limitations for ILVAs.[5] For example, the revised definition could be interpreted to prohibit, *e.g.*, new indices, custom indices, proprietary indices, blended indices, and indices for which values are not broadly disseminated to the public. These restrictions would stifle product development to a significant degree, making it difficult for companies to differentiate their products and leaving customers with fewer meaningful choices in the market. These restrictions would also create an illogical asymmetry between ILVAs and FIAs, where ILVAs (which are securities registered with the Securities and Exchange Commission (SEC)) would be severely restricted as to available indices, whereas FIAs would still be able to include a wide array of indices.

With these considerations in mind, we urge the Subgroup to remove the revised definition from the draft ILVA Compact Standards and move forward with the term "index" undefined.

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[3] *See* IIPRC-A-07-I-1, *Additional Standards for Index-Linked Crediting feature for Deferred Non-Variable Annuities and the General Account Portion of Individual Deferred Variable Annuity Contracts* (containing no definition of "index").

[4] *See* IIPRC-A-07-I-3, *Additional Standards for Market Value Adjustment Feature Provided Through a Separate Account* (defining "index" as "a publicly available interest rate index, where the source of the index is external to the company"). *See also* IIPRC-A-07-I-2*, Additional Standards for Market Value Adjustment Feature Provided Through the General Account*.

[5] We note that the definition of "index" in the MVA Compact Standards does not raise these concerns. While the definition in those standards makes reference to "external to the company," that restriction is not unduly restrictive as a practical matter. The index used for MVA calculations typically is not a major aspect of product design, and customers do not purchase MVA products based on the MVA's related index. Indeed, the sole purpose of the MVA index is to provide an objective measure of prevailing interest rates. In the context of an ILVA or FIA, however, the attractiveness of an index is just as important to the company and the customer from a product design standpoint as upside and downside crediting elements.

II. Actuarial Requirements (Section 1(B)(1))

a. ***The ILVA Compact Standards should allow for Interim Value methodologies that are materially consistent with the Hypothetical Portfolio methodology***

The ACLI and CAI are continuing their work to define and propose an objective quantitative framework that may accommodate Interim Value methodologies that are not based on the market value of assets consistent with the Hypothetical Portfolio approach, such as pro-rata methodologies. We believe the ILVA Compact Standards should allow for flexibility in Interim Value methodologies so long as the methodologies produce Interim Values that are materially consistent with the Hypothetical Portfolio and provide equity between the consumer and the insurance company. We believe allowing this flexibility in methodologies will continue to foster diversity and innovation in ILVA marketplace and improve consumer choice. We urge the Subgroup to continue to engage with the Compact member states for a determination on this matter and would welcome any opportunity for further dialogue with the Subgroup to support this effort.

b. **Clarify that illustrative examples, rather than "testing," is required for contracts where Interim Values are based on a Hypothetical Portfolio methodology**

We appreciate the drafting note that was added to section 1(B)(1)(g)(iv) of the Discussion Draft and the associated commentary in the response to commenters, but there is still some confusion on how to interpret the language. Our understanding of the framework in the draft ILVA Compact Standards and Actuarial Guideline 54 (AG 54) is that Interim Values based on a Hypothetical Portfolio methodology are considered equitable by definition. Accordingly, it's not clear what "testing" would be necessary to demonstrate equity. Based on the language used in the drafting note, it appears to us that rather than intending to require testing, the Subgroup intends for companies to provide illustrative examples of Interim Values across a range of scenarios as part of the Actuarial Memorandum to accompany the certification of equity.

We therefore suggest that the alternative language below be used in section 1(B)(g)(iv) and the accompanying drafting note to clarify the expectation.

> *Interim Values provide equity between the contract holder and the company as of the calculation date for all Index Strategies and Index Strategy Terms. The certification shall ~~describe the testing performed by the actuary in support of the certification. Testing must be performed for a sufficient range of positive and negative index changes to establish that equity between the contract holder andthe company exists under any reasonable realistic economic scenario that may occur under the contract~~ be accompanied by illustrative examples that demonstrate Interim Values under a reasonable number of realistic economic scenarios.*
>
> ***Drafting Note**: ~~Testing for equity does not involve testing~~ The illustrative examples do not need to span 1000s of economic scenarios, but rather ~~testing~~ capture specific realistic index changes over the Index Strategy Term. For example, ~~testing~~ scenarios should include, for a buffer and cap strategy, at least the range of index changes from level of the buffer to the level of the cap. Realistic index changes can be determined based on historical experience.*

c. ***The ILVA Compact Standards require additional clarification and flexibility regarding MVAs***

1. **MVA Flexibility** - We appreciate the flexibility that has been introduced in the current draft of the ILVA Compact Standards with respect to MVAs. However, we still have concerns with

the specificity of the language in the Discussion Draft related to the maturity of the fixed income assets supporting the ILVA. As we explain in more detail below, we recommend that the Compact provide more flexibility with respect to the permissible MVA term. This recommendation is an extension of similar dialogue that occurred during the LATF ILVA Subgroup process that preceded the adoption of AG 54.

We believe that ILVA Interim Values are consistent with the Hypothetical Portfolio methodology so long as the method used to determine the market/fair value is equitable to the consumer and the company and the requirements for Fixed Income Asset Proxy and Derivative Asset Proxy are met. When AG 54 was developed, there were numerous discussions about how tying an MVA feature to the maturity of fixed income assets could become problematic and complicated under certain circumstances, and that tying the MVA to the consumer's Index Strategy selections or some other benchmark would be substantially more consumer friendly while remaining consistent with the outlined approach. Therefore, options other than the maturity of the fixed income assets should be allowed.

A company may design the MVA to be connected to consumers' Index Strategy Term selection(s) while the company may design their asset-liability management (ALM) practice around the liability duration and/or book value requirements, which could be tied to the index terms. ALM practices are typically tied to liability rather than asset duration. Investment strategies may change over time, so it may become impractical to bring in determination of underlying asset duration in all situations. Therefore, we believe that simplification is required.

Permitting MVAs tied to Index Strategy Terms or some other benchmark would allow for simplification of the MVA calculation for ILVA products with design features such as: multiple premiums in flexible premium contracts; commingling of funds in Index Strategies with different asset durations; reinvestment of Index Strategy credits; and the existence of guaranteed death or living benefit features, if applicable. For example, a flexible premium contract could have an Index Strategy with some allocations of premium past the surrender charge period and some allocations of premium still within the surrender charge period (where there may be different investment strategy durations for these allocations). This would be further complicated by varying durations of Index Strategy credits from previous Index Strategy Terms allocated to the same Index Strategy, as well as benefit charges assessed against the Index Strategy for death or living benefit features (complicated by determinations from which bucket benefit charges are assessed). We have included the example that we previously supplied to the LATF ILVA Subgroup to illustrate some of this complexity and the need for the requested flexibility.

In addition to the considerations raised above, the language in the Discussion Draft related to the book value of the Fixed Income Asset Proxy includes a technical inconsistency. AG 54 does not include a reference to the maturity of the fixed income assets supporting the ILVA when describing the book value of the Fixed Income Asset Proxy. This approach is appropriate based on the other conditions related to accrual of the book value from the beginning of the Index Strategy Term to the end of the Index Strategy Term.

To address our concerns, we therefore recommend the following changes to section 1(B)(1)(d)(vii) of the ILVA Compact Standards (aligning with AG 54):

The Hypothetical Portfolio value is the sum of the value of the Derivative Asset Proxy and either the book value of the Fixed Income Asset Proxy or market value of the Fixed Income Asset Proxy and shall comply with the following requirements:

1. *The Index Strategy Base equals the Strategy Value at the Index Strategy Term start date;*
2. *The book value of the Fixed-Income Asset Proxy is assumed to be a hypothetical fixed income asset ~~with a maturity based on the maturity of the fixed income assets supporting the ILVA, and~~ with a yield that results in:*
   i. *At the beginning of the Index Strategy Term, the book value of the Fixed Income Asset Proxy equal to the Index Strategy Base minus the Derivative Asset Proxy Value;*
   ii. *At the end of the Index Strategy Term, the book value of the Fixed Income Asset Proxy, assuming no change in yield, projected to equal the Index Strategy Base;*

We also recommend adding a drafting note that outlines the permitted flexibility in the valuation of the market to fair value as long as other requirements are met as follows:

> ***Drafting Note**: Interim Values are considered consistent with the Hypothetical Portfolio approach so long as the method used to determine the market/fair value of fixed income assets within the Interim Value calculation is equitable to the contract holder and the company and the requirements of the asset proxy portfolio (Fixed Income Asset Proxy, Derivative Asset Proxy) are met.*

2. **MVA Applied to Strategy Value -** We also want to raise several considerations related to the provisions for MVAs that apply to Strategy Values. We again appreciate the flexibility to accommodate a range of product designs and understand the Subgroup's reasoning for pointing to IIPRC-A-07-I-3 (*Additional Standards for Market Value Adjustment Feature Provided Through a Separate Account*) but believe that revisions to IIPRC-A-07-I-3 are needed to ensure that ILVAs function under these additional standards as intended. Namely, several components of IIPRC-A-07-I-3 are focused on the mechanics of traditional Modified Guaranteed Annuity (MGA) contracts. We have suggested targeted revisions in the attached redline of the standards to explicitly incorporate ILVAs and delineate the relevant features from MGAs, without fundamentally affecting the underlying conceptual framework. We have also suggested a revision to the name of the standards based on the Subgroup's response to commenters related to Section AA of the ILVA Compact Standards. Because the ILVA Compact Standards do not restrict how ILVA contracts are funded (general account vs. separate account), our revisions aim to maintain consistency with this backdrop in the associated additional standards for MVAs.

   We are attaching a redline of IIPRC-A-07-I-3 reflecting the recommendations noted above.

3. **Nonforfeiture Demonstration -** Finally, after reviewing the Discussion Draft and the response to commenters, we believe it important to clarify the interaction between an MVA and the nonforfeiture demonstration from Section 7 of the NAIC Variable Annuity Model Regulation (Model #250). Our interpretation is that whether an MVA is applied to the Fixed Income Asset Proxy within the Interim Value calculation or is applied to the Strategy Value, the conceptual outcome for the nonforfeiture demonstration should be the same. Namely, the MVA is either reflected in both the projected cash surrender value of the ILVA contract

and the minimum nonforfeiture value (via being included in the net investment return) or it is omitted in both. In the case where the MVA is applied to the Strategy Value, our interpretation is that linking it to the current Separate Account MVA Standards means that there will not be a constraint on the magnitude of the MVA introduced by the Model #250 nonforfeiture demonstration.

d. **Section 1(B)(1)(d)(vii)(3) should allow for an additional methodology for the Fixed Income Asset Proxy calculation**

The ACLI and CAI advocate allowing the use of an additional fair value approach when determining the market value of the Fixed Income Asset Proxy. Many companies use a fair value approach, in which appropriate market parameter are used as inputs for the valuation, for the entire Interim Value (both the Derivative Asset Proxy and the Fixed Income Asset Proxy). It would be appropriate to explicitly allow for this market-based approach to be used in valuing the Fixed Income Asset Proxy, as the approach is consistent with aligning the ILVA to a variable annuity as outlined in the drafting note at the bottom of page 2 of AG 54. This approach would align the Interim Value with the market value of the hypothetical asset supporting the ILVA and make it consistent with a variable annuity. We recommend that the Subgroup consider the following revised language. (We have also updated language in item iii to be consistent with our previous comments):

3. The market value of the Fixed Income Asset Proxy

i. may be determined using a fair value methodology that must produce an initial market value of the Fixed Income Asset Proxy equal to the Index Strategy Base minus the Derivative Asset Proxy Value; or

ii. may be determined using a fair value methodology of the Fixed Income Asset Proxy using an appropriate broad market-based credit curve that is consistent with the overall credit risk profile of the underlying fixed income portfolio supporting the liability; or

iii. is its book value using the yield specified in 2. above adjusted using an MVA ~~appropriate for the maturity of the fixed income assets supporting the ILVA~~ that is equitable to the contract holder and the company;…

e. ***Section 1(B)(1)(d)(vi) providing for a justification of trading costs should be further clarified***

While we appreciate the deletion from the draft ILVA Compact Standards of the 10bps limit on trading costs, allowing only trading costs that are determined based on actual or recent historical data is still overly restrictive. Companies may rely on longer term historical trading costs or anticipated future projections of trading costs. AG 54 permits "any Trading Costs [that] represent reasonably expected or actual costs" and requires an actuarial certification to that effect. We propose that the Subgroup incorporate the language of AG 54 and require an actuarial certification in section 1(B)(1)(g).

Proposed (B)(1)(d)(vi) language ~~(replacing the entire (B)(1)(d)(vi))~~
Justification including the basis for trading costs reflected in the interim value. Justification may be demonstrated by either using actual trading costs or reasonably expected trading costs at the time the interim value is determined~~or by using trading costs for the same or substantially similar derivative assets based on the trading costs in a recent historical period.~~

Proposed new certification in (B)(1)(g)
An actuarial certification is required that any Trading Costs represent reasonably expected or actual costs at the time the Interim Value is calculated.

f. The valuation techniques for the Derivative Asset Proxy should be consistently aligned with AG 54

We appreciate the Subgroup's effort to revise the language of section 1(B)(1)(g)(v) to conform to AG 54. However, there remains an inconsistency within the Discussion Draft with regard to permissible valuation techniques for the Derivative Asset Proxy. In section 1(B)(1)(g)(v), the draft allows different valuation techniques (i.e., "standard Black-Scholes methods, Monte-Carlo Simulation techniques, and other market consistent option valuation techniques for more complex options"). However, in section 1(B)(1)(d)(vii)(5), the draft 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." We believe that these statements conflict with each other and that section 1(B)(1)(d)(vii)(5) should be aligned with the language of section 1(B)(1)(g)(v) and the AG 54 framework***.***

III. Contract Provisions

a. Sections 3(C) (Assignment) and 3(U) (Ownership) should allow restrictions on assignments and ownership changes to accommodate SEC Rule 12h-7

In its response to comments, the Subgroup noted that assignment provisions are uniform across standards and assignment and stated that ownership changes are important consumer protections. The Subgroup requested additional information regarding the rationale for allowing restrictions on assignment, which we address below.

1) Why are restrictions on assignments important for ILVAs, specifically?

Response: Life insurance companies must reserve the right to approve and restrict assignments of ILVA contracts in order to be exempt from burdensome and irrelevant periodic reporting requirements under the Securities Exchange Act of 1934 (the 1934 Act) applicable to public companies that would otherwise apply. Unlike ILVAs, the issuance of traditional variable annuities does not subject an insurance company to these onerous 1934 Act reporting requirements. Because traditional variable annuities entail the pass through of separate account investment experience, they are considered by the SEC to have been issued by insurance company separate accounts that are registered as investment companies under the Investment Company Act of 1940 (the 1940 Act). As such, the separate accounts are subject to alternative periodic reporting and the issuing insurance companies are not subject to general periodic reporting applicable to public companies under the 1934 Act. Accordingly, insurance companies issuing traditional variable annuities do not need to rely on Rule 12h-7 and are therefore not required to restrict assignments of traditional variable annuity contracts.

2) What is involved in reporting requirements that would be important enough to take away consumers' right to assign or change ownership of their property?

Response: Issuers of ILVAs depend on Rule 12h-7 under the1934 Act for an exemption from reporting obligations under the 1934 Act that were designed for companies with publicly traded securities, not for issuers of insurance products that are registered under the Securities Act of 1933 and regulated as insurance under state law. These reporting obligations include detailed periodic financial reporting, quarterly on Form 10-Q and annually on Form 10-K, as well as current reports on Form 8-K that are required to be filed by public companies upon the occurrence of certain material events of interest to shareholders. The SEC recognized that such periodic reporting was not necessary for the protection of regulated insurance product investors given, "first, the nature and extent of the activities of insurance company issuers, and their income and assets, and, in particular, the regulation of those activities and assets under state insurance law; and, second, the absence of trading interest in the securities." (SEC Release Nos. 33-8996: 34-59221 (January 16, 2009).)[6]

We also highlight that there is clear precedent for Compact standards to permit restrictions on assignability so that insurers may comply with specific provisions of the federal securities laws. Both IIPRC-L-06-I-4 (*Additional Standards for Private Placement Plans for Individual Variable Adjustable Life Insurance Policies*) and IIPRC-AB-03-I-PP (*Additional Standards for Private Placement Plans for Individual Deferred Variable Annuity Contracts*) (together, the Private Placement Standards) provide that a private placement contract shall not include any restrictions on the availability of assignments, except "in situations where restrictions are required for purposes of satisfying applicable laws or regulations, *or the requirement that the assignee be a qualified owner*" (emphasis added). The ability to restrict assignments to qualified owners is significant, as the Private Placement Standards recognize that a "qualified owner" is an owner who is "an accredited investor or qualified purchaser, or both as those terms are defined by the Securities Act of 1933, as amended, the Investment Company Act of 1940, as amended, or the regulations promulgated under either of those acts." Thus, the Private Placement Standards permit insurers to restrict assignments in order to comply with specific provisions under the federal securities laws relating to private placements. Likewise, the ILVA standards should permit insurers to restrict assignments in order to comply with the Rule 12h-7 conditional exemption from public company reporting.

3) The assignment and ownership sections limit any restriction except where required to meet applicable laws or regulations. Why wouldn't the limitation on assignment and ownership changes in the standard meet the exception in (e) of the rule?

<u>Response:</u> In light of the SEC's second justification for the exemption from 1934 Act reporting requirements – the lack of trading in the securities - Rule 12h-7(e) requires that "[t]he issuer [take] steps reasonably designed to ensure that a trading market for the securities does not develop, including, except to the extent prohibited by the law of any State or by action of the insurance commissioner, bank commissioner, or any agency or officer performing like functions of any State, *requiring written notice to, and acceptance by, the issuer prior to any assignment or other transfer of the securities and reserving the right to refuse assignments or other transfers at any time on a non-discriminatory basis*" (emphasis added). In correspondence and discussions that the ACLI and CAI had with the SEC staff shortly after Rule 12h-7 was adopted, the SEC staff indicated it was not clear that Compact uniform product standards constituted the "law of any State" within the meaning of Rule 12h-7, or that Compact standards constitute action of an agency "performing like functions of any State" within the meaning of Rule 12h-7. Therefore, the SEC staff was not able to provide

[6] We would generally note that, unlike life insurance policies, consumers rarely seek to assign or change ownership of annuity contracts due to significant constraints on such transactions under the Internal Revenue Code. Assignment or change of ownership of qualified annuity contracts, including individual retirement annuities (IRAs), is prohibited under the Code. For non-qualified annuities, assignment or change of ownership to anyone other than a spouse or grantor trust is a taxable event that is treated as a surrender of the annuity contract for tax purposes, ending tax deferral and subjecting the original owner to income tax on all earnings.

comfort that requirements set forth in Compact standards fit within the exception to the Rule 12h-7(e) requirement. Accordingly, because insurance companies need to rely on Rule 12h-7 so that they are not required to file Form 10-Ks, Form 10-Qs and other public company reports, it is essential that the Compact permit ILVA contracts filed with the Compact to include a provision permitting such restrictions on assignments, lest insurance companies be unable to file their ILVA contracts through the Compact. We note that many states have permitted such provisions to be included in ILVA contracts.

For the reasons set forth above we are recommending that Sections 3(C) and 3(U) and the accompanying drafting notes be revised to read as follows:

C. ASSIGNMENT

(1) The contract shall contain an assignment provision. The contract shall not include any restrictions on the availability of contract assignments, except in situations where restrictions are required for purposes of satisfying applicable laws or regulations, including Rule 12h-7 under the Securities Exchange Act of 1934, as amended.

(2) The contract shall describe procedures for assignments and shall state that assignments, unless otherwise specified by the owner, shall take effect on the date the notice of assignment is signed, subject to any payments made or actions taken by the company prior to receipt of this notice.

(3) The contract may state that the company shall not be liable for the validity of the assignment.

Drafting Note*: Restrictions on assignment in contracts such as right of first refusal or first offer provisions are prohibited by Item (1). A company that relies on the exemption provided by Rule 12h-7 under the Securities Exchange Act of 1934 from the requirement to file reports pursuant to Section 15(d) of that Act may, for the purpose of complying with that regulation, require written notice by the contract owner to, and acceptance by, the company to any assignment or other transfer of the contract and reserving the right to refuse assignments or other transfers at any time on a non-discriminatory basis.*

U. OWNERSHIP

(1) The contract shall contain an ownership provision. The provision shall describe the procedures for designating or changing the owner and indicating when the designation is effective. The contract shall not include any restriction on change of owner other than for purposes of satisfying applicable laws or regulations, including Rule 12h-7 under the Securities Exchange Act of 1934 Act, as amended.

(2) The contract shall state that changes in owner designation, unless otherwise specified by the owner, shall take effect on the date the notice of change is signed by the owner, subject to any payments made or actions taken by the company prior to receipt of this notice.

(3) The contract shall state what happens on the death of the owner.

Drafting Note: *Restrictions on change of owner in contracts such as right of first refusal or first offer provisions are prohibited by Item (1). A company that relies on the exemption provided by Rule 12h-7 under the Securities Exchange Act of 1934 from the requirement to file reports pursuant to Section 15(d) of that Act may, for the purpose of complying with that regulation, require written notice by the contract owner to, and acceptance by, the company to any change in ownership or other transfer of the contract and reserving the right to refuse assignments or other transfers at any time on a non-discriminatory basis.*

b. Section 3(K) (Discontinuation of or Substantial Change to an Index) should allow for a broader range of reasons for replacement of an Index

We respectfully resubmit our original comment on Section 3(K) for the Subgroup's consideration: 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 replace an index during an Index Strategy Term 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.

We believe that the revised ILVA standards should contemplate the legitimate reasons why an insurer may *need* to replace an index *during* an Index Strategy Term, beyond just discontinuation or substantial change. For example, while an index continues to exist and without a substantial change in that index's methodology, the following disruptive events may arise:

- The index could stop publishing values for short or extended periods of time, or even indefinitely, due to severe market or operational disruptions or an unreliable index provider. In such instances, it may become essential for an insurer to replace the index to minimize product disruption.

- An index provider could unilaterally exercise a contractual right to terminate its licensing agreement with the insurer, a decision over which the insurer has no control. Index providers reserve rights to terminate licensing agreements (albeit, normally with advance notice). If the index provider were to exercise such a right, the insurer would lose the ability to use that index. Conversely, an insurer may have good reason to exercise its contractual right to terminate a licensing agreement. For instance (without limitation), in order to protect itself and its customers, an insurer may move to terminate a licensing agreement if the index provider is in material breach of applicable law, subject to a significant regulatory proceeding, or otherwise engaged in harmful business activities. It's also possible that the index provider and insurer could fail to successfully negotiate renewal of a licensing agreement upon expiration, perhaps because the index provider seeks an unacceptable licensing fee. In any event, without an effective licensing agreement in place, the insurer would need to replace the index for any ongoing Index Strategy Terms.

- The market for instruments used by a company to hedge its Index Strategies could experience significant volatility or illiquidity, making hedging of the Index Strategies exceedingly costly or impractical. In that case, in order for the product to operate as intended, the insurer may need to replace the index associated with the problematic instruments.

For these reasons, we believe the standard in Section 3(K) must be broadened. We acknowledge that Section 3(K) currently tracks the Compact standards for FIAs.[7] However, on this issue, we believe there is a compelling reason to deviate from the FIA standards: The staff of the SEC has required companies to disclose with specificity in their ILVA prospectuses the reasons why an index may be replaced during an Index Strategy Term and, in response to such staff comments, companies have listed the reasons set forth in our comment. Of course, the views of the SEC and its staff are not relevant to FIAs, thus supporting a deviation from the FIA Compact standards in this limited context.

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[7] *See 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-I-1, Section 3(C).*

We also note that expanding the reasons for replacing an index during an Index Strategy Term will not give rise to significant risk of abuse by insurers, primarily for two reasons. First, the replacement of an index would still be subject to Compact approval. Second, insurers do not actively seek to replace indexes during Index Strategy Terms, as replacing an index is burdensome, costly, and presents significant operational and other challenges. Nevertheless, in order to protect customers and companies, the ILVA standard needs to be broader because indexes may *need* to be replaced for reasons other than discontinuation or substantial change.

Accordingly, we submit that Section 3(K) should be revised as follows:

K. ***REPLACEMENT, DISCONTINUATION OF OR SUBSTANTIAL CHANGE TO AN INDEX DURING AN INDEX STRATEGY TERM***

(1) The contract shall contain a provision indicating what occurs when any index is replaced during an Index Strategy Term ~~discontinued or the calculation of an index is substantially changed~~, with the provision being labeled as such. The provision shall state that ~~if~~ the index may be replaced during an Index Strategy Term if the index is discontinued, index values are not available, the insurer is no longer licensed or otherwise permitted to use the index, the index's calculation changes substantially, or hedging instruments become difficult to acquire or the cost of hedging becomes excessive. If the index is to be replaced under this provision ~~is discontinued or if the calculation of the index is changed substantially~~, the company may substitute a comparable index subject to approval by the Interstate Insurance Product Regulation Commission. The contract shall also specify that, before a substitute index is used, the company shall notify the owner and any assignee of the substitution.

(2) The approval shall be contingent on the company providing the IIPRC with either confirmation ~~that the index has been discontinued~~ or documentation of the ~~substantial change to the index and the~~ reasons supporting the need for the index replacement~~to be discontinued~~.

c. The ILVA Compact Standards should permit GLB riders without a benefit base

In its response to comments, the Subgroup requested clarification for what is meant by "GLB riders without a benefit base," what the base for GLB benefits would be in the absence of a benefit base, and why removing the GLB benefit base is important for ILVA products in particular.

The industry is currently offering variations of the traditional GLBs that offer protected income solutions. One of these solutions is more prevalent with ILVA contracts than variable annuity contracts due to the structure of the crediting of index interest and buffer or floor protections inherent in these designs.

This protected income approach has advantages over a traditional GLWB, as the level of income payments are tied to the performance of the Index Strategies in which the consumer decides to invest. Therefore, while traditional GLWBs rarely see step-ups in their income amounts once the income phase begins, the protected income solutions will show increases in income payments when positive performance occurs in the Index Strategies during the income phase. Consumers can choose a fully protected option during the pre-income and/or income phase thus providing full downside protection, however, they also have the ability to choose other options with less downside protection and higher upside potential. Since income payments adjust by the Index Strategy performance during the income phase, regardless of income withdrawals, rider or other fees, companies and consumers do not need a benefit base to track these income payments during the Income Phase. The allowable income amounts change by that performance. When the account value of the contract is reduced to zero by anything other than an excess withdrawal, the income amount for that year becomes a fixed annual lifetime amount for the consumer.

While having the benefit base requirement may apply to certain GLWB designs, it is not necessary with this protected income approach. Protected income solutions offer the consumer the ability to have a floor but also offers additional options for levels of protection and growth potential. Applying a benefit base requirement to protected income solutions will complicate the benefit design and process for consumers. Protected income solutions, as long as a floor option is offered by the benefit, should be allowed for use with the ILVA products filed through the Interstate Compact.

To accommodate GLB riders without a benefit base, we recommend the addition of item 11 in Section 1(A) of the ILVA Compact Standards, which would state the following:

> *(11) If the ILVA product contains a guaranteed living benefit (GLB), the GLB will be subject to IIPRC-A-03-1-GLB: Additional Standards for GLB for Individual Deferred Variable Annuities. In the ILVA market, GLBs may allow changes to income payments during the income phase based upon the performance of index strategies such that income payments may increase or decrease during the income phase, and will be approved provided that the GLB offers (but the contract owner is not required to elect) an option that would act as a floor on the benefits received, such as a 0% floor or 100% Buffer. A benefit base is not required once income payments have begun as the income payments would be adjusted based upon the performance of the Index Strategies.*

IV. <u>Application Standard Acknowledgement</u>

We respectfully resubmit for the Subgroup's consideration our prior comment that Section M(8) of the Individual Annuity Application Standards (the "Application Standards") should not require comparisons of other product types, as such comparisons are unnecessary, inconsistent with other Compact standards, and may raise issues under other applicable law.

In our initial comments on the Application Standards, we requested the product comparison in Section M(8) be removed. In that regard, we noted that such comparisons are not required under Compact standards for fixed index annuities, fixed rate annuities and variable annuities, and we urged 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. While we were certainly encouraged that the Subgroup deleted a similar requirement from Section X of the original draft of the ILVA Compact Standards, the Subgroup did not accept our request with respect to the Application Standards, stating in the Subgroup's Response that "the application shall include an acknowledgment by each proposed owner of receipt of a written product comparison of each indexed-linked variable annuity strategy with a comparable non-variable indexed annuity strategy and a variable annuity." The Subgroup further noted in its Response that "if the information has been disclosed to the consumer, including disclosure in a prospectus, then the company can meet the acknowledgement."

We continue to believe that such comparisons are unnecessary and inconsistent with other Compact application standards for the reasons raised in our initial comments. The comparison is especially problematic for companies that do not offer all of the product types required by the comparison, and it would not be appropriate for those companies to artificially invent information for that purpose. We further submit that such comparisons may raise issues under other applicable law. For example, we strongly suspect that the SEC would not permit a comparison of other products in an ILVA prospectus. Nor do we expect that FINRA would allow any such comparisons in marketing material. Accordingly, we once again request that the comparison requirement be removed from the Application Standards entirely.

The ACLI and the CAI appreciate this opportunity to comment on the revised 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,

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