DATE: March 7, 2016

FROM: Industry Advisory Committee

SUBJECT: IIPRC Private Placement Standards -- Rationale for Proposed Changes

The existing Private Placement Standards for Life and Annuity do a good job of setting appropriate standards with respect to policies and contracts that contain investment options that are valued each business day and are available for investment or redemption as of each business day. However, it has become commonplace for private placement products to offer investment options which have limited availability and/or limited liquidity. The types of investment options with these limitations include private funds (including hedge funds) and certain managed accounts.

When there are limitations on availability, the terms of the limitations may vary by investment option. They may include the requirement of a notice period (typically 5 days for hedge funds) before a contribution can be made, and may involve limitations on dates when funds can be accepted; for example, contributions may be limited to the first business day of each month.

When there are limitations on liquidity, the terms of the limitations may also vary by investment option. They may involve the requirement of a notice period (typically 60 to 95 days for hedge funds) before a redemption can be effective, and may involve limitations on dates when funds can be redeemed (for example, redemption effective dates may be limited to the last business day of each month). This notice period may not be applicable for redemptions on account of death benefit payments. There may be periods of time (typically 8 to 35 days for hedge funds) between the effective date of a redemption and the date the valuation can be completed, with unit values determined. There may also be a period of time between the effective date of a redemption and the date the cash is available for disbursement. At times, cash disbursements may occur in multiple payments.

An informal survey of several companies in the marketplace was taken before we began our work to confirm that development of an enhanced standard was of interest to a number of companies.

We believed it is appropriate to amend the standards so that these relatively complex features can be better understood and so that standardized methods for addressing them are provided to regulators and companies.

To address limited availability and limited liquidity, the proposed changes include:
1. Definitions of new terms to address limited availability, including “contribution”, “contribution date” and “contribution notice period”.

2. Definitions of terms to address limited liquidity, with the inclusion of different terms due to the fact that valuation and liquidity may occur on different dates, including a revised definition of “liquidity date” and new terms “redemption”, “redemption date” and “redemption notice period”.

3. An expansion of the DEFERRAL AND VALUATION OF PAYMENTS section to address limited liquidity considerations. This generally permits deferral of payments from the separate account until separate account funds are disbursed. For life insurance, it also permits deferral of claim payment until the valuation has been completed and the death benefit can be accurately determined.

4. A section was added (POLICY TRANSACTIONS for the life insurance standard or CONTRACT TRANSACTIONS for the annuity standard) to add clarity for use of the limited availability and limited liquidity terminology.

5. Changes were also made in a number of other sections to address the limited availability and/or limited liquidity considerations.

Changes are also being recommended in two other areas:

1. The definition of “qualified owner” was expanded to also include a “qualified client”, and the term was used in the Scope paragraph.

2. When a qualified owner ceases to be a qualified owner, changes were made so the insurer has alternatives which may be used to address or remedy the situation. It had been pointed out that this flexibility is desirable to allow each insurer to address compliance based on its interpretation of the applicable laws and regulations. Following the recommended changes, alternatives available to the insurer will include (a) requiring a surrender, (b) requiring a policy exchange, or (c) requiring a transfer of funds from the exempt fund(s) to a non-exempt fund or the general account.