

## Draft Pending Adoption

Draft: 12/21/22

Life Insurance and Annuities (A) Committee  
Tampa, Florida  
December 14, 2022

The Life Insurance and Annuities (A) Committee met in Tampa, FL, Dec. 14, 2022. The following Committee members participated: Judith L. French, Chair (OH); Carter Lawrence, Vice Chair (TN); Mark Fowler (AL); Karima M. Woods represented by Philip Barlow (DC); Colin M. Hayashida represented by Patrick P. Lo (HI); Doug Ommen (IA); Vicki Schmidt (KS); James J. Donelon (LA); Marlene Caride (NJ); Barbara D. Richardson (NV); Adrienne A. Harris represented by Mona Bhalla (NY); Cassie Brown represented by Rachel Hemphill (TX); Scott A. White (VA); and Nathan Houdek and Richard Wicka (WI). Also participating was: Grace Arnold (MN).

### 1. Adopted its Nov. 15 Minutes

Director French said the Committee met Nov. 15. During this meeting, the Committee took the following action: 1) adopted its Summer National Meeting minutes; 2) adopted the 2023 Generally Recognized Expense Table (GRET); 3) adopted the Life Actuarial (A) Task Force's 2023 proposed charges; and 4) adopted its 2023 proposed charges.

Commissioner Lawrence made a motion, seconded by Commissioner Caride, to adopt the Committee's Nov. 15 minutes (Attachment One). The motion passed unanimously.

### 2. Adopted the Report of the Life Actuarial (A) Task Force

Hemphill gave the Life Actuarial (A) Task Force report. She said the Task Force met Dec. 11–12. She said there are a few items she wants to highlight for the Committee. She said the Task Force adopted an index-linked variable annuity (ILVA) actuarial guideline. She said this actuarial guideline specifies the conditions under which an ILVA is consistent with the definition of a variable annuity and exempt from the *Standard Nonforfeiture Law for Individual Deferred Annuities* (#805), and it specifies nonforfeiture requirements consistent with variable annuities.

Hemphill said the Task Force adopted revisions to *Actuarial Guideline XLIX-A—The Application of the Life Illustrations Model Regulation to Policies with Index-Based Interest to Policies Sold On or After December 14, 2020* (AG 49-A) regarding indexed universal life (IUL) illustrations. She said there was a robust discussion of potential changes, including actuarial and non-actuarial changes to the *Life Insurance Illustrations Model Regulation* (#582). She said the Task Force directed the IUL (A) Subgroup to further consider and discuss comments received and potential actuarial changes. There was not a motion to propose action to the Committee at this time; however, if the Committee were to choose to work on non-actuarial revisions to Model #582 to promote consumer understanding, the Task Force and the Subgroup would be happy to coordinate any actuarial changes that it contemplates with those non-actuarial changes.

Hemphill said the Task Force continues to work to develop a replacement economic scenario generator (ESG). She said the Task Force heard presentations from the American Academy of Actuaries (Academy) on a simplified corporate model, interest rate stylized facts, and acceptance criteria, as well as a presentation from NAIC staff on qualitative results from the ESG Field Test. She explained that these presentations followed similar presentations and discussions held during the Task Force's virtual meetings since the Summer National Meeting, including: 1) a regulator-to-regulator session on Sept. 1, pursuant to paragraph 6 (consultations with NAIC staff members related to NAIC technical guidance) of the NAIC Policy Statement on Open Meetings, where NAIC staff provided technical guidance relating to acceptance criteria for the ESG, and no action was taken; and 2) public calls on Sept. 29 on equity model stylized facts and Oct. 27 on corporate model stylized facts and acceptance criteria. She said there

## Draft Pending Adoption

has been significant ongoing work to ensure that the replacement ESG will be reasonable, prudent, and suitable for statutory valuation.

Hemphill said the Task Force adopted an NAIC staff memorandum and recommendation replacing the London Interbank Offered Rate (LIBOR) with the Secured Overnight Financing Rate (SOFR) to be used for setting swap spreads effective Dec. 30. This change is consistent with previously adopted Amendment Proposal Form (APF) 2022-04, which was incorporated in the 2023 *Valuation Manual*. Hemphill said the Task Force adopted an NAIC staff memorandum providing guidance on negative interest maintenance reserve (IMR), addressing an industry concern raised in a letter to the Statutory Accounting Principles (E) Working Group that there could be a potential double-counting if a net negative IMR were reflected in principle-based reserving (PBR) or in asset adequacy testing (AAT), despite being a non-admitted asset. This memorandum reflected NAIC staff and the Task Force's interpretation and guidance that the non-admitted asset would not be reflected in the PBR or AAT.

Birny Birnbaum (Center for Economic Justice—CEJ) said he wants to comment on IUL illustrations. He said while he appreciates the efforts of the actuaries on the Task Force to address illustration issues, the revisions to AG 49-A as a “quick fix” for IUL illustrations will not fix any of the structural problems with IUL illustrations or illustrations more broadly. He said the stated goal of AG 49-A and its various revisions has been to stop unrealistic and deceptive information being presented to consumers, and the Task Force efforts with AG 49-A, including the latest version, have not just failed to address IUL illustration problems, but they have made the situation worse.

Birnbaum said for any other investment, consumers are told that past performance is not a guarantee of future performance, and back-testing is prohibited. He said AG 49-A does not just permit such back-testing; it requires back-testing. He said in addition to memorializing a discredited practice in consumer financial disclosures, each version of AG 49-A has prompted insurers to develop more complex and opaque product designs simply to game AG 49-A and continue to produce unrealistic illustrated accumulation values.

Birnbaum said consumers are now in a bizarre situation where sold policies with now discredited illustrations will continue to get updated illustrations using the same discredited methodology because each version of AG 49-A grandfathers the previous discredited illustration regime. He said any neutral evaluation of the Task Force's performance in protecting consumers from IUL illustrations must conclude that the Task Force, despite its best efforts, has failed not once, not twice, but at least three times. He said the Task Force's failure is largely a result of trying to work within the framework of Model #582, despite that regulation being developed and adopted before the introduction of indexed products; i.e., products that reference market outcomes instead of products that reflect insurer investment outcomes.

Birnbaum said it should be clear that the issue of illustrations needs to be moved out of the Task Force and to a group charged with examining Model #582 and the *Annuity Disclosure Model Regulation* (#245) to modernize life and annuity illustrations consistent with best practices of consumer financial disclosure. While the Task Force may have a role if there are technical questions, the lead of this effort should be a new working group of the Committee.

Director French said the Task Force has been discussing IUL illustrations and the potential need for actuarial and non-actuarial changes. She explained that the revisions to AG 49-A are not so much a “quick fix,” but rather a “quick first step” in addressing issues with IUL illustrations.

Hemphill made a motion, seconded by Commissioner White, to adopt the report of the Life Actuarial (A) Task Force. The motion passed unanimously.

## Draft Pending Adoption

### 3. Heard an Update from the Accelerated Underwriting (A) Working Group

Commissioner Arnold updated the Committee on the work of the Accelerated Underwriting (A) Working Group. She explained that since the Accelerated Underwriting Educational Report was adopted by the Committee at the Spring National Meeting, an ad hoc group of state insurance regulators has been meeting to consider specific guidance for state insurance regulators with respect to accelerated underwriting (AU) in life insurance. She said this ad hoc group identified market conduct as one of the areas where additional guidance could be helpful, and as the ad hoc group started putting pen to paper, it realized that coordinating with other NAIC groups is going to be critical to developing specific guidance.

Commissioner Arnold said the Working Group's task is narrowly focused on AU in life insurance; any guidance developed needs to be consistent with, and supportive of, all the related initiatives and work being undertaken by other NAIC groups, like the Collaboration Forum initiative under the Innovation, Cybersecurity, and Technology (H) Committee; the Market Conduct Examination Guidelines (D) Working Group; the Big Data and Artificial Intelligence (H) Working Group; and others. She said in mid-October, the ad hoc group received feedback from NAIC staff and state insurance regulators involved with other NAIC groups regarding the Committee's approach and efforts to ensure consistency and coordination.

Commissioner Arnold said the ad hoc group has incorporated the feedback it received from other NAIC groups, and it plans to have an open meeting in the new year to expose the guidance, which includes a referral to the Market Conduct Examination Guidelines (D) Working Group.

### 4. Heard and Update from the Annuity Suitability (A) Working Group

Commissioner Ommen updated the Life Insurance and Annuities (A) Committee on the work of the Annuity Suitability (A) Working Group. He said the Working Group continues to work on the implementation of the 2020 revisions to the *Suitability in Annuity Transactions Model Regulation* (#275). He said as of Nov. 27, 29 states have adopted the 2020 revisions, and six jurisdictions have legislation pending. He said work continues on the frequently asked questions (FAQ) document addressing the safe harbor/comparable standards provision in Model #275. He said Iowa and the other states that have adopted the 2020 revisions are gathering information related to the enforcement of the safe harbor, which will help to inform the Working Group's work on the FAQ document.

Commissioner Ommen reminded the Committee that Section 6E specifies the following requirements under the comparable standards safe harbor for all companies:

- (1) Recommendations and sales of annuities made in compliance with comparable standards shall satisfy the requirements under this regulation. This subsection applies to all recommendations and sales of annuities made by financial professionals in compliance with business rules, controls and procedures that satisfy a comparable standard even if such standard would not otherwise apply to the product or recommendation at issue.

He said Iowa is seeing progress as insurance companies are working with securities broker-dealer partners to implement business rules, controls, and procedures that are complementary to the securities Regulation Best Interest (Reg BI) requirements but are specifically designed for fixed indexed annuities.

### 5. Heard an Update on the Enhanced Cash Surrender Value

Director French updated the Committee on the survey that was sent to states to gather information on enhanced cash surrender value (CSV) offers. She said 31 jurisdictions participated in the survey. She said the results will be reviewed and inform any next steps on the issue.

## **Draft Pending Adoption**

Having no further business, the Life Insurance and Annuities (A) Committee adjourned.

SharePoint/NAIC Support Staff Hub/Member Meetings/...

## PROJECT HISTORY

### 2023 REVISIONS TO ACTUARIAL GUIDELINE XLIX-A— THE APPLICATION OF THE LIFE ILLUSTRATIONS MODEL REGULATION TO POLICIES WITH INDEX-BASED INTEREST SOLD (ON OR AFTER DECEMBER 14, 2020)

**1. What issues was the project intended to address?**

After the 2020 adoption of *AG XLIX-A— The Application of the Life Illustrations Model Regulation to Policies with Index-Based Interest to Policies Sold on or After December 14, 2020* (AG 49-A), state regulators developed concerns with some new product designs that illustrated more favorably than those based on a traditional capped Standard and Poor’s 500 index (S&P 500). In particular, the revisions to AG 49-A intend to improve illustrations for indexed universal life (IUL) products with uncapped volatility-controlled funds and a fixed bonus.

**2. What states participated in drafting the model?**

The following states are currently members of the IUL Illustration (A) Subgroup of the Life Actuarial (A) Task Force: Minnesota (Chair), California, Connecticut, Illinois, Indiana, Iowa, Nebraska, New York, Ohio, Texas, Utah, and Virginia.

**3. What general procedure was followed in drafting the model? What efforts were made to assure that all interested parties were provided an opportunity to comment during the drafting process?**

To address the illustration issues, open meetings of the existing IUL Illustration (A) Subgroup were held to draft revisions to AG 49-A (see Table 1). The subgroup coordinated with all of the industry interested parties, including representatives from the American Council of Life Insurers and the American Academy of Actuaries. Notice of the open conference calls was posted to the NAIC’s home page on the Internet and emailed to over 500 interested parties.

Table 1:

Meeting Date	Open/Regulator-only?
7/18/2022	Open
10/12/22	Open
11/9/22	Open

**4. What significant issues were raised during the drafting process, and how were those issues resolved?**

The key question the group faced was whether to address the issues with the illustrations of specific IUL product designs by revising AG 49-A or to more comprehensively address life insurance illustration issues by opening up the *Life Insurance Illustrations Model Regulation* (#582). The Task Force decided to move forward with a phased approach that would address the immediate issues impacting by revising AG 49-A, while continuing to consider larger changes to life insurance illustration regulations.

**5. What are the implications of this project for accreditation and codification?**

The Guideline should be handled in a manner that is consistent with the treatment of other guidelines.

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**Disclaimer:** The revisions to Actuarial Guideline 49-A have not been adopted by the NAIC's Life Insurance and Annuities (A) Committee or the Executive (EX) Committee and Plenary and are thus subject to change or to non-adoption. However, the revisions have been adopted by the Life Actuarial (A) Task Force and this version has been posted to the Task Force's public website to provide regulators and interested parties with the most current language.

*Revised Actuarial Guideline - Draft: 1/13/2022*

*Adopted by Life Actuarial (A) Task Force – 12/11/2022*

*Adopted by Life Insurance and Annuities (A) Committee – TBD*

## **Actuarial Guideline XLIX-A**

### **THE APPLICATION OF THE LIFE ILLUSTRATIONS MODEL REGULATION TO POLICIES WITH INDEX-BASED INTEREST SOLD (On or After December 14, 2020)**

#### **Background**

The *Life Insurance Illustrations Model Regulation* (#582) was adopted by the NAIC in 1995. Since that time there has been continued evolution in product design, including the introduction of benefits that are tied to an index or indices. Although these policies are subject to Model #582, not all of their features are explicitly referenced in the model, resulting in a lack of uniform practice in its implementation. In the absence of uniform guidance, two illustrations that use the same index and crediting method often illustrated different credited rates. The lack of uniformity can be confusing to potential buyers and can cause uncertainty among illustration actuaries when certifying compliance with Model #582.

This guideline provides uniform guidance for policies with index-based interest. In particular, this guideline:

- (1) Provides guidance in determining the maximum crediting rate for the illustrated scale and the earned interest rate for the disciplined current scale.
- (2) Limits the policy loan leverage shown in an illustration.
- (3) Requires additional consumer information (side-by-side illustration and additional disclosures) that will aid in consumer understanding.

#### **Text**

##### **1. Effective Date**

This Actuarial Guideline shall be effective for all new business and in force illustrations on policies sold on or after December 14, 2020.

##### **2. Scope**

This Actuarial Guideline shall apply to any life insurance illustration that meets both (i) and (ii), below:

- i. The policy is subject to Model #582.
- ii. The policy offers Indexed Credits.

##### **3. Definitions**

A. Alternate Scale: A scale of non-guaranteed elements currently being illustrated such that:

- i. The Annual Rate of Indexed Credits for each Index Account does not exceed the lesser of

the maximum Annual Rate of Indexed Credits for the illustrated scale less 100 basis points and the credited rate for the Fixed Account. If the insurer does not offer a Fixed Account with the illustrated policy, the Annual Rate of Indexed Credits for each Index Account shall not exceed the average of the maximum Annual Rate of Indexed Credits for the illustrated scale and the guaranteed Annual Rate of Indexed Credits for that account. However, the Annual Rate of Indexed Credits for each Index Account shall never be less than the guaranteed Annual Rate of Indexed Credits for that account.

- ii. If the illustration includes a loan, the illustrated Policy Loan Interest Credited Rate shall not exceed the illustrated Policy Loan Interest Rate. For example, if the illustrated Policy Loan Interest Rate is 4%, the Policy Loan Interest Credited Rate shall not exceed 4%.
  - iii. All other non-guaranteed elements are equal to the non-guaranteed elements for the illustrated scale.
- B. Annual Net Investment Earnings Rate: Gross portfolio annual earnings rate of the general account assets (excluding hedge assets for Indexed Credits), less provisions for investment expenses and default cost, allocated to support the policy. Charges of any kind cannot be used to increase the Annual Net Investment Earnings Rate.
- C. Annual Rate of Indexed Credits: The total annualized Indexed Credits expressed as a percentage of the account value used to determine the Indexed Credits.
- D. Benchmark Index Account: An Index Account with the following features:
- i. The interest calculation is based on the percent change in S&P 500<sup>®</sup> Index value only, over a one-year period using only the beginning and ending index values. (S&P 500<sup>®</sup> Index ticker: SPX)
  - ii. An annual cap is used in the interest calculation.
  - iii. The annual floor used in the interest calculation shall be 0%.
  - iv. The participation rate used in the interest calculation shall be 100%.
  - v. Interest is credited once per year.
  - vi. The Hedge Budget used to determine the cap in 3 (D) (ii) does not exceed the Annual Net Investment Earnings Rate. Charges of any kind cannot be used to increase the annual cap.
  - vii. There are no enhancements or similar features that provide additional Indexed Credits in excess of the interest provided by 3 (D) (i) through 3 (D) (v), including but not limited to experience refunds, multipliers, or bonuses.
  - viii. There are no limitations on the portion of account value allocated to the account.
  - ix. A single Benchmark Index Account will be determined for each policy. This can be either an Index Account offered with the illustrated policy or determined according to Section 4 (A) (ii) for purposes of complying with this guideline. A policy shall have no more than one Benchmark Index Account.

- E. Fixed Account: An account where there are no Indexed Credits.
- F. Hedge Budget: For each Index Account, the total annualized amount assumed to be used to generate the Indexed Credits of the account, expressed as a percent of the account value in the Index Account. This total annualized amount should be consistent with the hedging program of the company.
- G. Index Account: An account where some or all of the amounts credited are Indexed Credits.
- H. Indexed Credits: Any interest credit, multiplier, factor, bonus, charge reduction, or other enhancement to policy values that is linked to an index or indices. Amounts credited to the policy resulting from a floor greater than zero on an account with any interest credit, multiplier, factor, bonus, charge reduction, or other enhancement to policy values that is linked to an index or indices are included.
- I. Loan Balance: Any outstanding policy loan and loan interest, as defined in the policy.
- J. Policy Loan Interest Rate: The current annual interest rate as defined in the policy that is charged on any Loan Balance. This does not include any other policy charges.
- K. Policy Loan Interest Credited Rate: The annualized interest rate credited that applies to the portion of the account value backing the Loan Balance:
  - i. For the portion of the account value in the Fixed Account that is backing the Loan Balance, the Policy Loan Interest Credited Rate is the applicable annual interest crediting rate.
  - ii. For the portion of the account value in an Index Account that is backing the Loan Balance, the Policy Loan Interest Credited Rate is the Annual Rate of Indexed Credits, net of any applicable Supplemental Hedge Budget, for that account.
- L. Supplemental Hedge Budget: For each Index Account, the Hedge Budget minus the minimum of the Annual Net Investment Earnings Rate and the Hedge Budget that is used in the determination of the Benchmark Index Account. The Supplemental Hedge Budget will never be less than zero. This amount should be consistent with the hedging program of the company.

#### 4. Illustrated Scale

The total Annual Rate of Indexed Credits for the illustrated scale for each Index Account shall be limited as follows:

- A. Calculate the geometric average annual credited rate for the Benchmark Index Account for the 25-year period starting on 12/31 of the calendar year that is 66 years prior to the current calendar year (e.g., 12/31/1949 for 2015 illustrations) and for each 25-year period starting on each subsequent trading day thereafter, ending with the 25-year period that ends on 12/31 of the prior calendar year.
  - i. If the insurer offers a Benchmark Index Account with the illustrated policy, the illustration actuary shall use the current annual cap for the Benchmark Index Account in 4 (A).
  - ii. If the insurer does not offer a Benchmark Index Account with the illustrated policy, the illustration actuary shall use actuarial judgment to determine a hypothetical, supportable current annual cap for a hypothetical, supportable Index Account that meets the definition of the Benchmark Index Account, and shall use that cap in 4 (A).



- B. For the Benchmark Index Account the Annual Rate of Indexed Credits shall not exceed the minimum of (i) and (ii):
- i. The arithmetic mean of the geometric average annual credited rates calculated in 4 (A).
  - ii. 145% of the Annual Net Investment Earnings Rate.
- C. For any other Index Account that is not the Benchmark Index Account in 3 (D), the Annual Rate of Indexed Credits illustrated as a percentage of the account value in the Index Account prior to the deduction of any charges used to fund a Supplemental Hedge Budget shall not exceed the minimum of (i) and (ii) for policies sold prior to May 1, 2023 and shall not exceed the minimum of (i), (ii), and (iii) for policies sold on or after May 1, 2023:
- i. The Annual Rate of Indexed Credits for the Benchmark Index Account calculated in 4 (B) plus the Supplemental Hedge Budget for the Index Account.
  - ii. The Annual Rate of Indexed Credits reflecting the fundamental characteristics of the Index Account and the appropriate relationship to the expected risk and return of the Benchmark Index Account. The illustration actuary shall use actuarial judgment to determine this value using lookback methodology consistent with 4 (A) and 4 (B) (i) where appropriate.
  - iii. The lesser of (1) and (2) multiplied by the Annual Rate of Index Credits for the Benchmark Index Account, calculated in 4 (B), divided by (2); plus, the Supplemental Hedge Budget for the Index Account:
    1. The Hedge Budget of the Index Account
    2. Hedge Budget of the Benchmark Index Account.
- D. For the purposes of compliance with Section 6 (C) of Model #582, the Supplemental Hedge Budget is subtracted from the Annual Rate of Indexed Credits before comparing to the earned interest rate underlying the disciplined current scale.

At the beginning of each calendar year, the insurer shall be allowed up to three (3) months to update the credited rate for each Index Account in accordance with 4 (B) and 4 (C).

## 5. Disciplined Current Scale

The earned interest rate for the disciplined current scale shall be limited as follows:

- A. If an insurer engages in a hedging program for Indexed Credits in an account, the assumed earned interest rate underlying the disciplined current scale for that account, inclusive of all general account assets, both hedge and non-hedge assets, that support the policy, net of default costs and investment expenses (including the amount spent to generate the Indexed Credits of the policy) shall not exceed the lesser of (i) and (ii):
- i. The Annual Net Investment Earnings Rate, plus 45% of the lesser of (1) and (2):
    1. Hedge Budget minus any annual floor, to the extent that the floor is supported by the Hedge Budget.

2. The minimum of the Annual Net Investment Earnings Rate and the Hedge Budget that is used in the determination of the Benchmark Index Account.
- ii. The Annual Rate of Indexed Credits plus the Annual Net Investment Earnings Rate minus the Hedge Budget.

These rates should be adjusted for timing differences in the hedge cash flows to ensure that fixed interest is not earned on the Hedge Budget minus any annual floor, to the extent that the floor is supported by the Hedge Budget.

Guidance Note: The above approach does not stipulate any required methodology as long as it produces a consistent limit on the assumed earned interest rate underlying the disciplined current scale.

For a policy with multiple Index Accounts, a maximum rate in 5 (A) should be calculated for each account. All accounts, fixed and indexed, within a policy can be tested in aggregate.

- B. If an insurer does not engage in a hedging program for Indexed Credits, the assumed earned interest rate underlying the disciplined current scale shall not exceed the Annual Net Investment Earnings Rate.
- C. These experience limitations shall be included when testing for self-support and lapse-support under Model #582, accounting for all illustrated benefits including any illustrated benefits and bonuses that impact the policy's account value.

## 6. Policy Loans

If the illustration includes a loan, the illustrated Policy Loan Interest Credited Rate shall not exceed the illustrated Policy Loan Interest Rate by more than 50 basis points. For example, if the illustrated Policy Loan Interest Rate is 4.00%, the Policy Loan Interest Credited Rate shall not exceed 4.50%.

## 7. Additional Standards

The basic illustration shall also include the following:

- A. A ledger using the Alternate Scale shall be shown alongside the ledger using the illustrated scale with equal prominence.
- B. A table showing the minimum and maximum of the geometric average annual credited rates calculated in 4 (A).
- C. For each Index Account illustrated, a table showing actual historical index changes and corresponding hypothetical Indexed Credits using current index parameters for the most recent 20-year period.

## PROJECT HISTORY

### ACTUARIAL GUIDELINE LIV— NONFORFEITURE REQUIREMENTS FOR INDEX-LINKED VARIABLE ANNUITY PRODUCTS

**1. What issues was the project intended to address?**

The purpose of the Guideline is stated as follows: “The purpose of this guideline is to specify the conditions under which an Index-Linked Variable Annuity (ILVA) is consistent with the definition of a variable annuity and exempt from Model 805 and specify nonforfeiture requirements consistent with variable annuities.”

**2. What states participated in drafting the model?**

The following states are currently members of the Index-Linked Variable Annuity (ILVA) (A) Subgroup of the Life Actuarial (A) Task Force: Ohio (Chair), Utah (Vice-Chair), California, Illinois, Indiana, Nebraska, New Jersey, New York, Texas, Virginia, and Washington.

**3. What general procedure was followed in drafting the model? What efforts were made to assure that all interested parties were provided an opportunity to comment during the drafting process?**

In response to the emergence of products commonly referred to as index-linked variable annuities, registered index-linked annuities, or other names, Pete Weber (OH) recommended that the Life Actuarial (A) Task Force form an ILVA (A) Subgroup to draft a standard that would define the minimum interim values for these products at a call of the Task Force on June 17, 2021. After approval of the formation of the ILVA (A) Subgroup from the Task Force and subsequent approval from the Life Insurance and Annuities (A) Committee and the NAIC’s Executive (EX) Committee and Plenary, open meetings of the subgroup began.

The work of the subgroup was coordinated with all industry interested parties. In addition to twelve open subgroup conference calls that were held over 2021 and 2022 (see Table 1) to develop a draft Actuarial Guideline, several updates were provided to the Life Actuarial (A) Task Force during open sessions. Notice of these conference calls was posted on the NAIC’s home page on the Internet and e-mailed to approximately 500 interested parties, including representatives of the American Council of Life Insurers, the Committee of Annuity Insurers, and the American Academy of Actuaries.

Table 1:

Meeting Date	Open/Regulator-only?
7/15/2021	Open
9/23/2021	Open
11/23/2021	Open
2/16/2022	Open
3/2/2022	Open
3/9/2022	Open
3/17/2022	Regulator-only
5/17/2022	Open
5/18/2022	Open
7/13/2022	Open
8/29/2022	Open
9/20/2022	Open
9/27/2022	Open

**4. What significant issues were raised during the drafting process, and how were those issues resolved?**

Two key questions emerged during the process of drafting the actuarial guideline:

1. Should the actuarial guideline allow companies to utilize market value adjustment term lengths other than the maturity of the Fixed Income Asset Proxy?
2. Should the actuarial guideline allow companies to continue to have the option to include or exclude a market value adjustment in their ILVA products?

There was concern that reaching a strong consensus on both of these items would be time consuming if not impossible. To address both issues and advance the actuarial guideline, revisions were made to remove specific requirements related to market value adjustments. In place of specific market value adjustment requirements, a drafting note was added that granted more flexibility to the states to be able to approve products that are consistent with the principles laid out in the actuarial guideline. In particular, the first principle of the actuarial guideline states that the interim values must provide equity between the contract holder and the insurance company. That principle should guide states in determining whether a market value adjustment is appropriate or not.

**5. What are the implications of this project for accreditation and codification?**

The Guideline should be handled in a manner that is consistent with the treatment of other guidelines.

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**Disclaimer:** Actuarial Guideline 54 (ILVA) has not been adopted by the NAIC’s Life Insurance and Annuities (A) Committee or the Executive (EX) Committee and Plenary and is thus subject to change or to non-adoption. However, Actuarial Guideline 54 has been adopted by the Life Actuarial (A) Task Force and this version has been posted to the Task Force’s public website to provide regulators and interested parties with the most current language.

**New Actuarial Guideline - Draft: 1/13/2022**

*Adopted by Life Actuarial (A) Task Force – 12/11/2022*

*Adopted by Life Insurance and Annuities (A) Committee – TBD*

## **Actuarial Guideline LIV**

### **Nonforfeiture Requirements for Index-Linked Variable Annuity Products**

#### **Background**

**The purpose of this guideline is to specify the conditions under which an Index-Linked Variable Annuity (ILVA) is consistent with the definition of a variable annuity and exempt from Model 805 and specify nonforfeiture requirements consistent with variable annuities.**

A number of insurers have developed and are issuing annuity products with credits based on the performance of an index with caps on returns, participation rates, spreads or margins, or other crediting elements, that include a risk of negative index returns subject to limitations on the loss, such as a floor or a buffer. These products are not unitized and do not invest directly in the assets whose performance forms the basis for the credits.

There is no established terminology for these annuity products. These products go by several names, including structured annuities, registered index-linked annuities (RILA), or index-linked variable annuities, among others. This guideline refers to these products as index-linked variable annuities (ILVA).

Variable annuities are exempted from the scope of NAIC Model 805, *Standard Nonforfeiture Law for Individual Deferred Annuities*; however, NAIC Model 805 does not define the term "variable annuity".

NAIC Model 250, *Variable Annuity Model Regulation*, defines variable annuities as “contracts that provide for annuity benefits that vary according to the investment experience of a separate account.” Section 7B of NAIC Model 250 provides that "to the extent that a variable annuity contract provides benefits that do not vary in accordance with the investment performance of a separate account" the contract shall satisfy the requirements of the NAIC Model 805.

The application of the NAIC Model 250 to a traditional variable annuity with unitized values is straightforward. The unitized feature provides an automatic linkage between annuity values and the investment experience of a separate account. Daily values (market values of the separate account assets) are the basis of all the benefits, including surrender values.

The fact that ILVA accounts are not unitized means they do not have values determined directly by the market prices of the underlying assets. Therefore, this guideline sets forth principles and requirements for determining values, including death benefit, withdrawal amount, annuitization amount or surrender values, such that an ILVA is considered a variable annuity and thereby exempt from Model 805. An ILVA that does not comply with the principles and requirements of this guideline is not considered a variable annuity and therefore is subject to Model 805.

**Drafting Note:** This guideline interprets the term “variable annuity” for purposes of exemption from Model 805. It is not intended to modify the definition of a variable annuity under Model 250 or other Model Regulations.

**Scope**

This guideline applies to any index-linked annuity exempt from the NAIC Model 805 on the basis that it is a variable annuity and includes index-linked crediting features that are built into policies or contracts (with or without unitized subaccounts) or added to such by rider, endorsement, or amendment.

**Principles**

This guideline is based on the following principles:

1. Interim Values defined in the contract provide equity between the contract holder and the insurance company.
2. Interim Values are consistent with the value of the Hypothetical Portfolio over the Index Strategy Term.

**Definitions**

“Derivative Asset Proxy” means a package of hypothetical derivative assets established at the beginning of an Index Strategy Term that is designed to replicate credits provided by an Index Strategy at the end of an Index Strategy Term.

“Fixed Income Asset Proxy” is a hypothetical fixed income asset.

“Hypothetical Portfolio” means a hypothetical portfolio composed of a Fixed Income Asset Proxy and a Derivative Asset Proxy.

“Index” means a benchmark designed to track the performance of a defined portfolio of securities.

“Index Strategy” means a method used to determine index credits with specified index or indices and cap, buffer, participation rate, spread, margin or other index crediting elements.

“Index Strategy Base” means the notional amount used to determine index credits that does not change throughout the Index Strategy Term except for withdrawals, transfers, deposits, loans, and any explicit charges.

“Index Strategy Term” means the period of time from the term start date to the term end date over which an index changes and the index credit is determined.

“Interim Value” means the Strategy Value at any time other than the start date and end date of an Index Strategy Term.

“Strategy Value” means the value, attributable to an Index Strategy, used in determining values including death benefit, withdrawal amount, annuitization amount or surrender values.

“Trading Cost” means the additional cost of liquidating the derivative assets in the Derivative Asset Proxy or actual derivative assets supporting the Index Strategy that is not accounted for in the Derivative Asset Proxy calculation.

**Text**

The Index Strategy Base must equal the Strategy Value at the Index Strategy Term start date.

The Fixed Income Asset Proxy is assumed to be a hypothetical fixed income asset 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 less the Derivative Asset Proxy value; and
- 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.

**Drafting Note:** The guideline defines the conditions under which an index-linked variable annuity is exempt from Model 805 on the basis that it is a variable annuity. A variable annuity provides daily values (analogous to Interim Values in this guideline) based on the market value of separate account assets. In order to more closely align an ILVA to a variable annuity Interim Values should be consistent with the market value of hypothetical assets supporting the ILVA (i.e. Hypothetical Portfolio). The market value of the assets may be determined by a fair value methodology or by applying an MVA to the book value. A state may want to consider whether including or excluding an MVA is appropriate. In making a determination regarding whether including or excluding an MVA is appropriate and, if applicable, what an acceptable MVA formula is, the state should consider whether the Interim Values provide reasonable equity between the contract holder and the insurance company.

The value of the package of derivative assets is determinable daily. Assumptions used to determine the market value of the Derivative Asset Proxy including implied volatilities, risk-free rates, and dividend yields must be consistent with the observable market prices of derivative assets, whenever possible.

Interim Values must be materially consistent with the value of the Hypothetical Portfolio over the Index Strategy Term less a provision for the cost attributable to reasonably expected or actual Trading Costs at the time the Interim Value is calculated.

If a contract provides Interim Values determined using a methodology other than a Hypothetical Portfolio methodology as described in this guideline, the company must demonstrate that the contractually defined Interim Values will be materially consistent over the Index Strategy Term with the Interim Values that would be produced using the Hypothetical Portfolio methodology for each combination of Index Strategy and Index Strategy Term under a reasonable number of realistic economic scenarios that include index changes that test crediting constraints and recognize initial option pricing market conditions.

The company must provide an actuarial memorandum with each ILVA product filing that includes the following:

1. Actuarial certifications must be included with each ILVA product filing and must include the following:
  - a. Interim Values defined in the contract provide equity between the contract holder and the insurance company;
  - b. The assumptions used to determine the market value of the Derivative Asset Proxy including implied volatilities, risk-free rates, dividend yields, and other parameters required to value the derivatives are consistent with the observable market prices of derivative assets over the Index Strategy Term, whenever possible. Valuation techniques include the standard Black-Scholes method, Monte-Carlo Simulation techniques, and other market consistent option valuation techniques for more complex options;
  - c. The contractually defined Interim Values are materially consistent with the Interim Values that would be produced using the Hypothetical Portfolio methodology for each combination of Index Strategy and Index Strategy Term over the Index Strategy Term less a provision for the Trading Costs at the time the Interim Value is calculated; and
  - d. Any Trading Costs represent reasonably expected or actual costs at the time the Interim Value is calculated.
  
2. If the Interim Values are determined using a methodology other than the Hypothetical Portfolio methodology described in this guideline, the actuary shall describe the testing performed to verify that the values are materially consistent with the Hypothetical Portfolio methodology. The actuary should define any parameters or assumptions used in determining material consistency and provide a summary of the results of the testing.
  
3. Descriptions of
  - a. The value of the Fixed Income Asset Proxy;
  - b. The market value adjustment formula, if any;

- c. The market value of the Derivative Asset Proxy including any Trading Costs; and
- d. All formulas, methodologies and assumptions used to calculate these values for each Index Strategy and Index Strategy Term as well as the sources for all assumptions.

ILVA nonforfeiture benefits for Index Strategies subject to this guideline must comply with Section 7 of Model 250 not including Section 7.B with net investment return consistent with the requirements for determining Interim Values in this guideline.

**Effective Date**

The Guideline applies to all contracts (including associated riders, endorsements, or amendments) issued on or after July 1, 2024.