

## Comments on 2<sup>nd</sup> Exposure of ILVA Draft Standards and Subgroup Responses and PSC Responses

NOTE: The following are in the order presented in each of the comment letters. All changes in the 2<sup>nd</sup> exposure draft were accepted and the November 14, 2023 draft tracks only the revisions discussed below.

### American Academy of Actuaries Comments

#### July 23, 2023 Letter

**1. Recommend revision of Section AA. Separate Accounts to be more inclusive of ILVAs**

**Response:** Subgroup and PSC accepted Academy's suggested revisions.

Discussion: This clarifies the application of Section AA which was carried over from the Variable standard and did not address ILVAs which do not utilize unitized separate accounts.

#### August 28, 2023 Letter

**1. Revision to Non-variable account value and indexed linked variable account value definitions**

**Response:** Subgroup and PSC accepted Academy's suggested revisions including correcting terminology in Section 3Z. In addition, for consistency the scope was revised to make comparable changes to the index linked variable account value definition.

Discussion: The requirements applicable to the non-variable account value and the indexed linked variable account value are not specific to how the account values are funded. Requirements applicable to each of the account values are included within the draft standard and removing the references to "general account" and "separate account" would not change the requirements.

**2. Consistency with AG 54**

**Response:** Subgroup and PSC: No change to the suggested sections (except definition of index as discussed below under the ACLI/CAI comments).

Discussion: Products filed with the Compact are subject to the Compact standard and not AG54, unless specifically referenced in the standard. Therefore, there is no inconsistency and should be no uncertainty. As a general rule products filed with the Compact are subject to different requirements than products filed with the states because of the specific standards adopted by the Compact that are not necessarily identical to individual state requirements or NAIC model provisions.

**3. Modify GLB benefit base**

**Subgroup Response:** The GLB standard is on the PSC prioritization list for discussion by the PSC to adjust the benefit base for GMABs. Recommend that the PSC address the comments on the GLB standard when the GLB standard is brought up for discussion/revision by the PSC.

**PSC Response:** The PSC will address the comments on the GLB standard after the Commission approves the 2024 Annual Prioritization request.

## **ACLI/CAI Comments**

### **I.a. Broaden definition of “account value”**

**Response:** Subgroup and PSC: Changed definition of non-variable account value and indexed linked variable account value. See discussion under Academy comment 1, above.

### **I.b. Delete definition of “index”**

**Response:** Subgroup and PSC: Revised the definition of index to be consistent with the AG54 definition which is “a benchmark designed to track the performance of a defined portfolio of securities” (as suggested by the Academy). In addition, revised the contract requirement in Section 3H(5) of the draft standard to change “or” to “and” so that either the contract or specification page MUST describe each index not just “identify” each index.

Discussion: The Compact non-variable standard does not define index and therefore such indices would not be prohibited for non-variable indexed annuities. To the extent that states and the Compact have allowed custom, proprietary, blended or other indices in non-variable indexed annuities (and ILVAs filed in the states), it makes sense to permit these for ILVA products. Custom indices have been used for many years particularly in low interest rate environments in order for companies to design indices that may provide a higher return. The AG 54 definition of index provides a reasonable standard without being overly restrictive for these products. The revision to the contract provision requiring the index be described provides additional information for the contract holder to understand the index which is particularly important if the index is a custom or proprietary index.

### **II.a Allow other methodologies that are materially consistent with the hypothetical portfolio methodology**

**Subgroup Response:** No revision.

**PSC Response:** This is a Commission level decision.

Discussion: Whether (or which) other methodologies will be permitted in the Compact standard will be brought to the PSC and full Compact Commission for a determination.

### **II.b Clarify that illustrative examples rather than “testing” is required, since interim values must be based on the hypothetical portfolio methodology**

**Response:** Subgroup and PSC: Accepted revisions and in addition added a requirement for the illustrative examples to be presented in a standard format as shown in Appendix C in the draft.

Discussion: Agreed that if the hypothetical portfolio methodology is used, it is presumed to meet the equity requirement. Therefore, illustrative examples are a more appropriate description of the requirement.

**II.c.1 Remove the requirement that the book value of the Fixed Income Asset Proxy be assumed to have a maturity based on the maturity of the fixed income assets supporting the ILVA.**

Response: Subgroup and PSC: accepted revision but not the drafting note and revised the market value of Fixed Income Asset Proxy for consistency.

Discussion: Agreed that this is an appropriate revision. The book value of the Fixed Income Asset Proxy is fully defined without the requirement, and it continues to apply in determining the market value of the Fixed Income Asset Proxy as appropriate.

In addition, in order to address the MVA concerns identified by the ACLI/CAI, the same revision was made to the market value of the Fixed Income Asset Proxy and substituted a standard for the MVA. The drafting note could be confused to allow “other methodologies”. Therefore, “appropriate for the maturity of the fixed income assets supporting the ILVA” was replaced with “that produce results reasonably similar to changes in the market value of the fixed income asset proxy and provide reasonable equity to both the contract holder and insurance company”. This is consistent with the requirement in the Compact MVA standard for variable annuities and is applicable whether the MVA is applied to the fixed income asset proxy or to the strategy value. It is also consistent with the certification requirement in the draft.

**II.c.2 Revise IIPRC-A-07-I-3 (*Additional Standards for Market Value Adjustment Feature Provided Through a Separate Account*) to be applicable to ILVAs.**

Response: Subgroup and PSC: accepted ACLI revisions to standard. Some revisions may need to be tweaked to comply with drafting standards.

Discussion: Revisions were needed since the standard only addresses MGAs and some provisions are not applicable to ILVAs.

**II.c.3 Clarify nonforfeiture demonstration.**

Response: Subgroup and PSC: No revision.

Discussion: The interpretation by the ACLI/CAI of the requirement is correct and no clarification was needed.

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

**Response:** Subgroup and PSC: Removed reference to “fair value” which is not defined and revised to allow any alternative methodology that meets the basic requirement that the beginning and ending market values equal the book values and is comparable to the defined methodology.

**Discussion:** The fair value methodology is not described in the AG 54 and is without a standard definition. Since it is without definition the proposed revision simply refers to an “alternative” methodology. The revision proposed by the ACLI/CAI would allow a methodology that states have determined is not equitable or otherwise does not meet the intent of the AG 54. The provision in the draft would permit the state-approved variations of those methodologies.

See II.c.1 above regarding revision to market value of Fixed Income Asset Proxy.

**II.e Justification for trading cost.**

**Response:** Subgroup and PSC: No revision except to add “expected” to the provision and to include a certification in 1(B)(1)(g)

**Discussion:** The ACLI/CAI proposed revision would allow “reasonably expected trading costs” without a specific basis for determining what reasonably expected means. Trading costs could have a substantial impact on the interim values. The ACLI/CAI states that companies may rely on longer term historical trading costs or “anticipated future projections of trading costs”. The Compact standards need a more defined basis for determining what “reasonably expected” means and it reasonable that anticipated future projections of trading costs be based on similar derivative assets and recent historical data.

**II.f Valuation of Derivative Asset Proxy.**

**Response:** Subgroup and PSC: Revised 1(B)(1)(d)(vii)(5) to be consistent with 1(B)(1)(g)(v) as suggested by the ACLI/CAI

**Discussion:** The revision addresses the unintended inconsistency

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

**Response:** Subgroup : Accepted ACLI/CAI proposed revisions

**Discussion:** Per ACLI: 1) Variable annuities are not subject to the same reporting requirements, 2) Many states permit restrictions, 3) the SEC requirements are designed for companies with publicly traded securities not insurers. The PSC may want to consider whether it is problematic to refer to a specific SEC Rule that if amended may require a revision to the standard

**PSC Response:** The PSC had a long discussion about this requirement and concerns about state laws regarding assignments and ownership changes and requests responses to the following questions during the public call:

- a. What is the need to specify Rule 12h-7 as this draft already allows restrictions for federal law?
- b. How can the draft address the concern the standards may need to be amended if the citation in the SEC rules change?
- c. Please comment on the extent of agreement that since Rule 12h-7 recognizes state law in terms of the ability to restrict assignment, restriction on assignment would only be available for Compact products in those states that did not prohibit restrictions on assignment.

**III.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.**

**Response:** Subgroup and PSC: Made revisions to clarify the requirement as it is applied by the Compact for non-variable indexed annuities.

Discussion: This section mirrors Section 3.C in 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*. For forms subject to this standard companies file each index that will or may be used as required under the standard. However, the Compact has not required that companies specifically disclose that any particular index that is filed will be used as substitute for another index and does not review comparability of an index that may be substituted for another index. In addition, the Compact has not restricted the reasons for a company to discontinue an index to only be when either the index is discontinued, or when the calculation of an index has substantially changed. Therefore, revisions were made to the section in the draft standard to more accurately reflect the Compact's application of the comparable section for non-variable indexed annuities. The revisions should address the ACLI/CAI's concerns as well.

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

See item 3 under Academy comment above.

**IV. (Delete) Application Standard Acknowledgement**

**Subgroup Response:** Defer to PSC/Commission

**PSC Response:** The PSC did not delete the acknowledgment and asks for comments during the public call. The PSC is seeking specific reasons and examples for whether to include or remove this requirement prior to making its recommendation to the Product Standards Committee.

Discussion: It is true that comparisons between products is not required for variable and non-variable products under the standards. ILVAs have been offered in the market for over 10 years at this point and so they are no longer a "new" product. Another consideration is the recently proposed SEC rule that would modify the required disclosure for the products.

*“We propose to require insurance companies to use Form N-4 to register the offering of RILAs, as well as amendments to the form to require disclosures specific for these securities. 64 As discussed above, the registration forms currently used by RILA issuers do not include line[1]item disclosure requirements addressing the unique aspects of RILAs, like limits on gains or the application of contract adjustments. They also require information about the issuer, such as MD&A, that may be less important to annuity investors, given that they are not making a direct investment in the insurance company, and that the Commission has not determined to require for variable annuities. Conversely, most variable annuity issuers already use Form N-4 to register their securities and the form is designed to provide investors with product-specific information about annuity contracts. 65 Requiring insurance companies to register RILA offerings on Form N[1]4 therefore leverages the form’s existing insurance-product specific disclosure requirements, including disclosure requirements that help effectuate the relatively new summary prospectus layered disclosure framework the Commission adopted in 2020 for variable contracts. With the RILA-specific disclosures we are proposing to add to Form N-4, we intend that the form will provide investors with the information necessary to make informed decisions about RILAs.*

*Including RILAs on Form N-4 also could provide further benefits to investors by facilitating not only investor comparison among RILAs, but also the comparison of index-linked options to variable options in the same annuity contract. For example, investors would be able to review summary information of all the available investment options of an annuity contract -- index-linked options, variable options, and fixed options—and compare these options in one place in the prospectus appendix required by Form N-4.”*

#### **IRI Comments**

**1) (Delete) Application Standard Acknowledgement**

**Response:** see above response to ACLI/CAI item IV

**2) Permit other interim value methodologies**

**Response:** see above response to ACLI/CAI item II.a

**3) Permit an Additional Methodology for the Fixed Income Asset Proxy Calculation**

**Response:** see above response to ACLI/CAI item II.d

**4) Revisions to Assignment and Ownership provisions**

**Response:** see above response to ACLI/CAI item III.a