July 23, 2024

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

RE: Section Z (Right to Examine Contract) of the New Uniform Standards for ILVAs

Dear Ms. Schutter:

The American Council of Life Insurers (ACLI), the Committee of Annuity Insurers (CAI) and the Insured Retirement Institute (IRI) appreciate the Compact staff's willingness to engage in a discussion regarding the free look provision in Section Z (Right to Examine Contract) of the Compact's new ILVA Standards, and the accompanying Checklist. This letter will follow up on the issues we discussed last week. We hope it will be helpful to you in engaging with the regulators on this issue.

We regret that concerns regarding this provision were not raised prior to adoption of the ILVA Standards, and that given the multitude of other issues to be addressed, Section Z did not receive the focus it warranted during the lengthy process resulting in adoption of the ILVA Standards. We hope that the concerns recently identified by our members with Section Z can be addressed quickly in light of the issues discussed below.

The approach of treating ILVAs like fixed products rather than variable annuities for purposes of the right to examine based on how the underlying assets are held (i.e., as a pool of assets in a non-unitized separate account rather than in a unit-linked separate account) is unfortunately flawed for a number of reasons, including: the treatment of ILVAs under AG 54; existing state standards and ILVA review practices; and from a risk allocation perspective. In all these respects, ILVAs are variable annuities, not fixed products.

State Law and ILVA Review Practices Treat ILVAs as Variable Annuities

Underlying the ILVA Standards is the overarching determination by the states, as embodied in AG 54, that, although they are not unit-linked, ILVAs are variable annuities, where the value of the contract fluctuates on a daily basis (i.e., the interim value). As stated in a drafting note to AG 54,

> 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).

In keeping with this determination, to our knowledge, the states have universally approved ILVA contracts with free look provisions in accordance with the state's requirements for variable annuities. Companies generally disclose in their ILVA prospectuses that an exercise of the free look privilege will be processed by returning either premium or account value (i.e., interim value), depending on what is required by state law. Most states require return of account value. As such, the ILVA Standards as written and interpreted by the Compact Staff are not an embodiment of existing state standards, but in fact are contrary to those state standards and practices in reviewing and approving ILVAs and are contrary to the basic treatment of ILVAs as variable annuities in AG 54.

The Market Risk Taken by an Insurance Company Is Comparable to a Variable Annuity

Treating a free look of an ILVA like that of a variable annuity is logical because, like variable annuities, the market risk during the ILVA free look period is based on the investment selections made by the contract owner. A variable annuity contract owner directs their premium among the unitized subaccounts from contract inception, including during the free look period. Similarly, the ILVA contract owner directs their premium among specific index-linked strategies, the underlying assets of which are invested by the insurance company in such a way as to support end of period crediting. Treatment consistent with a variable annuity is supported by one of the principles stated in AG 54, "Interim Values defined in the contract provide equity between the contract holder and the insurance company."

We note that in the comparable circumstance of the free look of a contract with a market value adjustment (MVA), the free look provision in the *Additional Standards for Market Value Adjustment Feature for Modified Guaranteed Annuities and Index-Linked Variable Annuities* provides for the return of account value adjusted by the MVA. This would result in the free look of an ILVA contract with an MVA that is incorporated within the interim value being based on premium, while an ILVA contract where the MVA adjustment is made separately from the interim value calculation would have a free look based on account value (i.e., interim value less the MVA). There is no logic that would support treating these two substantively equivalent ILVA contract designs so differently.

On the other hand, treating an ILVA like a fixed indexed annuity (FIA) isn't appropriate when considering the risk borne by the insurance company based on the contract owner's investment elections. For a FIA, the insurance company's exposure is limited to changes in the bid/ask spread on call options, and the worst that can happen is that the derivatives purchased to support the contract (a small portion of the amount invested) become worthless. For an ILVA, the derivatives purchased by the insurance company include put options that can swing to a significant negative position based on market movements, reflecting the market value of the index strategy. These examples illustrate the issue:

- For a FIA, if a company spends 4% on options and the market goes down 20%, the value of the call options will drop to close to 0. Their value will always be above 0 until the end of the crediting period. From the company's perspective, if the market drops significantly, they can be negatively impacted, but that impact is generally limited to the amount spent to purchase the call options.
- For an ILVA, if a company spends 4% on put and call options and the market goes down 20%, the impact to the value of the basket of options purchased might result in a loss to the company exceeding -10% (assuming a 10% buffer) of the contract owner's premium because of the added exposure related to the put options. From the company's perspective, if the market drops significantly, it can be negatively impacted to a very large extent (at least relative to the premium on the free looked contract).

The risk profile of an ILVA, and especially the tail risk, is therefore much closer to that of a variable annuity than that of an FIA.

Potential Adverse Ramifications of Current Section Z

Imposing a different free look regime for Compact-approved ILVAs than state-approved ILVAs could be a significant deterrent for companies to use the Compact for such filings (and, as noted above, it is contrary to normal Compact practice to adopt standards that deviate from existing state law). Alternatively, the ILVA Standards could lead companies to design future products to mitigate risk in ways that could be detrimental to consumers. For example, ILVAs could require that premiums remain in either a money market or fixed interest account, or some other conservative allocation, for the free look period before moving into the index linked strategies.

Proposed Amendment to Section Z

To remedy this issue, we offer the following mark-up of Section Z, which modifies the treatment of ILVA account value to parallel that of variable account value. We note that "strategy value" is defined in the ILVA Standards as "the value attributable to an Index Strategy used in determining contract values including death benefit, withdrawal amount, annuitization amount or surrender values," which, at any time other than the start date and end date of an Index Strategy Term, is the Interim Value (see definition of "Interim Value").

Z. RIGHT TO EXAMINE CONTRACT

(1) The Right to Examine Contract provision appearing on the cover page or that is visible without opening the contract shall include the following:

(a) (i) If the contract is not a replacement contract, a period of ten days beginning on the date the contract is received by the owner, and at the discretion of the company a longer period may be filed; or

(ii) If the contract is a replacement contract, a minimum of thirty days beginning on the date the contract is received by the owner, or any longer period as may be required by applicable law in the state where the contract is delivered or issued for delivery;

(b) A requirement for the return of the contract to the company or the agent of the company;

(c) For premiums paid to a non-variable account value ~~and an ILVA~~, the refund of any premiums paid if the contract is returned.

(d) For premiums paid to a variable account value or an ILVA, if the contract is returned, either a refund of:

(i) The premiums paid; or

(ii) The separate account value or the strategy value plus any amount deducted from the portion of the premium applied to the account.

We ask that this change be expedited as a correction to the ILVA Standards, and that administrative relief be granted to filers seeking approval in advance of the promulgation of the correction.

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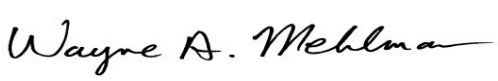
We hope that the foregoing is a useful explanation of the issue and our members' views. We look forward to the opportunity to discuss this issue with you and the appropriate regulators at your earliest convenience. Please let us know some dates and times that would work for you.

Respectfully submitted,

AMERICAN COUNCIL OF LIFE INSURERS (ACLI)



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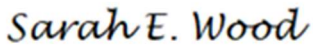

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