

Draft: 12/3/19

Annuity Disclosure (A) Working Group  
Conference Call  
Dec. 2, 2019

The Annuity Disclosure (A) Working Group of the Life Insurance and Annuities (A) Committee met via conference call Dec. 2, 2019. The following Working Group members participated: Mike Yanacheak, Chair, (IA); Chris Struk (FL); Craig Van Aalst (KS); Nour Benchaaboun (MD); Andrew Schallhorn (OK); and Sandra Dodson and Lynn Pazdral (TX). Also participating were: Steve Ostlund (AL); Perry Kupferman (CA); William Leung (MO); Bob Harkins (NE); Denise Lamy (NH); Thomas Kilcoyne and Jeff Rohaly (PA); and David Hippen (WA).

1. Heard Opening Remarks

Mr. Yanacheak reminded the Working Group that it had last met Oct. 21 via conference call. During that conference call, the Working Group considered two outstanding issues with revisions to the *Annuity Disclosure Model Regulation* (#245), and resolved one of them. The Working Group discussed whether the algorithm should be made available to the consumer for inspection, or was making it available to the insurance commissioner sufficient. After discussion, the Working Group settled on making the algorithm available to the insurance commissioner only, with a drafting note stating that states may want to consider making the algorithm available to consumers upon request.

The second issue the Working Group discussed on its Oct 21 call, was whether to allow the illustration of indices made up of only other indices, or to allow the illustration of indices made up of indices or “other financial instruments.” The Working Group discussed examples of what should and should not be allowed to be illustrated, whether that is called “indices” or “other financial instruments.” At the conclusion of the call, Mr. Yanacheak said he would draft language on the issue for comment. A revised draft dated Nov. 13, 2019 was distributed to the Working Group and interested parties. The American Council of Life Insurers (ACLI) submitted a comment letter.

2. Discussed Nov 13 Draft Revisions to Model #245

Mr. Yanacheak explained that the Nov 13 draft revisions to Model #245 includes the following language in Section 6F(9)(b)(i) based on the discussion during the Oct 21 conference call about whether indices made up of other financial instruments should be able to be illustrated.

(b) If any index utilized in determination of an account value has not been in existence for at least ~~ten-fifteen~~ (15) calendar years, indexed returns for that index shall not be illustrated, unless all of the following criteria are met:

(i) The index is a combination of indices, including commodities, interest rates, or exchange traded funds, each of which has been in existence for at least fifteen (15) years;

Mr. Yanacheak said that ACLI submitted alternate language for the Working Group to consider. Robbie Meyer (ACLI) explained that the ACLI is concerned that the proposed new language may unintentionally be construed to suggest that: (i) commodities, interest rates, and exchange traded funds are (or must be part of) indices to meet the criteria in this provision; and/or (ii) the list of financial instruments is intended to be an exclusive list. To address this concern the ACLI suggested revising this section in either one of the following two ways to include three additional financial instruments that underlie indices in the marketplace and make clear that the list of financial instruments is not exhaustive

(i) The index is a combination that includes, but is not limited to, of indices, including stocks, bonds, futures, commodities, interest rates, or exchange traded funds, each of which has been in existence for at least fifteen (15) years;

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Mr. Benchaaboun said he was comfortable with the ACLI first alternative, but did not want to keep the list open-ended with the “but is not limited to” language. Jennifer Cook (NAIC) said that the terms “includes” or “including” are inclusive and not exhaustive, meaning that “includes” means the same thing with or without the “but is not limited to” phrase. Mr. Benchaaboun said he did not want to leave the list open-ended and Mr. VanAalst and Mr. Struk agreed.

Birny Birnbaum (Center for Economic Justice—CEJ) said consumer protection is needed in this area because disclosure rules are not sufficient. He said the purpose of revising the model is to improve consumer protections by making it more difficult for companies to create custom designed indices based on data mining where the historical experience is not going to be reflective of future experience by virtue of it being data mined. He said the ACLI language fails to constrain the ability of companies in any way to data mine in order to create a favorable illustration. He said his understanding of intent of the revisions, as expressed by John Robinson (MN) on previous calls, was to allow for indices that are a combination of other indices that have been in existence for at least 15 years. Mr. Birnbaum suggested that the language should be the following:

- (i) The index is a combination of indices, including indices of stocks, bonds, futures, commodities, interest rates, or exchange traded funds, each of which has been in existence for at least fifteen (15) years;

Mr. Birnbaum said the CEJ wrote a comment letter in July that raised some additional issues he would like to have the Working Group discuss at some point.

Ms. Meyer said Mr. Birnbaum’s suggested language would undercut necessary and valuable illustrations of fixed indexed annuities that are based on indices made up of combinations of indexes and other financial instruments that are currently in the marketplace. Ms. Meyer said there are other criteria that must be met in addition to this criteria. Mr. Birnbaum said the desire to innovate does not mean industry should be able to data mine anything that has happened over the last 15 years to create a false picture of the future. He said the only reason these indices are being created is because they illustrate well, not because there is consumer demand. Mr. Yanacheak said he understands Mr. Birnbaum’s concerns, but thinks that this is most appropriately taken into account during the product approval process.

Mr. Schallhorn said he understands Mr. Birnbaum’s concerns that this language could allow a company to, for example, pick 5 stocks and call it an index that has been around for 15 years. He said he recalled that on previous calls, the focus was on allowing the illustration of an index that is made up of other of other indices that had been in existence for at least fifteen years. Mr. Benchaaboun said that he agreed that a company should not be able to take four stocks and call it an index, so he said he is supportive of Mr. Birnbaum’s language. Mr. Van Aalst said he prefers the ACLI second alternative.

Ms. Meyer said there are indexed products in the marketplace that have underlying components that are financial instruments (like stocks, bonds, interest rates) that are not indices, that now would not be able to be illustrated, which is problematic for ACLI. Mr. Birnbaum said, under the current model, they would not be able to be illustrated if they have not been in existence for the previous 15 years. He said even if they had been illustrated, the intent of this language is to stop illustrations that are not meaningful to the consumer. He said it is not innovation that benefits consumers to allow the illustration of indices created through data mining of any combination of financial instruments that have had really good experience in 10 of the last 15 years.

Ms. Meyer said her comment letter asks the Working Group to reconsider revising Section 6F(9)(b)(iii) to read as follows: (iii) Any algorithm or other method of combining the indices shall be fixed from the creation of the index except for changes made pursuant to the index provider’s established governance rules and procedures;

Ms. Meyer said the ACLI is concerned about how this criteria will work. She said one real world example is how will this criteria work with indices where LIBOR is a component. There are long-standing indices that will change when LIBOR is no longer used after 2021. Is it the regulator’s intention to jeopardize an illustration in this instance. She said that the proposed ACLI revision is not intended to allow unfettered changes to be made. She said that index providers have formal governance rules as to how changes are to be handled, and this revisions would simply allow changes made pursuant to the index providers established governance procedures.

Mr. Kilcoyne asked whether adding language saying established rules and procedures “necessary to administer the index” would increase regulator comfort level. Mr. Yanacheak said indices change over time when it is necessary and gave some examples of why an index might change over time. He agreed that Mr. Kilcoyne’s suggested language is accurate, but may be redundant. Mr. Benchaaboun said he is fine with the language proposed because it isn’t really contradictory to the intent of having the index fixed from its creation at issue. Mr. VanAalst and Mr. Schallhorn said they are okay with making the ACLI suggested revision.

Mr. Birnbaum said that there are no standards or requirements for an index provider's governance procedures. He said this is particularly problematic in the context of custom indices created through data mining by index providers who are primarily investment banks, and are doing so according to their own rules. He said the issue is compounded by the inherent conflict of interest between the investment banks creating the indices who are also providing the hedging underlying the index. He said also allowing this same index provider to make changes based on their own internal governance rules and procedures, which may be arbitrary and not visible to the consumer, doesn't make a lot of sense. Mr. Birnbaum said LIBOR is a substantial, major index that has been in existence for many years, akin to the S&P 500. He said if the S&P 500 went away, and anything that referenced the S&P 500 was going to replace it with something else because they are able to through their governance procedures, would be problematic. He said that replacing LIBOR is not a good example a minor change that consumers should not be concerned about. He also said there is a difference between the component being replaced and the method by which indices are combined to create the index being changed. He said it is not in the consumer's best interest to allow either changes to the algorithm or to the components.

Jim Poolman (Indexed Annuity Leadership Council) said his organization was a signatory on the ACLI letter. He said he is frustrated by the negative characterization of this product and of illustrations, which he considers to be an important consumer disclosure. He said the industry is trying to find language that addresses regulator concerns, while preserving innovation in the marketplace, which benefits consumers. He said he thinks this proposed language is a reasonable compromise.

Mr. Yanacheak said a revised draft based on the discussions during this call will be developed and that he will report on the Working Group's progress to the Life Insurance and Annuities (A) Committee at the upcoming National Meeting and request an extension of the Working Group's Model Law Development request. Mr Yanacheak said he would review Mr. Birnbaum's July comment letter for any additional issues that have not been discussed.

Having no further business, the Annuity Disclosure (A) Working Group adjourned.

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