January 27, 2022

Mr. Peter Weber, Chair
Mr. Tomasz Serbinowski, Vice Chair
National Association of Insurance Commissioners
LATF Index-Linked Variable Annuity (ILVA) (A) Subgroup

RE: ILVA Subgroup Exposure of *Actuarial Guideline ILVA: The Application of Model 250 to Variable Products Supported by Non-Unitized Separate Accounts*

Dear Messrs. Weber and Serbinowski:

The American Council of Life Insurers (ACLI)[1] and the Committee of Annuity Insurers (CAI)[2] appreciate the opportunity to submit comments on the ILVA Subgroup's exposure of *Actuarial Guideline ILVA: The Application of Model 250 to Variable Products Supported by Non-Unitized Separate Accounts* (Exposure).

We recognize the considerable effort that went into producing the Exposure. Your leadership of the Interstate Insurance Product Regulation Commission's (IIPRC) Actuarial Working Group formed a foundation which enabled the Subgroup to develop the Exposure in a timely manner. Guidance providing state regulators with a consistent understanding of the elements to consider in reviewing registered index-linked annuity (RILA) or ILVA product filings is critical to facilitating the continued growth and evolution of a product segment that provides customers with important access to insurance guarantees. RILA products are fundamentally spread-based products; they eliminate barriers that can be created by explicit fees which make it harder for people to get needed protections for their family and their retirement.

We appreciate that the Exposure initiates a starting point to demonstrate how these products might fit into the current NAIC framework for variable annuity nonforfeiture considerations but, in our opinion, there are critical changes that need to be addressed to ensure a final guideline will be workable. There are technical aspects of the Exposure which do not align with the realities of how RILA products are

[1] The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States.

[2] The Committee of Annuity Insurers is a coalition of life insurance companies that issue annuities. It was formed in 1981 to address legislative and regulatory issues relevant to the annuity industry and to participate in the development of public policy with respect to securities, state regulatory and tax issues affecting annuities. The CAI's current 31 member companies represent approximately 80% of the annuity business in the United States.

manufactured, and instituting the Interim Value framework as drafted could adversely impact the core design principles used to create RILAs. Additionally, it appears to us that the Exposure is too restrictive and would not meet some of the Subgroup's own objectives, including fostering product innovation responsive to the lifetime income challenge that retirement presents for millions of Americans.

We understand that the Subgroup does not want to see the RILA market disrupted, particularly since it is clearly meeting an investor need that was not previously being met with other annuity or investment products. Neither do we. Consequently, the ACLI and CAI have worked diligently throughout the comment period to create a revised proposed Actuarial Guideline (Proposal) which builds on the Exposure, is principles-based, recognizes the diversity of RILA designs in the marketplace and would accommodate ongoing innovation. We respectfully request that the Subgroup consider exposing the Proposal, as a refinement of the Exposure, for public comment. We believe it can work as an Actuarial Guideline (AG) under Model 250. However, if upon review, the Subgroup does not believe that modification of the Exposure, as reflected in the Proposal, is a workable alternative, then we would suggest that an approach other than an AG under Model 250 may need to be considered (revision to variable annuity definition in Model 250, creation of a new model regulation, etc.).

Some Key Points About RILAs

As you know, the RILA market has seen substantial growth over the past several years. This is due in part to the fact that RILAs, because they lie between conventional fixed indexed annuities and conventional unit-linked variable annuities on the risk/reward spectrum, are consistent with the investment objectives and risk tolerances of many retirement savers. But it is also due to the diversity of RILA product designs, the number of carriers offering these products, and the fact that RILAs are being distributed and offered through a variety of different distribution channels that have afforded meaningful RILA choices to consumers.

RILAs are registered as securities with the U.S. Securities and Exchange Commission. Investors receive robust prospectus disclosures about the features of the specific RILA they are considering, including examples demonstrating how the Interim Value calculations work in a variety of economic scenarios. Prospectus disclosures also detail the particular investment risks associated with that RILA's features (including risk of loss and any product feature limitations) that should be considered before purchasing the product. In addition, of course, recommendations made to a retail customer to purchase a RILA must follow the best interest procedures required by the SEC's Regulation Best Interest.

Unlike conventional variable annuities, RILAs are fundamentally spread-based products, not fee-based products[3]. Insurers manufacture RILA products by investing in fixed income assets with a return that covers the cost of liability benefits, expenses and profit/risk margins. In this respect, RILAs share many core manufacturing concepts with fixed indexed annuities. The spread-based chassis is also similar to other products treated as variable annuities that are exempt from the NAIC's *Standard Nonforfeiture Law for Individual Deferred Annuities* (Model 805), such as modified guaranteed (MGA or MVA) annuities. As we will demonstrate in the examples discussed below, a spread-based manufacturing model can improve the customer value proposition (relative to a fee-based model) due to the insurer's ability to invest in longer-term assets while prudently managing asset/liability risks. While the application of the Model 250 definition of a variable annuity may not be as straightforward for RILAs as it is for conventional unit-linked variable annuities, the relationship between contract benefits and the

[3] Note that in this context, the terms "spread-based" and "fee-based" are used to refer to a product manufacturing model, not the mechanics of the crediting strategies offered within index-linked products (where spreads and fees may be among the crediting parameters applied to index performance).

value of derivative instruments that can be used to replicate index credits demonstrates the necessary conditions for RILAs to be treated as variable annuities under Model 250.

Because RILAs provide variable benefits, insurers use separate accounts for their RILA products. However, for some insurers, the ability to offer attractive index-linked crediting strategies and other product features is often related to the ability to hold some of the assets supporting RILAs in insurers' general accounts. Therefore, there are a variety of practices regarding the "geography" of separate account and general account assets supporting RILAs. This flexibility does not impact the core value proposition of the product because the separate account structure does not need to provide unitized values for a RILA, and the flexibility is beneficial because it allows insurers to take the approach that they determine can deliver the product most efficiently to the market. We recognize that the details of separate account operations are not the focus of the Exposure, but this topic is relevant to the dialog, and we want to underscore the importance that unintended interpretation of provisions in an AG focused on Interim Values does not result in restrictions in other areas.

The Proposal

As noted above, in our opinion, critical changes need to be made to the Exposure to make it workable. The attached Proposal builds upon the Exposure but reflects certain important changes to the Principles and Text sections. Certain terms have been added to the Definitions section that relate to the revised Text. Clarifying statements and changes also have been made to the Background and Scope sections.

The fundamental starting point is the principles that should govern RILA/ILVA Interim Values. The Proposal is built on a core principle with which everyone agrees: any methodology employed to calculate Interim Values must provide equity to both contract holders (whether persisting or terminating) and the company based on the risks assumed during an Index Term. This closely tracks the first principle in the Exposure. However, because RILAs are not unit-linked, Interim Value mechanics are integrated with other asset/liability risk management considerations. The Proposal recognizes that a range of approaches can be taken to maintain equity with these considerations in mind. Additionally, for the reasons noted previously, any AG under Model 250 needs to recognize that RILAs are fundamentally spread-based products and that insurers employ a variety of practices with respect to where assets supporting the products are maintained. For this reason, it is both too simplistic and too restrictive to further define equity to mean that Interim Values must approximate the actual market values of the separate account assets as the Exposure does.

Instead, as reflected in the Proposal, the relationship between contract benefits and the value of derivative instruments that can be used to replicate index credits demonstrates the necessary conditions for RILAs to be treated as variable annuities under Model 250. Therefore, the second principle set forth in the Proposal recites that there may exist a hypothetical portfolio of derivative assets that is designed to replicate the index credits provided by an Index Strategy at the end of an Index Term. The third principle is that the Interim Value must demonstrate a relationship between the value of that hypothetical derivative portfolio and the contract benefits over the course of an Index Term, and further that this relationship should be materially consistent in a variety of economic environments.

The Text section in the Proposal builds upon these three principles. It begins by expressly acknowledging that Interim Values can be determined using multiple methods so long as the method used is consistent with the principles. It then references and summarizes two example methods that generally correspond to methods currently in the marketplace. The summaries of those two methods are intended to provide a safe harbor for Interim Value methods corresponding to what is described.

Illustrative Examples

To supplement the proposed revisions to the Actuarial Guideline, we have constructed several illustrative examples. The attached Excel file ("ACLI and CAI Interim Value Demonstrations 1-27-22.xlsx") provides a detailed explanation of the analysis. These examples are intended to highlight the previously mentioned technical concerns about the Exposure and how the Proposal improves the alignment between key product manufacturing concepts and the framework for Interim Values. We'd like to focus in particular on the following observations:

- Because RILAs are manufactured as spread-based products, the insurer's fixed income investment horizon is often longer than the term of the index-linked crediting strategies. The option budget available to determine the crediting parameters (cap rate, participation rate, etc.) is a function of the yield earned on these fixed income assets and the target spread determined by the insurer. Our concern is that the conditions outlined in the Exposure regarding the value of the Fixed Income Asset Proxy are inconsistent with this reality. To achieve a conceptually similar outcome that produces a more intuitive emergence of Interim Values, the Proposal provides an alternative framework that focuses on amortization of the option budget rather than the accrual of a hypothetical zero-coupon bond.

- The Excel file also includes an example comparing the determination of the option budget for a hypothetical RILA under spread-based and fee-based manufacturing models.[4] This example demonstrates that the spread-based approach has the potential to deliver better customer value through both a higher option budget and the absence of a fee assessed against the account value. This is not meant to be an exhaustive comparison of different product designs, but reinforces the importance of aligning the Interim Value framework with the core principles used to manufacture RILA products.

- In addition to highlighting the technical concerns with the Exposure, the examples provide illustrative Interim Values under both Method 1 and Method 2 from the Proposal. A range of economic scenarios are pre-populated in the Excel file, and the results can be compared in both tabular and graphical formats. While there are differences in the calculation mechanics between Method 1 and Method 2, the examples show that they provide a similar emergence of Interim Values. This also reinforces the concept that even though Method 2 does not involve a direct valuation of derivative assets, the value of the Derivative Asset Proxy and the Interim Value are materially consistent in a variety of economic environments.

Conclusion

The ACLI and the CAI appreciate the opportunity to comment on the Exposure. We stand ready to help the Subgroup achieve its goals while also working to ensure that our members can continue to effectively serve the investment and retirement needs of their customers with innovative RILA products that offer attractive benefits and protections. It is in that spirit that we urge the Subgroup to carefully consider the Proposal and our request that it be exposed for public review and comment. We look forward to continued collaboration with the Subgroup to develop guidance to satisfy our shared objective of equity to both contract holders and insurers in the design and administration of RILA/ILVA products.

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[4] As noted in the Excel file, some RILAs include explicit fees that are used to increase the insurer's option budget. These products are still fundamentally spread-based and are manufactured differently than conventional unit-linked variable annuities.

Respectfully submitted,

AMERICAN COUNCIL OF LIFE INSURERS (ACLI)

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