CANNEX RESEARCH

Comment to the NAIC Life Insurance and Annuities Illustrations Working Group

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Executive Summary

The current illustration framework, as established in the NAIC Annuity Disclosure Model Regulation, provides a structured approach to presenting product performance to consumers. However, the interaction of three factors— (1) the renewal rate assumption, amplified by premium bonus designs; (2) the historical scenario selection methodology; and (3) the inconsistency between current strategy rates and the economic environment of the illustrated scenario— produces illustrated returns that can materially exceed reasonable consumer expectations.

In the short term, enhanced disclosures and supplemental reduced-rate scenarios can improve transparency within the existing framework. In the long term, modernizing the scenario selection methodology toward standardized, forward-looking representative scenarios, requiring economic consistency between strategy rates and illustrated scenarios, and strengthening standards for newly developed indices will be necessary to ensure the illustration framework keeps pace with evolving product designs and index innovations.

Background and Context

CANNEX is a provider of data, analytics and research dedicated to increasing the transparency and access of annuity products in North America. Our recommendations contained herein are informed by the services we provide in the U.S. marketplace which include the fair and objective modeling and comparison of retail annuities. We welcome the opportunity to engage in a technical dialogue with the Working Group regarding our methodology or any of the directional proposals described in this document. Contact: Damian Baboolal, Vice President Research (damian.baboolal@cannex.com)

The Regulatory Framework

The NAIC Annuity Disclosure Model Regulation[1] establishes standards for annuity illustrations provided to consumers at the point of sale. Section 6 governs how fixed indexed annuity (FIA) illustrations must be constructed. The key provisions for FIA illustrations are found in Section 6-F, which requires:

- **Three Scenarios (Section 6-F-9):** Non-guaranteed illustrated values for FIAs must be calculated for three scenarios based on historical index performance: (i) the most recent 10 calendar years, (ii) the worst-performing continuous 10-year period out of the last 20 years (the "low scenario"), and (iii) the best-performing continuous 10-year period out of the last 20 years (the "high scenario").

[1] https://content.naic.org/sites/default/files/model-law-245.pdf

- **Current Non-Guaranteed Elements (Section 6-F-8):** Non-guaranteed elements (participation rates, caps, spreads, and other interest crediting adjustments) underlying the illustrated values must be "no more favorable than current non-guaranteed elements" and must "not include any assumed future improvement of such elements."

- **Index Age Requirement (Section 6-F-9-b):** Any index used in illustrations must have been in existence for at least 10 calendar years i.e. there is at least 10 years of live index data; otherwise, indexed returns for that index cannot be illustrated.

The Market Reality

A recent survey by the NAIC Life Insurance and Annuities Illustration Working Group, as reported by Life Annuity Specialist on March 2, 2026 in the article titled *A Third of Top FIA Carriers Advertise Illustrated Returns of 16% to 27%* [2], revealed that among the roughly 25 to 30 largest FIA carriers:

- Approximately one-third showed illustrated annual returns of **10% or less**.
- Another third indicated illustrated returns ranging from **11% to 15%.**
- The remaining third showed returns mostly in the **16% to 25% range**, with one carrier illustrating annual returns as high as **27%**.

The article provides the following additional context:

- The average annual return of the S&P 500 is between 8% and 9%.
- The Working Group chairman, Ben Slutsker (Director of Life Actuarial Valuation, Minnesota Department of Commerce), noted that competitive pressures may be driving carriers to lean into increasingly aggressive illustrated rates to win sales.

The Core Problem

While the Model Regulation's illustration framework was designed to provide consumers with a realistic view of potential product performance, certain guidelines defined by the NAIC, when applied to current market conditions and product designs, can produce illustrated returns that may be far higher than what a consumer should reasonably expect. The result is that product illustrations risk setting unrealistic performance expectations and may be used to steer sales conversations in a misleading direction.

[2] https://www.lifeannuityspecialist.com/c/5104234/718734

The Working Group's Question

> *"Regulators have observed index annuity disclosures that suggest annual returns can range from 10%-25% for several years. This has brought up potential concerns around whether consumers are receiving reasonable expectations regarding future performance upon purchasing an annuity. What are both short-term and long-term approaches to ensure consumers receive reasonable expectations for index annuity returns at the point-of-sale?*
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> *Please keep any comments at a high-level regarding potential direction for the Working Group and types of proposals, rather than providing specific proposals themselves. In addition, please feel free to include any comments related to disclosures around newly-developed indices and any other elements related to the concerns described above."*

Analysis: Why Current Illustrations Produce Inflated Returns

We have identified three principal mechanisms by which the current illustration framework, as described in the NAIC Annuity Disclosure Model Regulation, when combined with product design and market conditions, produces returns that are materially higher than what a consumer should reasonably expect.

The Renewal Rate Assumption and Premium Bonus Interaction

The issue: Section 6-F-8 requires that non-guaranteed elements used in the illustration be "no more favorable than current non-guaranteed elements." In practice, most carriers interpret this by holding strategy rates (participation rates, caps, spreads) constant at their current levels for all illustrated years. This means the initial-term rates are assumed to renew at the same values indefinitely.

Why this is misleading: In reality, initial-term strategy rates are not guaranteed to renew at the same level. Carriers routinely set more attractive rates for the initial term as a competitive marketing strategy, with the expectation and pricing intent that renewal-term rates will be lower. The current regulation does not distinguish between an introductory rate and a sustainable renewal rate.

The premium bonus amplifier: This problem is compounded in products that feature high premium bonuses. In a bonus product, the insurer provides upfront account value growth (the bonus) in exchange for lower credited growth in subsequent terms. The product is priced as a package: the bonus is recouped through lower renewal rates and/or higher charges over the life of the contract. However, when the illustration projects the current (initial) strategy rates into all future terms, the consumer sees both the generous upfront bonus *and* ongoing returns at the initial-term rate. The illustration fails to reflect the intended economic trade-off embedded in the product design, producing a materially inflated trajectory of account value growth.

Scenario Selection Bias in Historical Windows

The issue: Section 6-F-9 defines the three illustration scenarios by reference to the best, worst, and most recent 10-year windows drawn from the last 20 years of each index's history. While this approach is simple and objective, it does not necessarily produce scenarios that represent a reasonable range of "good," "bad," and "moderate" outcomes for a forward-looking consumer.

Why this is misleading: The post-2008 period has delivered an extraordinarily strong equity bull market. The most recent 10-year window and the best 10-year window out of the last 20 years may both capture this historically exceptional period. For many common indices, this means the "high" and "most recent" scenarios are drawn from near-peak historical performance, while the "low" scenario (the worst 10-year window in the last 20 years) may still reflect above-average long-term performance.

The problem is even more acute for newer, bespoke indices. Many managed-volatility and excess-return indices have been engineered with back-tested histories optimized for favorable performance metrics. If the index has existed for only 10 to 15 years, the range of available historical windows is narrow and potentially unrepresentative. The current 10-year minimum existence requirement (Section 6-F-9-b) mitigates this somewhat but does not address the fundamental problem that a short live-performance history may not span a complete market cycle or be representative of the range of market outcomes.

Inconsistency Between Current Strategy Rates and Historical Scenarios

The issue: The current regulatory framework applies today's strategy rates (participation rates, caps, spreads) to historical index returns without adjustment for the economic environment that prevailed during the historical scenario period. This creates an internal inconsistency between the crediting parameters and the scenario being illustrated.

Why this is misleading: Strategy rates are directly linked to an insurer's options budget, which is itself a function of the prevailing interest rate environment. Specifically:

- Insurers invest premium proceeds primarily in investment-grade corporate bonds.
- The yield earned on those bonds, net of expenses, determines the options budget available to purchase the index-linked crediting strategy.
    - *Note that Crediting Strategy = Specific Index combined with a Crediting Method that contains Crediting Parameters i.e. Strategy Rates*
- When corporate bond yields are high, the options budget is larger, which supports more favorable strategy rates (higher participation rates, higher caps, lower spreads).

When the illustration applies current strategy rates—set in today's yield environment—to a historical scenario that began in a different yield environment, the result is *economically inconsistent*. For example, if current bond yields are elevated and current strategy rates are correspondingly generous, applying those generous rates to a "high" historical scenario that began when bond yields were low produces a compounding overstatement: the illustration assumes both (a) the strong index returns that occurred when rates were low, and (b) the favorable strategy parameters that exist because rates are currently high. In the real world, these two conditions are unlikely to coexist.

Index-type dependency: The magnitude of this inconsistency varies by index type. For traditional market indices like the S&P 500 (with medium to high volatility), the options pricing is sensitive to interest rates, so the gap between current strategy rates and the rates that would have prevailed in the historical scenario can be significant. For managed volatility excess-return indices, call option pricing is less sensitive to the interest rates, so the strategy rates may be more stable across rate regimes. However, even for these indices, the options budget itself is still a function of the bond yield environment, and the rates are still subject to pullback upon renewal.

Recommendations to the Working Group

We appreciate the Working Group's focus on this important consumer protection issue and offer the following high-level directional thoughts organized as short-term and long-term approaches.

Short-Term Approaches

1. Require Disclosure of Renewal Rate Risk

The Working Group should consider requiring enhanced disclosure language, prominently placed within the illustration, that:

- Clearly states that current strategy rates (participation rates, caps, spreads) are set by the insurer and are **not guaranteed to renew at the same levels** upon expiration of the initial term / guaranteed period.
- Discloses the **historical range of the insurer's renewal rates** for the same or comparable strategy types, where available, to give consumers empirical context on how rates have changed in the past.
- For products with premium bonuses, include a specific disclosure explaining that the bonus is designed as an upfront benefit in exchange for the expectation of lower growth in subsequent terms, and that **illustrating unchanged rates alongside the bonus may overstate long-term performance**.

2. Require a "Reduced Rate" Supplemental Scenario

As a near-term supplement to the existing three-scenario framework, the Working Group should consider requiring an additional illustrated scenario in which strategy rates are reduced from their current levels by a prescribed factor or to a prescribed floor (e.g., the guaranteed minimum levels, or a percentage reduction from current rates). This would give consumers an explicit view of how sensitive their projected returns are to the assumption that strategy rates remain unchanged—a sensitivity that is currently invisible in the standard illustration.

Long-Term Approaches

1. Modernize Scenario Selection: Move Toward Standardized Representative Scenarios

The current approach of selecting the "best" and "worst" 10-year windows from the last 20 years is mechanically simple but produces scenarios that are contingent on the particular historical period and do not necessarily represent a reasonable forward-looking range of outcomes. Over the longer term, the Working Group should explore replacing or supplementing the historical-window approach with **standardized representative scenarios** defined for each index or index category. These scenarios could be:

- **Derived from the full available index history** (not limited to the last 20 years), selecting windows that represent genuinely good, moderate, and adverse outcomes across multiple market cycles, where the index has a sufficiently long live-performance track record.
- **Generated using stochastic simulation** with forward-looking capital market assumptions, calibrated to each index's risk and return characteristics, and with defined criteria (e.g., percentile thresholds) for selecting the good, moderate, and adverse scenarios. This approach is particularly important for indices with short or no live history, and it would provide a more economically grounded view of potential outcomes.
- **Published or approved by a central body** (such as the NAIC or an appointed actuarial body) on a periodic basis, so that all carriers illustrate against the same standardized scenarios for a given index, eliminating the ability of product design or index selection to game the scenario window.

2. Require Consistency Between Strategy Rates and the Illustrated Scenario

The Working Group should explore requiring that the strategy rates used in each illustration scenario be **consistent with the economic environment assumed or implied by that scenario**. At a high level, this means:

- If a historical scenario is used, the strategy rates applied to that scenario should reflect what would have been supportable given the bond yield environment at the start of that historical period, not the yield environment prevailing today.
- Alternatively, if current strategy rates are used, the index return assumptions should be calibrated to be consistent with the current or forward-looking economic environment rather than drawn from an unrelated historical period.

This is the most technically complex of the proposed directions, but it addresses the most fundamental source of overstatement: the compounding inconsistency between high current rates and high historical returns.

3. Strengthen Standards for Newly Developed and Bespoke Indices

The proliferation of custom-designed, managed-volatility, and excess-return indices creates additional illustration risks. Many of these indices have limited live-performance history and extensive synthetic data (back-tested) periods that may not reflect realistic future performance. The Working Group should consider:

- **Extending the minimum live-performance requirement** beyond the current 10 years
- **Requiring additional disclosures for indices with less than 20 years of live history**, explaining the limitations of the available data.
- **Establishing standards or guidelines for the use and governance of proprietary indices** used in FIA illustrations, including transparency around index methodology, volatility targeting, fee structures embedded in the index, and the relationship between the index sponsor and the insurer.