**Actuarial Guideline ILVA**

**Nonforfeiture Requirements for Index Linked Variable Annuity Products Supported by**

**Non-Unitized Accounts**

**Background**

**The purpose of this guideline is to specify the conditions under which an Index-Linked Variable Annuity (ILVA) is consistent with the definition of a variable annuity and exempt from Model 805 and specify nonforfeiture requirements consistent with variable annuities.**

A number of insurers have developed and are issuing annuity products with credits based on the performance of an index with caps on returns, participation rates, spreads or margins, or other crediting elements, which include limitations on loss such as a floor or a buffer. These products are not unitized and do not invest directly in the assets whose performance forms the basis for the credits. However, unlike traditional non-variable indexed annuities, these annuities may reflect negative index returns.

There is no established terminology for these annuity products. These products go by several names, including structured annuities, registered index-linked annuities (RILA), or index-linked variable annuities, among others. This guideline refers to these products as index-linked variable annuities (ILVA).

Variable annuities are exempted from the scope of NAIC Model 805, *Standard Nonforfeiture Law for Individual Deferred Annuities,* however*,*  NAIC Model 805 does not define the term "variable annuity".

NAIC Model 250, *Variable Annuity Model Regulation*, defines variable annuities as “contracts that provide for annuity benefits that vary according to the investment experience of a separate account” Section 7B of NAIC Model 250 provides that "to the extent that a variable annuity contract provides benefits that do not vary in accordance with the investment performance of a separate account" the contract shall satisfy the requirements of the NAIC Model 805.

The application of the NAIC Model 250 to a traditional variable annuity with unitized values is straightforward. The unitized feature provides an automatic linkage between annuity values and the investment experience of a separate account. Daily values (market values of the separate account assets) are the basis of all the benefits, including surrender values.

The fact that ILVA products are not unitized means they do not have values determined directly by the market prices of the underlying assets. Therefore, this guideline sets forth principles and requirements for determining values, including death benefit, withdrawal amount, annuitization amount or surrender values, such that an ILVA is considered a variable annuity and thereby exempt from Model 805. An ILVA that does not comply with the principles and requirements of this guideline is not considered a variable annuity and therefore is subject to Model 805.

Drafting Note: This guideline interprets the term “variable annuity” for purposes of exemption from Model 805. It is not intended to modify the definition of a variable annuity under Model 250.

**Scope**

This guideline applies to any index-linked annuity exempt from the NAIC Model 805 on the basis that it is a variable annuity provided through non-unitized separate account(s) and includes index-linked crediting features that are built into policies or contracts (with or without unitized subaccounts) or added to such by rider, endorsement, or amendment.

This guideline does not apply to an annuity contract or a subaccount of an annuity contract that is subject to the requirements of NAIC Model 805, Standard Nonforfeiture Law for Individual Deferred Annuities.

**Principles**

This guideline is based on the following principles:

1. There exists a package of derivative assets that replicates the index credits provided by an index strategy at the end of an index term.
2. The value of the package of derivative assets can be determined daily using assumptions consistent with observable market values.
3. Interim Values defined in the contract provide equity to both the contract holder and the company where the Interim Values are consistent with the value of the Hypothetical Portfolio over the index term.

**Definitions**

“Derivative Asset Proxy” means a package of hypothetical derivative assets designed to replicate credits provided by an Index Strategy at the end of an Index Term.

“Fixed Income Asset Proxy” is a hypothetical fixed income asset.

“Hypothetical Portfolio” means a hypothetical portfolio composed of a Fixed Income Asset Proxy and a Derivative Asset Proxy.

“Interim Value” mean the Strategy Value at any time other than the start date and end date of an Index Term.

“Index Strategy” means a method used to determine index credits with specified index or indices and cap, buffer, participation rate, spread, margin or other index crediting elements.

“Index Strategy Base” means the notional amount used to determine index credits that does not change throughout the Index Term except for withdrawals, transfers, deposits, and explicit charges.

“Index Strategy Term” means the period of time from the term start date to the term end date over which an index change and index credit is determined.

“Strategy Value” means the value, attributable to an Index Strategy, used in determining values including death benefit, withdrawal amount, annuitization amount or surrender values.

**Text**

Index Strategy Base must equal the Strategy Value at an Index Term start date.

The value of the Fixed-Income Asset Proxy:

1. At the beginning of the Index Term equals the Index Strategy Base less Derivative Asset Proxy value;
2. At the end of the Index Term equals the Index Strategy Base; and
3. Earns interest at a level rate.

The value of the Hypothetical Portfolio at any time is the sum of the Fixed-Income Asset Proxy value and the Derivative Asset Proxy value less a provision for the cost of unwinding the hedge positions not to exceed 10 bps.

Contracts in the scope of this guideline must provide Interim Values that are consistent with the value of the Hypothetical Portfolio over the index term.

If a contract provides Interim Values determined using a methodology other than a Hypothetical Portfolio methodology as described in this guideline, the company must demonstrate that the contractually defined Interim Values will be materially consistent with the Interim Values that would be produced using the Hypothetical Portfolio methodology for each combination of Index Strategy and Index Strategy Term under a reasonable number of economic scenarios.

Drafting Note: Acceptable economic scenarios over which consistency should to be demonstrated is yet to be determined. Considerations are the Academy Interest Rate Generator and/or defined deterministic scenarios including shocks that trigger Index Strategy parameters including but not limited to caps, floors and buffers.

The company must provide an actuary’s certification that the provisions of this guideline are being met.

Assumptions used to value the Derivative Asset Proxy including yields, implied volatility, risk-free rate, and dividend yield must be consistent with the observable market prices of derivative assets, whenever possible.

ILVA nonforfeiture benefits must comply with Section 7 of Model 250 with net investment return consistent with the requirements for determining Interim Values in this guideline.

The company (or actuary) must describe the Derivative Asset Proxy and the assumptions used to calculate its value at any time.

**Effective Date**