AMERICAN ACADEMY *of* ACTUARIES

December 11, 2012

Rosanne Mead
Assistant Commissioner
Iowa Insurance Division
Des Moines, IA 50319

Dear Ms. Mead:

The American Academy of Actuaries[1] Annuity Illustration Subgroup (AIS) is pleased to present its comments on selected FAQs in the October 18, 2012 draft memorandum, *Fixed Indexed Annuity Illustrations and Iowa Administrative code rules 15.61-.69*. We have commented on the FAQs that relate to provisions that we provided input on during the development of the NAIC Annuity Disclosure Model Regulation, on which this regulation was based.

If you have any questions, please contact John Meetz, the Academy's life policy analyst, at 202/223-8196 or meetz@actuary.org.

Sincerely,

Linda Rodway, Chair
Annuity Illustration Subgroup
American Academy of Actuaries

Members of the Annuity Illustration Subgroup:
Noel Abkemeier FSA, MAAA,
Andy Ferris, FSA, MAAA.
David Hippen, FSA, MAAA,
Elizabeth Keith, FSA, MAAA
Barbara Lautzenheiser FCA, FSA, MAAA,
Cande Olsen, FSA, MAAA
Timothy Pfeifer, FSA, MAAA,
Gabriel Schiminowich, FSA, MAAA,
Dean Slyter, ASA, MAAA
Laura VanderMolen, ASA, MAAA
Ferdinand Uy, ASA, MAAA

cc: Jim Mumford, Iowa Insurance Department

---

[1] The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

B. *Question:* In reference to subparagraph 15.66(6)(i)(5)(2), if a client chooses more than one crediting method, would a producer need to show a separate high and low ledger for each crediting method (assuming the time period would be different for each crediting method)? For example, under Annuity A, an owner can select three different illustratable crediting methods plus a fixed option. Would the producer need to show a high and a low ledger for the monthly averaging, monthly sum, and point-to-point methods of crediting? Also, would the fixed option require a separate ledger or can it be combined with one of the other crediting methods being illustrated?

Answer: Yes, three types of ledgers would have to be shown for each option selected. The fixed ledger should be kept separate from the indexed options as this would inflate or bias the illustrated results.

AIS Comment: We are not sure exactly what the division means with its use of the phrase "high and low ledgers," in either question B or the question B answer, but it is important to remember that the "high and low scenarios" in the model refer to index history, rather than crediting history, i.e., this is raw index history; no product features are considered/required in order to determine what index history applies. The use of index history rather than crediting history provides timeframe consistency across companies and simplifies compliance. Conceptually, there is a choice of question to be answered: (a) "How would the product perform if the index repeated the high/low index experience?" or (b) "What would be the best/worst time for the crediting method?" Both have validity but the first was chosen.

It was our intention when proposing this section of the model regulation that an illustration with multiple crediting methods/indices (and/or a fixed option) combine the effects of all such options, even if the index time periods are different for the high and low scenarios. The inclusion of the fixed return would not bias the result, but rather would be realistic. For many indices the high scenarios and the low scenarios will coincide, but we also recognize the fact that some indices may go in the opposite directions over a specific period (e.g., the S&P vs. a volatility controlled index, where the point of using the two indices may be to offset each other). In this case, a footnote might be merited.

C. *Question:* In reference to subparagraph 15.66(6)(i)(7), what if an annuity has an option longer or shorter than ten years? How many years must be illustrated?

Answer: Regardless of the product, the rule requires a ten-year illustration. However, a longer or shorter period must be disclosed prominently in at least the narrative, and also may be footnoted in the illustration. The illustration must show how the specific product works. The illustration should not be used to speculate as to how the product may perform.

[The IID requests comment on this subparagraph 15.66(6)(i)(7). The Division is continuing to compare this to a prior version of the NAIC model, which stated:
If the ten-year historical period for the most recent experience of the index is shorter than the number of years needed to fulfill the requirement of subrule 15.66(8), the geometric mean annual effective rate over the initial historical period shall be used to calculate the account value for the remaining years of the illustration.]

AIS Comment: Since a 10-year illustration is required, it is not clear why there is a reference to a "shorter period" in the answer. If a crediting period is not coterminous with the end of the tenth year, it seems that it would be appropriate to show values through the end of that crediting period, since the ten-year values would be an understatement due to a lack of interest crediting. In most cases this probably would be covered anyway, due to illustrating through the end of the surrender charge period.

An insurer must be allowed to illustrate through the end of a crediting period; otherwise, the illustration would understate the facts and be misleading. This can occur both with a very long initial crediting period and with a repeat of a multi-year crediting period.

At one time or another, the AIS considered both approaches to interest crediting in years 11+ (repeating historical index performance vs. using a smoothed geometric mean annual effective rate), but ultimately the drafters of the model regulation chose to repeat historical index performance. Both approaches have pros and cons, but over time and on average, they produce the same results. Because of this, the AIS supports either approach. Observations on the two approaches are:

1. The one that would be most consistent with the methodology of the model regulation would be to use the index changes for the first and second year to construct index values for the 11th and 12th years (subparagraph 15.66(6)(i)(7)).
2. The second option would be the use the geometric mean of the index changes of the first 10 years to construct index values for the 11th and 12th years. This is consistent with a prior draft of the NAIC model, as noted above, and would provide the greatest consistency with illustrations that are provided over a 10-year period.

D. In reference to subparagraph 15.66(6)(i)(8),(1) and (2):

Question 1: It seems as though the low and high scenarios should show surrender values if different than account values.

Answer: [The IID requests comment on subparagraph 15.66(6)(i)(8)(1). The Division is contemplating amending subparagraph 15.66(6)(i)(8)(1) to state: "Must show surrender values (if different than account values); . . . "]

AIS Comment: We disagree with the contemplated amendment. We suggest 15.66(6)(i)(8)(1) should be revised to say, "Need not show surrender values (even if

different than account values);" The basic illustration shows the effect of surrender charges and there is no need to show that again. The purpose of the high and low scenarios is only to show how the interest crediting and crediting limitations work under extreme economic scenarios. Requiring that surrender values also be shown is an unnecessary complication.

Question 2: Would a producer be able to show 12 years of performance in the high and low scenarios for a 12-year option?

Answer: Regardless of the product, the rule requires a ten-year illustration. If the product has a longer or shorter reset period, that period must be disclosed prominently in at least the narrative, and also may be footnoted in the illustration. The illustration must show how the specific product works. An illustration cannot show a rate higher than the rate determined in the ten-year calculation.

AIS Comment: See AIS comment on Question C.

E. *Question:* Please explain subparagraph 15.66(6)(i)(9).

Answer: It means that the low scenario should show a "zero" return if the index is negative in performance and the high scenario should show the index returning less than the total return of the high index. This will not always happen, so the narrative should explain what could happen. In understanding the requirements of this rule, it may be helpful to consult with actuaries.

AIS Comment: This subparagraph says, "The low and high scenarios should reflect the irregular nature of the index performance and should trigger every type of adjustment to the index-based interest rate under the contract. The effect of the adjustments should be clear; for example, additional columns showing how the adjustment applied may be included. If an adjustment to the index-based interest rate is not triggered in the illustration (because no historical values of the index in the required illustration range would have triggered it), the illustration shall so state;"

We are not sure of the meaning of the sentence, "It means that the low scenario should show a "zero" return if the index is negative in performance and the high scenario should show the index returning less than the total return of the high index." Floors and caps can apply during interest crediting periods in either the low scenario or the high scenario.

The intent (and expectation) of our proposal relating to the requirements of this subparagraph was that the low and the high scenarios both demonstrate all the crediting limitations inherent in the product design; that is, that they demonstrate the operation of the entire range of possible types of product adjustments (caps, floors, participation rates, spread, fees, term, guaranteed rates, etc.).

The low and high scenarios are based on the 10 year time periods that reflect the least or greatest index growth, respectively, for each index chosen. The 10 year low and high scenarios may reflect different 10 year low and high calendar periods for

each index. The 10 year low and high scenarios are based on index growth and may not illustrate the lowest or highest total interest crediting amounts.

Interest crediting within an index-based interest crediting strategy is based on the features or adjustments within the strategy. Each strategy illustrated over the 10 year low and high scenario, must apply the product adjustments (caps, participation rates, spread, fees, term, guaranteed rates, etc). The 10 year low and high scenarios may not trigger every product adjustment; those adjustments not triggered in the 10 year scenario must be stated. The use of additional columns demonstrating how the adjustments are applied may be included.

J. *Question:* Regarding the entire subrule 15.66(7), it is not clear whether the periodic income amount for at least one of the annuity income options available needs to be an example or if it needs to be specific to each individual illustration. Would it be compliant with the rule to show an example of one of the annuity income options – life income with ten years period certain?

Answer: No. An example is not appropriate for an illustration. The illustration must be specific to the contract. *See* 15.66(6)(t).

AIS Comment: It was our intention when proposing this section of the model regulation that the periodic income be specific to each individual illustration. Note that subparagraph 15.66 (6)(t) says, "Annuitization benefits shall be based on contract values that reflect surrender charges or any other adjustment, if applicable;" But if there is more than one annuity income option, subparagraph 15.66(7) (d)(6) says that only one option (example) needs to be illustrated. It does not specify how that "example" is chosen.

K. An annuity has an annual reset 12-year options (with a fixed maturity age of 90).

Question: In reference to subparagraph 15.66(8), would the ledger need to show every year for 12 years, then show values every tenth contract year until age 90? Since the indexed option does not renew, would the producer need to show the value growing in the fixed account after the twelfth year?

Answer: Under the rules, an illustration has to show ten years; but, because this contract is calculated on a 12-year basis, the illustration would have to show how the 12-year contract works as well, because the illustration has to be specific to the contract. The producer would need to show the value growing in the fixed account after the twelfth year, using an interest rate no higher than what is currently being used at the time of issue, and must continue to display the ten-year schedule to age 90. Showing the values in the fixed account would be acceptable as long as the illustrated values are disclosed as being in the fixed account at a rate no higher than the rate currently being paid.

AIS Comment: The regulation in 15.66(8) makes reference to the "later of 30 years or age 70"; consequently, there is no need to extend the illustration to age 90.

Y. *Question:* What is meant by "if a fixed indexed annuity provides an option to allocate the account value to more than one indexed or fixed declared rate account: (i) the allocation used in the illustration shall be the same for all three scenarios. . . ." Does this mean that an illustration could show a 30%-40%-30% allocation so long as each of the three scenarios uses that same allocation? Or does "same" mean that each allocation must be 33.333% so the allocation itself is the same?

Answer: The allocation means the same three index options, in the same three percentages -- in this case, 30%, 40% and 30% for the high, low, and most recent scenarios. All scenario percentages must be the same in all scenarios.

AIS Comment: We believe it is clear that 30%, 40%, 30% is correct. Also, the illustration is intended to represent the situation for the prospective purchaser, which leads to illustrating only the options that the agent finds relevant for the customer, even if the contract provides more options.