AMERICAN ACADEMY *of* ACTUARIES

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June 15, 2015

Mike Boerner
Chair, Life Actuarial Task Force
National Association of Insurance Commissioners

Dear Mike:

The American Academy of Actuaries[1] Deposit Fund Subgroup appreciates the opportunity to provide recommendations to clarify the scope and definitions in Model Regulation 695, as requested by the Life Actuarial (A) Task Force (LATF) following comments received during the exposure of the CDA (A) Subgroup edits to Model Regulation 695.

Specifically, LATF asked the Deposit Fund Subgroup to:

- Clarify that contingent deferred annuities are not within the scope of Model Regulation 695; and
- Address inconsistent language related to the fixed rate of return, specifically, Section 3.B.(2) and Section 4.W.

The attached document reflects the proposed changes to Model Regulation 695 scope and definitions, including both the CDA (A) Subgroup's proposed changes and the Deposit Fund Subgroup's recommended changes. The Deposit Fund Subgroup's recommended changes to the CDA (A) Subgroup's proposed changes reflected in this document include:

- Removal of the phrase "or may not" in Section 3.B.(2).
- Addition of Section 3.D.
- Addition of the phrase ", subject to any minimum interest rate guarantee" to Section 4.W.

The Deposit Fund Subgroup's proposed additions are highlighted in blue in the attached document.

Please contact Brian Widuch, the Academy's life policy analyst (widuch@actuary.org; 202-223-8196), if you have any questions or would like further assistance.

Sincerely,

Tina Kennedy, MAAA, FSA
Chairperson
Deposit Fund Subgroup
American Academy of Actuaries

[1] The American Academy of Actuaries is an 18,500+ 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.

SYNTHETIC GUARANTEED INVESTMENT CONTRACTS
MODEL REGULATION

Table of Contents

Section 1. Authority

This rule is issued pursuant to the authority vested in the commissioner of the State of [insert state] under [insert citation for authority].

Section 2. Purpose

A. The purpose of this regulation is to prescribe:

(1) The terms and conditions under which life insurance companies may issue group annuity contracts and other agreements that in whole or in part establish the insurer's obligation by reference to a segregated portfolio of assets that is not owned by the insurer;

(2) The essential operational features of the segregated portfolio of assets; and

(3) The reserve requirements for these group annuity contracts and agreements.

B. This regulation is intended to aid in the timely approval of such products by the commissioner, and recognizes that timely approval is essential given the competitive nature of the market for these products.

Section 3. Scope and Application

A. This regulation applies to that portion of a group annuity contract or other agreement described in Section 4W and issued by a life insurer:

(1) That functions as an accounting record for an accumulation fund; and

(2) That has benefit guarantees relating to a principal amount and levels of interest at a fixed rate of return specified in advance.

B. The fixed rates of return:

(1) Shall be constant over the applicable rate periods;

(2) May ~~or may not~~ reflect prior and current market conditions with respect to the segregated portfolio; and

(3) Shall not reference future changes in market conditions.

~~A.~~C. This regulation is applicable to all contracts issued after its effective date. Contracts that have been negotiated prior to the effective date need not be refiled with the commissioner.

Drafting Note: The paragraphs above are intended only to reformat the deleted paragraph below for greater clarity and are not intended to change the meaning and/or intent.

~~This regulation applies to that portion of a group annuity contract or other agreement described in Section 4W and issued by a life insurer that functions as an accounting record for an accumulation fund and has benefit guarantees relating to a principal amount and levels of interest at a fixed rate of return specified in advance. The fixed rates of return will be constant over the applicable rate periods, and may reflect prior and current market conditions with respect to the segregated portfolio but may not reference future changes in market conditions. It applies to all contracts issued after the effective date of this regulation. Contracts that have been negotiated prior to the effective date need not be refiled with the commissioner.~~

D. This regulation shall not apply to contingent deferred annuities.

Drafting Note: This explanation of the fixed rate of return is intended to clarify the fact that the regulation excludes products such as those that guarantee the future performance of a stated index. It is recognized that versions of synthetics other than those described in the scope section may evolve over time; the intent of the regulation is not to preclude the issuance of such products, but rather to describe how a specific set of synthetics (those described in the scope) should be regulated.

Drafting Note: It is expected that individual regulators, where applicable, will retain the right to withdraw approval of previously filed contract forms for new issuance if they do not conform to the regulation. Therefore, no language explicitly withdrawing approval of previously filed forms was included.

Section 4. Definitions

As used in this regulation, the following terms shall have these meanings:

A. "Account assets" means the assets in the segregated portfolio plus any assets held in the general account or a separate account to meet the asset maintenance requirements.

B. "Actuarial opinion and memorandum" means the opinion and memorandum of the valuation actuary required to be submitted to the commissioner pursuant to Section 10B of this regulation.

C. "Affirmatively approved" means approval of an insurer's plan of operation for a class of contracts containing the form of contract under review, after the plan of operation associated with the class of contracts has been reviewed by the insurer's domiciliary insurance department, and the plan of operation has been found to be in compliance with the NAIC Synthetic Guaranteed Investment Contracts Model Regulation by the domiciliary insurance department. Affirmatively approved does not mean approval as a result of the deemer provision.

D. "Appointed actuary" means the qualified actuary appointed or retained either directly by or by the authority of the board of directors through an executive officer of the company to prepare the annual statement of actuarial opinion for the company as a whole pursuant to Section [insert reference to standard valuation law].

E. "Asset maintenance requirement" means the requirement to maintain assets to fund contract benefits in accordance with Section 10 of this regulation.

F. "Class of contracts" means the set of all contracts to which a given plan of operation pertains.

G. "Contract value record" means an accounting record, provided by the contract in relation to a segregated portfolio of assets, that is credited with a fixed rate of return over regular periods, and that is used to measure the extent of the insurer's obligation to the contractholder. The fixed rate of return credited to the contract value record is determined by means of a crediting rate formula or declared at the inception of the contract and valid for the entire term of the contract.

H. "Crediting rate formula" means a mathematical formula used to calculate the fixed rate of return credited to the contract value record during any rate period and based in part upon the difference between the contract value record and the market value record amortized over an appropriate period. The fixed rate of return calculated by means of this formula may reflect prior and current market conditions with respect to the segregated portfolio, but may not reference future changes in market conditions.

I. "Date of filing," with respect to a filing for approval of a contract form under this regulation, means the date as defined by the applicable statutes or regulations of the state of issue with regard to contract filings.

Drafting Note: Individual states may wish to insert a specific reference to the applicable statute or regulation.

J. "Duration" means, with respect to the segregated portfolio assets or guaranteed contract liabilities, a measure of price sensitivity to changes in interest rates, such as the Macaulay duration or option-adjusted duration.

K. "Fair market value" means a reasonable estimate of the amount that a knowledgeable buyer of an asset would be willing to pay, and a knowledgeable seller of an asset would be willing to accept, for the asset without duress in an arm's length transaction. In the case of a publicly traded security, the fair market value is the price at which the security is traded or, if no price is available, a price that appropriately reflects the latest bid and asked prices for the security. In the case of a debt instrument that is not publicly traded, the fair market value is the discounted present value of the asset calculated at a reasonable discount rate. For all other non-publicly traded assets, fair market value will be determined in accordance with valuation practices customarily used within the financial industry.

L. "Guaranteed minimum benefits" means contract benefits on a specified date that may be either:

(1) A principal guarantee, with or without a fixed minimum interest rate guarantee, related to the segregated portfolio;

(2) An assurance as to the future investment return or performance of the segregated portfolio; or

(3) The fair market value of the segregated portfolio, to the extent that the fair market value of the assets determines the contractholder's benefits.

M. (1) "Hedging instrument" means:

(a) An interest rate futures agreement or foreign currency futures agreement, an option to purchase or sell an interest rate futures agreement or foreign currency futures agreement, or any option to purchase or sell a security or foreign currency, used in a bona fide hedging transaction; or

(b) A financial agreement or arrangement entered into with a broker, dealer or bank, qualified under applicable federal and state securities or banking law and regulation, in connection with investment in one or more securities in order to reduce the risk of changes in market valuation or to create a synthetic investment that, when added to the portfolio, reduces the risk of changes in market valuation.

(2) An instrument shall not be considered a hedging instrument or a part of a bona fide hedging transaction if it is purchased in conjunction with another instrument where the effect of the combined transaction is an increase in the portfolio's exposure to market risk.

N. "Investment guidelines" means a set of written guidelines, established in advance by the person with investment authority over the segregated portfolio, to be followed by the investment manager. The guidelines shall include a description of:

(1) The segregated portfolio's investment objectives and limitations;

(2) The investment manager's degree of discretion;

(3) The duration, asset class, quality, diversification, and other requirements of the segregated portfolio; and

(4) The manner in which derivative instruments may be used, if at all, in the segregated portfolio.

O. "Investment manager" means the person (including the contractholder) responsible for managing the assets in the segregated portfolio in accordance with the investment guidelines in a fiduciary capacity to the owner of the assets.

P. "Market value record" means an accounting record provided by the contract to reflect the fair market value of the segregated portfolio.

Q. "Permitted custodial institution" means a bank, trust company or other licensed fiduciary services provider.

Drafting Note: When adopting this regulation, individual regulators may wish to review their applicable state laws to ensure that this definition hasn't inadvertently authorized an entity to act as a custodial institution that it would not wish to do so.

R. "Plan of operation" means a written plan meeting the requirements of Section 5B(1) of this regulation.

S. "Qualified actuary" means an individual who meets the qualification standards set forth in [insert reference to section of the regulations related to actuarial opinions and memoranda].

T. "Rate period" means the period of time during which the fixed rate of return credited to the contract value record is applicable between crediting rate formula adjustments.

U. "Segregated portfolio" means:

(1) A portfolio or sub-portfolio of assets to which the contract pertains that is held in a custody or trust account by the permitted custodial institution and identified on the records of the permitted custodial institution as special custody assets held for the exclusive benefit of the retirement plans or other entities on whose behalf the contractholder holds the contract; and

(2) Any related cash or currency received by the permitted custodial institution for the account of the contractholder and held in a deposit account for the exclusive benefit of the retirement plans or other entities on whose behalf the contractholder holds the contract.

V. "Spot rate" corresponding to a given time of benefit payment means the yield on a zero-coupon non-callable and non-prepayable United States government obligation maturing at that time, or the zero-coupon yield implied by the price of a representative sampling of coupon-bearing, non-callable and non-prepayable United States government obligations in accordance with a formula set forth in the plan of operation. To the extent that guaranteed contract liabilities are denominated in a currency of a foreign country rated in one of the two (2) highest rating categories by an independent nationally recognized United States rating agency acceptable to the commissioner and are supported by investments denominated in the currency of the foreign country, the spot rate may be determined by reference to substantially similar obligations of the government of the foreign country. For liabilities other than those described above, the spot rate shall be determined on a basis mutually agreed upon by the insurer and the commissioner.

W. "Synthetic guaranteed investment contract" or "contract" means a group annuity contract or other agreement that ~~in whole or in part~~ establishes the insurer's obligations by reference to a segregated portfolio of assets that is not owned by the insurer. The contract functions as an accounting record for an accumulation fund and the fixed rate of return credited to the fund reflects an amortization of the segregated portfolio's market gains and losses based on the period specified in the crediting rate formula, subject to any minimum interest rate guarantee.

X. "Unilateral contract termination event" means an event allowing the insurer to unilaterally and immediately terminate the contract, without future liability or obligation to the contractholder.

Y. "United States government obligation" means a direct obligation issued, assumed, guaranteed or insured by the United States of America or by an agency or instrumentality of the United States government.

Z. "Valuation actuary" means the appointed actuary or, alternatively, a qualified actuary designated by the appointed actuary to render the actuarial opinion pursuant to Section 10. Written documentation of any such designation shall be on file at the company and available for review by the commissioner upon request.