January 25, 2013

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 December 12, 2012 draft memorandum, *Annuity Illustrations; 191 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. These comments are in addition to the AIS comments made on the October 18, 2012 draft memorandum.

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

Sincerely,

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[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.

MEMORANDUM

To: **Persons Licensed in Iowa to Sell Annuities**

From: **Susan E. Voss, Insurance Commissioner**

Re: **Annuity Illustrations; 191 Iowa Administrative Code rules 15.61-.69**

Date: **December ___, 2012**

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I. __Introduction__

Iowa adopted rules to provide standards for the disclosure of certain minimum information about annuity contracts (191 Iowa Administrative Code rules 15.61-15.69), which became effective April 11, 2012. An e-mail from Rosanne Mead of the Division was distributed on November 15, 2012, which gave some guidance on these rules, which are based on the new NAIC regulation on fixed annuity illustrations. A memo from Rosanne Mead to persons interested in Iowa's adoption of the new rules, dated November 27, 2012, also was circulated by the Division.

The rules apply to certain annuities issued after January 1, 2013 (as detailed in rule 15.62). Since the adoption of these rules, questions have arisen as to interpretation and application of certain parts of those rules. This memorandum is intended to provide some guidance related to the questions received by the insurance Division.

This memorandum supersedes the memo of November 27, 2012 and related e-mail. The references in this memorandum are to 191 Iowa Administrative Code rules, as numbered.

Any specific waiver request of 191 Iowa Administrative Code rules 15.68-15.73 must be filed in accordance with 191 Iowa Administrative Code rules 4.21-4.36.

Should you have any questions concerning this notice or the rules, please contact Rosanne Mead at the Insurance Division. She may be reached at __rosanne.mead@iid.iowa.gov__.

II. Implementation of 191 Iowa Administrative Code 15.61-15.69 by Companies and Enforcement by the Division

A. Rule 191 IAC 15.64. Buyer's Guide. Companies shall have a Buyer's Guide available as directed by this rule as of July 1, 2013, and the Division will enforce the rule after that date. The NAIC currently is working on the ~~fixed~~ annuity Buyer's Guide model. It is anticipated that it will be adopted in the first quarter of 2013. Companies may use their current Buyer's Guides until July 1 for sales of fixed annuities. For the sale of variable annuities, no Buyer's Guide needs to be used until after July 1, 2013. After that date, the new NAIC model ~~fixed~~ annuity Buyer's Guide should be used for sales of variable annuities because it has language about variable annuities. ~~It can be used for variable annuities until a specific one is developed for variable annuities.~~

B. Rule 191 IAC 15.65. Content of disclosure documents. Companies shall be in compliance with this rule as of January 1, 2013, and the Division will enforce it after that date.

C. Rule 191 IAC 15.66. Standards for annuity illustrations. Companies shall be in compliance with this rule on and after July 1, 2013, and the Division will enforce it after that date.

D. Compliance with the rules. The IID will use a phased approach to enforcing the new illustration requirement. Prior to July 1, 2013, any apparent violation will be investigated and the IID will carefully consider whether the insurer made a good faith effort to comply with the new regulations. The IID will work with industry to clarify the requirements of the regulation. Formal administrative action will not be taken if a good faith effort has been made. Misrepresentations or omissions always are grounds for administrative investigation and action.

"Good faith effort" will be a question of fact, but will include how well a company is progressing in the development ~~of new Buyers' Guides, and~~ of disclosure and illustration documents. Another factor the Division will consider will be whether any implementation of new guides or documents has begun in sales presentations.

III. General principles.

A. The goal of these rules is to ensure that purchasers of annuity contracts understand certain basic features of annuity contracts. *See* 191-IAC 15.61. Illustrations are to be used to demonstrate how the product works, and are not intended to be used to compare two products against each other except as to how the contract features work~~not to be used for comparison purposes and marketing~~.

AIS Comment: The redlined language was copied from paragraph IV(N).

B. These rules apply only to illustrations as defined in 191 IAC 15.63. For something to be an illustration, three things must be present:

1. A personalized presentation or depiction. Whether something in a presentation is "personalized" is a question of fact. Caution should be used when using nonguaranteed elements in a presentation.
2. Prepared for and provided to an individual customer.
3. Includes~~ing~~ non-guaranteed elements of an annuity contract.

If any one of these three things are missing, it is not an illustration for purposes of these rules, and these rules do not apply. It is possible to present something that is not an illustration, *i.e*., does not contain all three elements above, but the determination of whether a presentation is detailed enough to be "personalized" will be a question of fact.

C. Illustrations must be specific to the annuity contract.

D. The use of annuity illustrations is optional.

E. The combining of an illustration and a disclosure would be permissible as long as the disclosure statement takes precedence over the illustration. The disclosure may not be unfairly minimized. The disclosure and the illustration are not sales documents. Duplication of information should be avoided to avoid confusion and unnecessary length.

F. The definitions in these rules override any definitions used in 191 IAC Chapter 16.(Replacements)

G. Substantive changes to a contract ~~after~~ between application and issue must be accompanied by a ~~new supplemental~~ revised illustration. Mere premium or contributions changes do not constitute substantive changes requiring a new illustration. "Substantive" means affecting the way the contract works. If a company wants to do a ~~supplemental~~ revised illustration for a nonsubstantive change, that is not prohibited.

IV. Topical Guidance.

The Division previously requested interested persons to submit questions about how to implement these rules. A summary of the Division's responses are set forth below for guidance.

A. *Delivery requirements*. The Division's expectations for compliance with the delivery requirements of these rules are set forth above in paragraphs II.A., II.B. and II.C.

B. *Insurers should ~~maintain~~ calculate separate ~~ledgers~~ values for each crediting method*. If a product has multiple crediting methods, an insurer must ~~maintain and~~ separately track the performance of each crediting method. ~~Each crediting method must be tracked for its performance and the insurer must be able to produce a computation for the high, low and fixed options~~~~scenarios.~~ The insurer need not show separate values for each crediting method on the illustration.

AIS Comment: The model regulation allows companies to show separate values for each crediting method, but it does not require it.

~~C.~~ *Indexed-based interest must be based on~~The regulation requires a~~ ten-year ~~illustration~~periods*. If an annuity has an ~~option~~index-based crediting method that is longer ~~or shorter~~ than ten years, the ~~longer or shorter period also must be disclosed prominently in the narrative, and 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~~insurer should construct index values beyond the ten-year period by repeating the movements of the index during the ten-year period.

~~D.~~

C. For example, if ~~a contract~~indexed-based interest is calculated on a 12-year basis, ~~the illustration would have to show how the 12-year contract works. The illustration should 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 70. 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~~ the insurer should construct index values for end of year 11 and end of year 12 by applying the annual changes from years 1 and 2 to the end of year 10 index value. This approach will produce the same historical index environment as an annual crediting method that repeats the first 10 years of index changes.

AIS Comment: This proposed language aligns with comments in our letter to the Division on 12/11/12.

D. *Illustration beyond age 70*. Depending on the age of the annuitant at the time of illustration, the requirements outlined in subrule 15.66(8) may result in an illustration for a period past the annuitization date, which is not allowed by subrule 15.66(6)(s). Rule 15.66(7)(e)(6)(2) addresses this. Rule 15.66(8) must be followed, but in the scenario described, a notation in the illustration is necessary to illustrate past age of 70 and still be in compliance. If the contract has a maximum annuitization age or date, and if it is less than what is required under 15.66(8), that fact has to be referenced in the narrative.

AIS Comment: An illustration should not show something that cannot happen (consistent with IID comments in paragraph IV(T)), so it should not demonstrate values beyond a contract's maximum annuity date. Doing so would cause significant consumer confusion as to the features of a specific contract and would make it impossible to accurately compare the features of different contracts.

E. *Illustration of nonguaranteed elements statement required by subrule 15.66(6)(n).* The required statement about nonguaranteed elements should be contained in the narrative summary, but the Division believes that a best practice would be to show it also prominently below the ~~ledger~~illustrated values.

F. *Annuitization must be illustrated. See* rule 15.66(7)(a).

G. *Subrule 15.66(6)(q) requires that illustrations be concise and easy to read*. There is no specific technical guidance on this subrule. The illustration should be reasonable in relation to the complexity of the product.

H. *Low and high scenarios under subrule 15.66(6)(i)(9).* The rule means that, in any of the prescribed scenarios, the values should reflect ~~the low scenario could reflect~~ at least one index-based interest rate at the floor (typically 0%) ~~"zero" return if the index is negative in performance. The high scenario could show the~~ , and at least one index-based interest rate that is ~~returning~~ less than the full ~~total return of the high~~ index value increase (i.e., limited by a cap, spread, and/or participation rate). ~~This will not always happen, so~~If this doesn't happen in any of the prescribed scenarios, the narrative should explain what could happen.

I. *Market value adjustment (MVA).* ~~An annuity product that has no ceiling on the MVA.~~ Subrule 15.66(9)(f) requires that a positive and negative scenario be shown. An illustration that shows the MVA at the floor (guaranteed values) and flat (nonguaranteed values), where no positive scenario is shown, would not meet the criteria of subparagraphs 15.66(9)(f) and (g). A flat ~~option~~ scenario is not considered a positive scenario.

J. *If an illustration is not used, client-specific information may be used as described in paragraph III.B.* According to the definition of "illustration" in section 15.63, as long as only guaranteed elements are used, a producer may use a company-approved brochure to explain the benefits of a contract, but the producer may not show numbers that ~~project~~ illustrate nonguaranteed elements.

~~A producer may not verbally do what is not permitted by the rules. There is no requirement that an illustration be in writing.~~An oral presentation of personalized values is an illustration and, thus, subject to the regulation.

Hypothetical generic examples are permitted, but the Division will review such examples to determine as~~s~~ a question of fact the personalized nature of the hypothetical for purposes of determining whether it is an illustration.

AIS Comment: Timing of the Division's review seems unclear.

K. *Terms*. Terms such as "projection" or "calculator" may be used in an illustration.

AIS Comment: Allowing an illustration to be called a "projection" seems to be in conflict with other paragraphs in this draft. We are uncertain why the term "calculator" is specifically allowed and what its definition would be.

L. *Surrender Value*. If the amount of a policy's surrender value is different than the account value, both surrender value and account value must be shown in an illustration. Surrender values need not be shown for the low and high 10-year scenarios.

AIS Comment: The model regulation allows companies to show surrender values in the low and high scenarios, but it does not require it.

The intent of requiring the low and high 10-year scenarios was to show the difference between the geometric mean annual effective rates for the account value in three scenarios (low, high, most recent 10), and to graph them for a simple view of the differences. If surrender values were required, would surrender values also be required in the graph? Doing so would cause the graph comparison to become more confusing than helpful.

Surrender values are already shown in the guaranteed illustrated values and the most recent 10-year illustrated values. Showing surrender values again for the low and high scenarios would cause the illustration to have too many numbers to be effective.

M. *Portrayal of periodic income options.* ~~The annuity income options that should be listed in the narrative summary depends on the type of annuity. The explanation must be specific to the product and examples should not be used~~At least one annuity option must be illustrated, and the numbers shown must constitute a personalized depiction. See: Subrule 15.66(7)(e)(6).

N. *Comparison of products*. Illustrations are not intended to be used to compare two products against each other except as to how the contract features work. It is not appropriate to use illustrations to compare the numbers or earnings on products. An insurer and a producer must use caution in presenting illustrated and non-illustrated products together.

O. *Violations.* Violations of the rule on illustrations will be considered unfair trade practices and will be prosecuted under Iowa Code Chapter 507B(2011). *See* 15.68.

P. *Use of internet materials.* If illustrations or documents from the internet are used for sales in Iowa, Iowa statutes and regulations (including these rules) would apply.

Q. *When in a sales presentation the disclosure requirements apply.* The requirements of the annuity disclosure regulation are triggered when the producer starts talking about the attributes or potential elements of any contract the producer is offering. A producer should identify the company for whom the producer is working and identify the product prior to the presentation. *See* 191 IAC 15.3(9). The name of the company and the product name must be clearly disclosed on the product-specific disclosure.

R. *Allocations to more than one account.* If a fixed indexed annuity provides an option to allocate the account value to more than one indexed or fixed declared rate account, the allocation used in the illustration shall be the same for all three scenarios. All scenarios must use the same allocation assumptions ~~percentages must be the same in all scenarios.~~ .

S. *Contracts issued other than as applied for.* A new illustration is required if a contract is issued other than as applied for. “Other than as applied for” refers to changes in benefits or features that are different from what was first illustrated. “Other than as applied for” includes changes in charges and fees. Changes in premium received (such out of pocket money or the various types of transfers or 1035-exchanges) are not included in the meaning of “other than as applied for.”

T. *Appendix V.* This is only an example illustration. It illustrates how information can be shown. There is no requirement that illustrations have to be exactly like Appendix V. If information is required by the rules to be included, then that information should be included. If a product has attributes which are not contemplated by these rules, paragraph 15.66(9)(h) requires that a description must be included. Additionally, an illustration may not show something that cannot happen. For example, if an interest rate has no room to go down, the ~~graph~~ illustration may not show an interest rate below what the contract provides.

U. *Account value vs. index value method.* The low and high 10-year scenarios should be determined based on lowest and highest index value growth, not account value growth. In other words, the high 10-year scenario should be the same for all insurers for each index (e.g. S&P 500), regardless of the index-based crediting methods, caps, spreads, participation rates, etc.

Although unlikely, it is mathematically possible that a low scenario determined using the index value method could result in higher account values than the account values in the high scenario. The Division considered this fact, but ultimately rejected the account value method due to its complexity. The index value method is simpler for systems calculations (since the low and high scenarios for each index are determined only once per year), easier for regulators to review (since all insurers use the same time periods for each index), and clearer for the consumer (since cap changes could cause low and high periods to shift under the account value method).

V. Questions to Interested Persons and Request for Comments:

A. Question related to section IV.D. Do we need to amend our regulation and/or the model to account for the IID response that a notation should be shown in the narrative summary? Does 15.66(7)(e)(6)(2) sufficiently address the issue?

B. NAFA and the AAA have provided a two-page chart. What should IID do with this information? Add it to the final FAQ?

AIS Comment: We do not recommend IID include the NAFA two-page chart in the final draft memorandum. Instead, we recommend the language in paragraph IV(U) above.

C. How do companies proposed to combine fixed ledger with other options ledgers? How will this avoid consumer confusion? Please provide an example.

AIS Comment: We assume "ledger" has the same meaning as "illustrated values." If a consumer plans to allocate a portion of the account value to a fixed interest strategy (e.g. 25%), it is appropriate for the illustrated values to reflect the interest earned in that strategy. On a guaranteed basis, the only interest shown would be the interest earned in the fixed interest strategy (assuming a 0% indexed strategy floor), so the consumer would see a weighted interest rate each year (e.g., 25% of the annuity earns a 1% guarantee, so the annuity grows 0.25% each year with rebalancing). On a hypothetical basis, the weighted interest rate would reflect both the fixed rate and the index-based rate(s). Since the illustration is not intended to highlight specific interest rates, there is no need to separate the fixed rate from the index-based rate(s).

D. Replacements. What amendments to the Iowa replacement regulation (IAC 191-16) are necessary to either IAC 191-15 or 16 to minimize any confusion between the two rules. Is there a need for additional cross-references? A side-by side review of the definitions and types of illustrations may be necessary.

E. On a fixed indexed annuity that accepts modal premiums each year, may the annual geometric mean rate be used in the indexed interest rate calculation? The alternative would be to show monthly values but this would result in 120 lines of values for 10 years. If yes, does that require an amendment to the rule?

AIS Comment: We believe the rule allows for modal premium products without amendment and recommend the following approach (assuming monthly premiums):

Assume over a 10-year period, an index changes 1% in the first year, 2% in the second year, etc, and an annuity credits the entire index change as interest. Each of the 12 monthly premiums paid during the first policy year should earn 1%

interest exactly one year from when each premium was paid. After the first 12 months, the 13th premium should be placed into a "bucket" with the first premium (plus 1% interest), and the total amount in that bucket should earn 2% exactly one year later. The 14th premium should be placed into a bucket with the second premium (plus the 1% interest), and the total amount in that bucket should earn 2% exactly one year later. If the illustration needs to extend beyond 10 years, in the 11th year, the buckets would earn 1%, then 2%, then 3%, etc.

The model regulation requires illustrations to show annual values, but insurers could choose to show monthly values. If annual values are shown, we recommend adding asterisked language to the Premium column, such as "This product assumes premium was paid monthly. Not all premiums shown were applied to the contract at the beginning of each year."

F. If a customer elects to allocate their premium to less than all of the various index strategies or subaccounts, do you have to show all of the potential allocation strategies or just the strategies selected by the customer? For example, if a variable annuity offered 200 different allocation subaccounts, would the illustration have to show all 200?

AIS Comment: Only the selected allocation strategies need to be shown.

G. Should the Division amend subparagraph 15.66(6)(i)(8)(1) to clarify that an illustration must show surrender values if different than account values?

AIS Comment: We intentionally excluded surrender values from the high and low scenarios in the model regulation. If the Division amends subparagraph 15.66(6)(i)(8)(1), we recommend adding the word "even" to the parenthetical phrase so the regulation reads "[(8) The low and high scenarios:] 1. Need not show surrender values (<u>even</u> if different than account values)." Please see our full Comment in paragraph IV(L).