CARLTON FIELDS

Changes to the Index Product Illustration Requirements Are No Child's Play

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The NAIC's Annuity Disclosure Working Group and IUL Illustration Subgroup continue to chalk out changes to the Annuity Disclosure Model Regulation (Model) and Actuarial Guideline 49 (AG 49) to address index product innovation.

Annuity Disclosure Working Group

The Annuity Disclosure Working Group held class on May 13 and June 5 to discuss the March 7 draft revisions to the Annuity Disclosure Model Regulation, which proposes to modify the requirements applicable to illustrations of index accounts. During those calls, the Working Group discussed the requirements that:

- The index be in existence at least 20 years.

  Birny Birnbaum argued that an index must be around at least 20 years to be able to illustrate the 10-year low and high scenarios to show consumers how index volatility impacts the interest credited. He asserted that less than 20 years would not show meaningful differences in the low and high scenarios. He and several regulators were also concerned that composite indices could be "drawn up" to illustrate favorably by data mining recent historical experience. Regulators also believed that some seasoning of the index helps ensure that the index is not arbitrarily being put together.

- The index may only be comprised of other indices.

  Various commenters raised their hands pointing out that erasing the term “components” from the Model would exclude indices that are based on ETFs, futures contracts, and other financial instruments that are commonly used in indices. Regulators were hesitant to use components out of concern that things “may get out of hand” unless components are defined.

- The index algorithm or method be fixed.

  Hands were also raised to object to the language requiring that the index algorithm or method be fixed. Commenters noted that this requirement is too restrictive, and that there are market reasons for changes in the algorithm or method, including where the construction of the underlying index changed.

- The index algorithm or method be available for inspection by regulators and consumers.

  Commenters also questioned whether requiring the algorithm or method to be available for inspection by consumers would cause more consumers to be confused. All agreed that consumers need to understand how the index operates and how its value can change. The Working Group noted that the level specificity of what needs to be disclosed is not yet settled.

After the June 5 call, the issues remain unsettled. The Working Group will schedule one more class to continue the lesson.

IUL Illustration Subgroup

The IUL Illustration Subgroup held class on May 28 to discuss a menu of options for enhancing IUL illustrations, reflecting comments from all the papers submitted to the Subgroup. While the menu contained 23 different subjects, the meeting focused on the options that are considered “beyond disclosure,” because they require changes to AG 49 and possibly beyond. During the discussion, Mr. Birnbaum asserted that a complete overhaul of the illustration requirements is needed, as he does not believe merely adding more charts or disclosures to AG 49 would be sufficient. The chair assigned homework and asked for comments on the following options:

- Clarify whether charges can impact assumed earned interest underlying the AG 49’s ‘disciplined current scale.’
- Limit the use of variable/index loans.
- Have consistent treatment of various IUL product types.

- Apply AG 49 constraints to cash value internal rate of return.

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