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Spring Webinar Series 2025

Index-Linked Variable Annuities

Presented by: Karen Givens

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What is an Index-Linked Variable Annuity (ILVA)?

Contract Features

- ILVA contracts credit interest based on the performance of an index.
- ILVAs include features like caps, participation rates, spreads, margins, and protections such as floors or buffers to manage the risk of negative index returns.

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Contract Features

- The value of the annuity can increase or decrease based on the index performance, but there are protections like floors or buffers to limit losses. The ILVA Standard requires some protection on loss.
- ILVAs are considered variable annuities because their benefits vary based on the performance of an index and can result in a loss. This classification exempts them from the standard nonforfeiture law, which typically applies to fixed annuities.

Actuarial Guideline 54

- The guideline was developed by the Life Actuarial (A) Task Force and the ILVA (A) Subgroup, with input from various states and industry stakeholders.
- **Purpose:** This guideline specifies conditions under which an Index-Linked Variable Annuity (ILVA) is considered a variable annuity and exempt from Model 805. It also outlines nonforfeiture requirements consistent with variable annuities.

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Crediting Elements

- **Caps:** This is the maximum rate of interest that can be credited in a given period. If the index performs exceptionally well, the interest credited will be capped at this rate.
- **Participation Rates:** This determines the percentage of the index's gain that will be credited to the annuity. For example, if the participation rate is 80% and the index gains 10%, the annuity will be credited with 8%.
- **Spreads or Margins:** These are deductions from the index's performance before interest is credited. For instance, if the index gains 10% and the spread is 2%, the annuity will be credited with 8%.
- **Floors or Buffers:** These are protections that limit losses. A floor might ensure that the interest credited never falls below 0%, even if the index performs poorly.

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What is Interim Value?

- Refers to the value of the annuity at any time other than the start or end date of an index strategy term.
- It is used to determine various contractual values such as death benefits, transfer amounts, withdrawal amounts, annuitization amounts, or surrender values

Hypothetical Portfolio

- The hypothetical portfolio is a mix of two types of theoretical investments designed to mimic the performance of an index:
  - Fixed Income Asset Proxy: This represents stable investments like bonds.
  - Derivative Asset Proxy: This represents investments that track the index, like options or futures.
- Purpose
  - Stability: The fixed income part provides a stable base value.
  - Growth: The derivative part captures the gains or losses based on the index performance.

Hypothetical Portfolio

- How It Works
  - Start: The portfolio is set up with a mix of these assets.
  - During the Term: The value changes based on market conditions.
  - End of Term: The final value determines the interest credited to the annuity.

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Interim Value Example

- Imagine an ILVA contract with an index strategy term of one year. If the contract holder wants to withdraw funds six months into the term, the interim value will be calculated based on the hypothetical portfolio's performance up to that point, ensuring a fair and transparent valuation.
- These aspects ensure that interim values are fair, consistent, and transparent, providing contract holders with a clear understanding of their annuity's value at any point during the index strategy term.

Questions?

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Uniform Standard Background

Historical Information

- In 2022, the NAIC, through its Life Actuarial (A) Task Force, adopted Actuarial Guideline 54 (AG 54), effective on July 1, 2024.

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Index Linked Variable Annuity (ILVA) Uniform Standard

- April 25 - Contract standards adopted by Commission
  - Amendments to separate account MVA standard to accommodate ILVA also adopted
- May 28 - States identify intent to opt out
  - Oregon has opted out
- Aug. 12 - Effective date for filing approval
  - Review will occur in regular queue only for the time being
  - Not eligible for ERP queue

Index Linked Variable Annuity (ILVA) Uniform Standard

- Expansion of certain annuity benefit feature standards to accommodate ILVA products
  - Scope provision amended to include ILVA products
  - Waiver of Surrender Charges, Guaranteed Minimum Death Benefits & Bonus benefit standards impacted
  - Amendments became effective December 2, 2024

Do the ILVA Standards permit other methodologies?

- No, the ILVA standard requires use of hypothetical portfolio methodology to determine interim values.
- Unlike AG 54, the ILVA standard does not allow other methodologies because no standard definition of materially consistent has been developed, which would allow the Compact to uniformly determine that the interim values are materially consistent with the interim values resulting from the hypothetical portfolio methodology.

Questions?

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Tips for Compliance with the ILVA Uniform Standards

Key Issues in Reviews

- Interim Values – must be described in both the contract and actuarial memorandum
- Description of the specific option pricing model/s and the parameters used in the model to value the options that make up the derivative asset proxy component of the interim value
- Free Look Refund Amount
  - For non-variable account value and ILVA - refund amount is return of purchase payments
  - For variable account value – refund amount is contract value
  - Standards have specific definitions for “variable account value” and “ILVA”

Key Issues in Reviews

- Actuarial memorandum – double-check for all descriptions and certifications required including for MVA
  - Examples:
    - Certification that interim values provide equity between company and holder
    - Opinion that MVA formula is expected to produce results reasonably similar to changes in the market value of the investments backing the contract
    - Description of all elements used in determining amount credited including fees/charges

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Key Issues in Reviews

- Special provisions on change/discontinuation of index
  - Prior approval required to change index
  - Form must address
  - Conditions supporting discontinuation of index are set forth in standard
  - Drafting Note clarifies companies are permitted to substitute an index for in-force contracts to address these scenarios during a strategy term or making the index or index strategy unavailable at the end of a strategy term or no longer making the strategy available for new issues.
  - Companies are not permitted to unilaterally discontinue a strategy term during the term period

Key Issues in Reviews

- Special Cover Page Requirements
  - Product description must include the word “variable”. For example: “Flexible Premium Deferred Index-Linked Variable Annuity Contract”
  - Specific disclosures required
- Limitations on loss/some downside protection is required by the use of a floor or buffer (See Scope)
  - Example – a “0” in the range of variability for a buffer would not comply

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Questions?

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