

Department of Banking, Insurance, Securities & Health Care Administration

Insurance Division

BULLETIN 110: Indexed Annuities

Sept. 18, 1996

INTRODUCTION

The filing of indexed annuities has caused concern in this Department. These contracts are fixed annuities where non-guaranteed additional credit interest is based upon a formula tied to some data or index outside the contract. There are equity indexed products which frequently use the Standard and Poor's 500 index. There are also fixed income indexed products, which use a bond index, such as the Lehman Brothers index. The benefits in these contracts are tied directly to the index, so that contract values can vary based upon the performance of the investment markets. The application of the index or outside data to the contract values can vary greatly from contract to contract. These contracts need adequate disclosure to prevent the consumer from getting the impression that these contracts are similar to variable annuities and to promote consumer understanding.

PRODUCT TRAITS

All products should have the following distinguishing characteristics:

- The application of the index to the contract values must be established at least one year in advance.
- The products must be sold by licensed insurance agents.
- The contract must contain the minimum guarantees required by Vermont's Standard Nonforfeiture law.

REQUIRED FOR APPROVAL IN VERMONT

The contract description on page one must contain the word "indexed". Other words can be used with the approval of the Department.

- The insurer must provide a copy of a buyer's guide or informational material which at a minimum provides a description of the index used and a description of how it is applied.
- The insurer must display in the buyer's guide the index values for the most recent five years and the change per year expressed as a percentage and demonstrate its effect on a hypothetical dollar amount paid into the contract at the beginning of the five years shown.
- Long term illustrations can not be used to imply future performance. On the other hand, demonstrations of the most recent five years of policy mechanics under

both positive and negative market conditions may be used for further understanding of the policy.

- The insurer must warrant to the Department that any change in the index used will be filed with the Department prior to use.
- The index must be widely quoted and available on most business days in the United States.
- If caps and participation ratios are used to limit the growth of annuity values, a description of the feature(s) and a listing of the current caps or ratios imposed by the insurance company must be provided. If non-guaranteed future caps or ratios may be applied, the buyer's guide must disclose such facts.
- The use of a ratchet design must be disclosed. As used in this paragraph a ratchet design is one that locks into the contract all index-related gains at least once a year (calendar year or policy year). A design which determines index increases less frequently than annually or which does not fully "vest" all such increases at least annually is not designated a "ratchet" design. The buyer's guide must disclose the frequency and degree of the guarantee of index related gains.
- Sales brochures and promotional literature must emphasize the insurance nature and long term focus of the product and may not refer in any way to this contract being an investment vehicle.
- A copy signed by the insured or certificate holder, indicating the receipt of a copy of the buyer's guide and an understanding of its disclosures, must be kept in the insurers records.

IN GENERAL

The filing must contain a draft of the buyer's guide. The insurer is free to insert other language in the buyer's guide . The company is free to use its own format in the guide. The buyer's guide must have language that can be easily understood by the buyer. The insurer must provide the Department with a Flesch score certificate for the buyers guide of 50 or greater. The buyer' guide must be easy to read and understand and no longer than two 8 2" x 11" pages.

As with all filings made in Vermont the insurer must supply:

- a filing fee,
- stamped addressed return envelope to receive notice of our action.
- To receive our file number, prior to our review, a stamped self addressed acknowledgment envelope,
- two copies of the cover letter,
- a Flesch test certificate,
- one copy of the contract,
- appropriate actuarial memo,
- and a microfiche.

Insurers may contact the following individual, if you have any questions concerning this bulletin of indexed annuities:

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