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Bulletin 408

Illustrations for Participating Income Annuities

The intent of the bulletin is to clarify how the annuity illustration standards in Bureau of Insurance Rule 915 apply to participating income annuity illustrations. A participating income annuity is a fixed annuity that pays both a guaranteed income stream and a nonguaranteed dividend, with the dividend determined by the insurer based in part upon the policy experience (*e.g.*, investment, mortality, expense).

Section 6 of the Rule prohibits fixed annuity illustrations that have the capacity or tendency to mislead.¹ In particular, any illustration based on non-guaranteed elements: (1) may not be more favorable than the current values of those non-guaranteed elements; (2) may not include any assumed future improvement of the non-guaranteed elements; and (3) must reflect any planned changes in the non-guaranteed elements, such as the expiration of a bonus period.²

Therefore, because a dividend scale for a participating income annuity is a nonguaranteed element, illustrations for these annuities may not assume any future improvement in the applicable dividend scale (or scales if more than one dividend scale applies, such as for a flexible premium annuity). Furthermore, they may not assume that the current dividend scale will be maintained in future years unless the company reasonably expects it to be more likely than not that the current dividend scale, and any specific underlying measures used to calculate the dividend scale, are sustainable on a long-term basis.

The company's expectations must be both subjectively and objectively reasonable. To be subjectively reasonable, they must be the same assumptions on which the company itself relies. The program must be designed so that the company will apportion dividends fairly and equitably, whether performance meets, exceeds, or falls short of expectations. The company may not arbitrarily change the assumptions it uses in its illustrations – if it bases expected future investment performance on a long-term time horizon at times when observed past performance is better in the long term than the short term, it may not switch to a shorter time horizon when short-term performance improves.

¹ Bureau of Insurance Rule 915, § 6(D)(1).

² *Id.*, § 6(F)(8).



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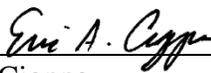
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To be objectively reasonable, assumptions about future investment performance must be consistent with assumptions that are reflected in the marketplace within the normal range of analyst forecasts and investor behavior. If the dividend scale is based on a portfolio rate method, the portfolio rate underlying the illustrated dividend scale shall not be assumed to increase. For a participating income annuity product where the dividend scale is based on an investment cohort method, the illustrated dividend scale should assume that reinvestment rates grade to long-term interest rates. For the purposes of this grading, the assumed long-term U.S. Treasury rates should not exceed the rates listed in the table below, based on the tenor (time to maturity/reinvestment) of the investments underlying the cohort of policies. Grading to the long-term U.S. Treasury rates should take place over (a) no less than 20 years from issue if U.S. Treasury rates as of the illustration date are below the long-term rates, or (b) no more than 20 years from issue if the U.S. Treasury rates as of the illustration date are above the long-term rates.

Tenor	Maximum Assumed Long-term U.S. Treasury Rate
3 Month (or less)	3.00%
5 Year	4.50%
10 Year	5.00%
20 Years (or more)	5.50%

The rates in the table above are stated on a bond equivalent yield basis. For points on the U.S. Treasury yield curve not listed above, the maximum long-term rates should be determined using linear interpolation. This rate table will be reviewed periodically and may be adjusted to reflect changes in market conditions.

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 Eric A. Cioppa
 Superintendent of Insurance

NOTE: This Bulletin is intended solely for informational purposes. It is not intended to set forth legal rights, duties, or privileges, nor is it intended to provide legal advice. Readers should consult applicable statutes and rules and contact the Bureau of Insurance if additional information is needed.