ARC 7915B

INSURANCE DIVISION[191]

Notice of Intended Action

Twenty-five interested persons, a governmental subdivision, an agency or association of 25 or more persons may demand an oral presentation hereon as provided in Iowa Code section 17A.4(1)*"b."*

Notice is also given to the public that the Administrative Rules Review Committee may, on its own motion or on written request by any individual or group, review this proposed action under section 17A.8(6) at a regular or special meeting where the public or interested persons may be heard.

Pursuant to the authority of Iowa Code section 505.8, the Iowa Insurance Division hereby gives Notice of Intended Action to adopt new Chapter 97, "Accounting for Certain Derivative Instruments Used to Hedge the Growth in Interest Credited for Indexed Insurance Products and Accounting for the Indexed Insurance Products Reserve," Iowa Administrative Code.

The purpose of the new rules is to address the mismatch related to changes in value for the derivative assets as compared to the interest accrual in the reserve calculation and to provide insurance companies with the ability, once certain criteria are met, to: (1) change the accounting for option assets that hedge insurance companies indexed insurance products to the amortized cost method, and (2) change the indexed annuity reserve calculation methodology such that index credit returns will be included in the reserve only after they have been credited to the policy. The new chapter will allow for a more accurate representation of an insurance company's capital position.

The Insurance Division intends that these proposed rules will go into effect September 30, 2009.

Any interested person may make written suggestions or comments on these proposed rules on or before July 21, 2009. Written comments shall be directed to Matt Hargrafen, Iowa Insurance Division, 330 Maple Street, Des Moines, Iowa 50319; may be E-mailed to matthew.hargrafen@iid.iowa.gov; or may be sent by facsimile to (515)281-4096.

A public hearing will be held on July 21, 2009, at 10 a.m. in the Lobby Conference Room of the Iowa Insurance Division, 330 Maple Street, Des Moines, Iowa, at which time persons may present their views orally or in writing. At the hearing, persons will be asked to give their names and addresses for the record and to confine remarks to the subject of the proposed rules.

Any persons who intend to attend the public hearing and have special requirements, such as those relating to hearing and mobility impairments, should contact the Insurance Division and advise of their specific needs.

These rules are intended to implement Iowa Code chapter 508.

The following amendment is proposed.

Adopt the following **new** 191—Chapter 97:

CHAPTER 97
ACCOUNTING FOR CERTAIN DERIVATIVE INSTRUMENTS USED TO HEDGE THE GROWTH IN INTEREST CREDITED FOR INDEXED INSURANCE PRODUCTS AND ACCOUNTING FOR THE INDEXED INSURANCE PRODUCTS RESERVE

191—97.1(508) Authority. This chapter is promulgated by the commissioner of insurance pursuant to Iowa Code section 505.8.

191—97.2(508) Purpose. The purpose of this chapter is to allow insurance companies to utilize certain alternative asset and reserve accounting practices for eligible derivative assets and indexed products, respectively, in order to better match asset and reserve accounting as it relates to interest crediting for indexed products and to provide for a more true and fair representation of the capital position of insurance companies that offer or have in force indexed products. Specifically, this chapter addresses the mismatch related to the changes in value of an eligible derivative asset as compared to the interest accrual in the reserve calculation for the underlying indexed product and provides insurance companies with the ability, once certain criteria are met, to: (1) account for eligible derivative assets using the amortized cost method, and (2) use a reserve calculation methodology for indexed annuity products under which interest credits based upon one or more external indices are included in the reserve only after those interest credits have been credited to the contract holder under the terms of the annuity contract.

191—97.3(508) Definitions. For the purposes of this chapter, the following definitions shall apply:

"Eligible derivative asset" means:

1. A call or put option derivative asset that is purchased to hedge the growth in interest credited to an indexed product as a direct result of changes in the related external index or external indices, or
2. A call or put option derivative asset that is written to offset all or a portion of a call or put option derivative asset that meets the criteria set forth in paragraph "1" of this definition.

Other derivative instruments, such as index futures, swaps and "swaptions," that may be used to hedge the growth in interest credited to indexed products as a direct result of changes in the related external index or external indices are not eligible derivative assets because an amortized cost for such instruments does not exist.

"External index" means an index of publicly traded securities that is published or disseminated by a source external to the insurance company, such as, but not limited to, the Standard & Poor's 500 Composite Stock Index (the S&P 500® Index), the Nasdaq-100 Index®, the Dow Jones Industrial Average℠, the Hang Seng Index, and the Dow Jones EURO STOXX 50® Index.

"Indexed annuity products" means fixed indexed annuity contracts that:

1. Provide a minimum guaranteed interest accumulation on a portion of all premium payments, and
2. Include interest crediting provisions under which interest (which may be subject to caps, participation rates, spreads, terms or similar limitations) is credited based upon the performance of one or more external indices.

"Indexed life products" means fixed indexed life insurance policies that:

1. Provide a minimum guaranteed interest accumulation on a portion of all premium payments, and
2. Include interest crediting provisions under which interest (which may be subject to caps, participation rates, spreads, terms or similar limitations) is credited based upon the performance of one or more external indices.

"Indexed products" means indexed annuity products and indexed life products.

"Interest crediting period" means the period of time over which the performance of an external index or external indices is measured for purposes of determining the amount of interest credited under an indexed product.

191—97.4(508) Asset accounting. Insurance companies may elect to account for eligible derivative assets at amortized cost, if the insurance company can demonstrate that such eligible derivative assets meet all of the following criteria for an economic hedge:

97.4(1) At inception of the hedge, or as of the date that an insurance company elects to use the accounting practices prescribed by this chapter if later, there must be formal documentation of the economic hedging relationship and the insurance company's risk management objective and strategy for undertaking the economic hedge, including identification of the specific eligible derivative assets purchased to hedge indexed products, the nature of the particular risk being hedged, and how the eligible derivative assets' effectiveness will be assessed, retrospectively and prospectively, on a qualitative basis.

97.4(2) At inception of the hedge, or as of the date that an insurance company elects to use the accounting practices prescribed by this chapter if later, and at the end of each quarterly reporting period thereafter, the insurance company must maintain documentation that the economic hedge is expected to be and continues to be highly effective as defined by the criteria in 97.4(1) in achieving offsetting changes in fair value attributable to the hedged risk during the period that the economic hedge is designated.

191—97.5(508) Indexed annuity product reserve calculation methodology. Insurance companies account for indexed annuity product reserves in accordance with Iowa Code section 508.11 and with the applicable actuarial guidelines and statutory accounting principles. Based on the current guidelines, this chapter provides insurance companies with the ability to make the following adjustment to their indexed annuity product reserves:

97.5(1) Insurance companies determine indexed annuity product reserve calculations based on the Actuarial Guideline XXXV reserve, assuming the market value of the eligible derivative assets associated with the current interest crediting period is zero, regardless of the observable market for such eligible derivative assets.

97.5(2) At the conclusion of each interest crediting period, interest credited to an indexed annuity product is reflected in the reserve as realized, based on the actual performance of the relevant external index or external indices.

191—97.6(508) Indexed life product reserve calculation methodology. Insurance companies account for indexed life product reserves in accordance with the applicable actuarial guidelines and statutory accounting principles. This chapter does not provide for any adjustment to the reserve calculation methodology for indexed life products.

191—97.7(508) Other requirements.

97.7(1) Indexed annuity products. The alternative accounting practices prescribed by this chapter must be applied to both the indexed annuity product reserves and eligible derivative assets used to hedge indexed annuity products.

97.7(2) Indexed life products. The alternative accounting practices prescribed by this chapter must be applied only to eligible derivative assets used to hedge indexed life products. This chapter shall not impact the calculation of indexed life product reserves.

97.7(3) If an insurance company elects to use the alternative accounting practices prescribed by this chapter, it shall report quarterly to the company regulation bureau of the Iowa insurance division, for analysis purposes, the market value of its eligible derivative assets and what the Actuarial Guideline XXXV reserves would be using market value of such eligible derivative assets.

97.7(4) Application of this chapter is not mandatory. An insurance company that elects to use the alternative accounting practices prescribed by this chapter may not elect to change its accounting practices back to those that would apply in the absence of this chapter without the prior approval of the Iowa insurance commissioner.

These rules are intended to implement Iowa Code chapter 508.