

EXTERNAL-INDEXED CONTRACT GUIDELINES INTRODUCTION

External-indexed contracts have raised serious concerns beyond other general account contracts:

- the complexity of the calculation of the accumulated value and the inherent potential for consumer understanding of the contract;
- the transference of some elements of investment risk under some of the proposed methods of calculating the index credit;
- the necessity for increased education of agents who may have no experience in proposing contracts with this degree of complexity;
- possible ambiguity regarding the minimum nonforfeiture standards under various contract scenarios;
- adequate analysis of the liabilities and appropriate matching of general account assets to meet these liabilities on a long and a short term basis.

Definitions:

- **“External-index”** means a regularly published index whose value is outside of the control of the insurer and/or its affiliates.
- **“External-indexed contract”** means any contract of life insurance or annuity whose contract values are dependent upon an external-index or external-indices other than those contracts which are variable contracts and included in Separate Accounts.
- **“Cap”** means the maximum index credit rate that may be derived from an external-index.
- **“Floor”** means the minimum index credit rate that may be derived from an external-index.
- **“Index credit rate”** means the percentage rate derived based upon the external-index and policy provisions that will be used to calculate an index credit.
- **“Index credit”** means the amount added to the contract as a result of the application of the index credit rate.
- **“Index charge”** means any rate deducted from the external-index value in the calculation of index credit rate. This term shall include terms such as “Interest spread”, “Asset expense charge”, “Asset management charge”, “Administrative fee” , etc.
- **“Index value”** means the value of the external-index.
- **“Index participation rate”** means the rate that is used to determine the portion of the percentage change in the external-index applicable to calculate the index credit rate.
- **“Term”** means the index-based crediting period.
- **“Net premium”** means the premium accepted under the contract less any sales charges or front-end loads.
- **“Contract value”** means the sum of all net premiums and index credits less any prior withdrawals. The contract value does not reflect any surrender charges.
- **“Cash value”** means the value available upon surrender of the contract. The cash value is net of any surrender charges.

Scope:

The unique characteristics of external-indexed contracts and the considerations necessary for their effective regulation override any distinctions based upon whether the contracts are issue as individual or group contracts. Therefore all of the guidelines contained in this document are applicable to all external-indexed contracts.

POLICY PROVISIONS

The following policy provisions are in addition to any required provisions otherwise applicable to the type of contract underlying the external-indexed contract.

- Any external-index to be used must be clearly identified and may only be changed by an endorsement approved by the Commissioner.
- The contract shall contain on the cover page a prominent statement that it is an external-indexed contract or other statement with substantially the same meaning.
- Any limitation upon allocation of funds within the contract must be clearly identified and may only be changed by an endorsement approved by the Commissioner.
- Any limitation, restriction, penalty or charge for the transfer during the term must clearly defined.
- The contract must clearly state the values of all elements affecting the index credit rate and clearly define the method for calculating the index credit rate and the index credit. Values that are not guaranteed for the life of the contract must have guaranteed maximum and minimum guaranteed values. Guaranteed values may only be changed by an endorsement approved by the Commissioner.
- Index credit rates and index credits must be greater than or equal to zero.
- An annual report must be provided to the contract holder without charge. The report must contain at least the following information:
 - a) the beginning and ending date of the current report period;
 - b) the account value at the beginning of the current report period and at the end of the current report period;
 - c) the cash value at the beginning of the current report period and at the end of the current report period;
 - d) the amounts that have been credited or debited to the contract during the current report period identified as to type and date;
 - e) the amount of any outstanding indebtedness as of the end of the current report period;
 - f) such other data which will enable the contract holder to verify the values in the current report.
- In addition to the annual report a similar report shall be available upon request of the contract holder. Reasonable charges may be assessed for providing such a report.

DISCLOSURE AND ADVERTISING

A contract summary disclosure must be delivered no later than the completion of the application for the contract. The disclosure may require acknowledgement of receipt of the disclosure, but shall not require a statement that the applicant understands the features of the contract.

The contract summary disclosure shall at least provide the following:

- a simplified explanation of the key elements of the contract;
- appropriate examples showing the method of calculating the index credit (any examples that use values other than guaranteed values must be identified as hypothetical values that do not attempt to predict actual future values);
- prominent display of any limitations on payment of premium or allocation of values;
- prominent display of any surrender charges;
- prominent display of any limitation, restriction, penalty or charge for transfers during a term;
- a statement emphasizing the insurance nature of the contract and that the contract is not a variable contract or other type of investment contract.

The filing company should review and evaluate the contract summary disclosure to assure that it is in no way deceptive, confusing or misleading and contains at least the items above. The filing company shall submit with the filing of an external-indexed contract a certification of such review and compliance.

Any advertising to be used with these contracts shall be reviewed carefully by the company. No advertising may be used which has not been reviewed and approved by the company. Prior approval by the Arkansas Insurance Department is not required, but all such materials shall be available for review upon request.

AGENT EDUCATION

The filing company is responsible for assuring that all persons soliciting an external-indexed contract are suitably licensed and trained. The company shall maintain detail files of training procedures available for the inspection by the Commissioner. With any filing of an external-indexed contract the company shall submit a certification that the contract will not be solicited by any person who is not trained and qualified.

NONFORFEITURE

Unless the external-indexed contract is an employer sponsored retirement plan, the minimum Nonforfeiture values must satisfy the Standard Nonforfeiture Law. If an exemption from these standards is requested, it must be accompanied by justification for such exemption. A detailed actuarial memorandum must be submitted demonstrating compliance.

RESERVES

A detailed actuarial memorandum must be submitted demonstrating compliance with Actuarial Guideline XXXV or XXXVI as appropriate.

A certification must be submitted that the company will address external-indexed contracts separately in the annual (Section 8) actuarial opinion and memorandum addressing each year the amount and type of assets held and the level of reserves and how developed.

A certification must be submitted that the company will establish and maintain a detailed file defining the system for hedging. Results of regular analysis of the effectiveness of the system should be made a part of the file.