The Contingent Deferred Annuity (A) Subgroup met via conference call Jan. 19, 2012, to continue discussions of contingent deferred annuities and how they should be treated.

1. Presentation of Additional Analysis from American Academy of Actuaries (AAA)

The American Academy of Actuaries (AAA) drafted a report that was distributed to the Subgroup prior to its Dec. 22, 2011, conference call. This initial report used a model to demonstrate that a typical contingent annuity product includes a material life contingent component. On the Dec. 22 call, several follow-up questions were asked and the AAA agreed to provide additional analysis. Cande Olsen (Actuarial Resources, Inc.) presented this additional analysis. The analysis compared the lifetime income generated by a contingent annuity arrangement and a self-insurance arrangement. Under the analysis performed, the contingent deferred annuity showed greater total lifetime income than with self-insurance, but less assets remained at death.

Materials from the AAA, as well as additional comments on the issue submitted by MetLife and the American Council of Life Insurers (ACLI) were distributed and posted on the NAIC website. The Insured Retirement Institute (IRI) also submitted a comment letter for discussion on the Subgroup’s next call. The ACLI and IRI letters supported the classification of contingent deferred annuities as annuities, and the MetLife letter supported the position that contingent deferred annuities were more like financial guaranty insurance.

2. Comments, Questions and Concerns

Felix Schirripa (NJ) said he was concerned that the AAA’s second analysis did not address several issues he was hoping to have analyzed, such as the market risk component of the product. There was no discussion of how this product addresses market risk. Mr. Schirripa said he wanted to know how large a component is the market risk and can it effectively be managed. Mr. Schirripa observed that, without any longevity protection, this product would be financial guaranty insurance and wondered just how much of the product is delivering longevity protection as opposed market risk protection. Mr. Schirripa said he planned to update an historical perspective document he had shared with the AAA Work Group, for discussion on the Subgroup’s next call.

Roy Mensch (NY) pointed out that the returns assumed in the AAA’s scenarios will affect the results of the analysis and might not correlate with current returns. Ms. Olsen agreed to provide the return information Mr. Mensch requested.

Lee Covington (IRI) pointed out that the longevity protection component of a contingent deferred annuity looks like a guarantee living withdrawal benefit (GLWB) rider on a variable annuity. Tomasz Serbinowski (UT) agreed with the similarity, but said he did not think that the similarity was dispositive of the issue of how the product should be categorized, because the remaining benefit of a contingent annuity is nothing more than a financial guaranty.

Roman Gabriel (Prudential) observed that the AAA’s reports looked at two different aspects of the contingent annuities: the types of risks the product manages and how those risks measure against self-insuring. The AAA reports did not look at how the market risk is managed by the insurer.

Birny Birnbaum (Center for Economic Justice) said that the AAA report seemed biased in favor of contingent deferred annuities and he would like the affiliations of the members of the AAA Contingent Annuities Work Group to be disclosed. Mr. Birnbaum also said that the characteristics of the scenarios in the report seemed to be chosen to support a particular outcome, rather than to shed light on a potential issue or problem. Mr. Birnbaum planned to share additional concerns on future calls.
3. Comments from NAIC Legal Division

During Dec 22, 2011 conference call, Mr. Schirripa had asked the NAIC Legal Division to opine on the issue of contingent deferred annuities. Dan Schelp (NAIC) explained that the NAIC cannot give a legal opinion as to whether contingent deferred annuities would be considered to be financial guaranty insurance under the NAIC Life and Health Insurance Guaranty Association Model Act (#520) or under state law. Mr. Schelp was of the opinion, however, that there are significant legal issues involved with the definition of financial guaranty insurance, and those issues were not sufficiently addressed in the AAA’s report. Mr. Schelp also pointed out that New York has issued an opinion in this area, which provided a reasonable legal argument for why contingent deferred annuities should be considered financial guaranty insurance. While New York’s reasoning is not controlling on the NAIC, Mr. Schelp said it is something that the Subgroup will need to address if it wants to permit life insurance companies to market contingent deferred annuities.

Mr. Schelp questioned the primary legal argument in the AAA’s report supporting the regulation of contingent deferred annuities as annuities: that the primary protection provided by financial guaranty insurance is associated with the risk of a financial event, and not the risk associated with a specific life. Mr. Schelp said that, according to the AAA’s report, while contingent deferred annuities provide an element of protection against loss of income due to market drops in the covered assets, the primary characteristic of a contingent deferred annuity is longevity protection for a specified life regardless of market performance; and, therefore, if the primary characteristic of contingent deferred annuities is life protection, they should not be classified as financial guaranty insurance. Mr. Schelp took issue with this conclusion and said that, as a legal principle, the fact that contingent deferred annuities have a life element would not preclude a state from also regulating a product as financial guaranty insurance. Mr. Schelp said that an unresolved issue is the intent of the NAIC and the states with respect to the regulation of financial guaranty insurance, which needs to be explored before concluding that contingent deferred annuities are not also financial guaranty insurance.

Mr. Schelp mentioned the New York Office of General Counsel’s Opinion Letter No. 09-06-11, which was issued June 25, 2009, finding that contingent deferred annuities are not permissible under the New York insurance law because they constitute an impermissible form of financial guaranty insurance. While New York’s opinion is not binding on the NAIC or any other states, as the only state to take a public position on this issue, it is certainly persuasive.

The Contingent Deferred Annuities (A) Subgroup plans to have a conference call Jan. 26 to continue its discussion.