April 28, 2011

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Dear Ms. Leslie Jones and Mr. Blaine Shepherd,

On March 15, 2011 the Contingent Annuity Subgroup of the Life Actuarial Task Force (LATF) circulated a draft memorandum (Draft Memorandum) that expressed concerns about a type of life insurance company product most commonly known as Contingent Annuities. The LATF has requested comments from the industry in reaction to the Draft Memorandum. Great-West Life & Annuity Insurance Company (Great-West) submits this letter in response.

Introduction

The Draft Memorandum concentrates on the fundamental question whether Contingent Annuities are in fact “annuities” for insurance law purposes. Great-West is strongly of the opinion that Contingent Annuities are in fact “annuities” and that they serve the traditional function of lifetime annuities in that they afford protection against the same longevity risk that traditional annuities address – the risk that a person in retirement may outlive his available assets.
Great-West also believes that Contingent Annuities are a broadly attractive vehicle for responding to the well-acknowledged need for products that address the income needs of retirees, a core calling of today’s life insurance industry. The decline of lifetime defined benefit pensions coupled with the ever increasing longevity of the population makes protection against the depletion of personal assets before death a pressing personal and social imperative. Contingent Annuities help address that problem by providing an income substitute in the form of a lifetime annuity as assets are depleted.

Great-West has an interest in the subject because it is an issuer of Contingent Annuities. Great-West offers a Contingent Annuity called the Great-West SecureFoundation, a group fixed deferred annuity contract,¹ that is available on certain 401(k), 401(a), Governmental 457(b) and IRA retirement plan platforms. Great-West SecureFoundation provides participants in those retirement plans with a guaranteed withdrawal benefit for the life of one or two persons, based on contributions that the participant allocates to designated target date funds and/or a balanced portfolio (together, the “designated funds”). The target date funds are conservative by nature, consisting of an evolving mix of investments in equity and bond mutual funds that lower the investment risk as a participant approaches retirement. The balanced portfolio program is also a conservative investment choice. All the designated funds are managed by a Great-West affiliated investment adviser that uses Ibbotson Associates, an industry leader in asset allocation and investment analysis, to assist in creating the optimal mix of investments. The designated funds are only available to participants who purchase the Great-West SecureFoundation contingent annuity.

Each payroll contribution (or transfer of other assets in the plan) made by a plan participant to the designated funds adds to the “Benefit Base.” The Benefit Base determines the amount of the guaranteed withdrawal benefit. Plan participants pay a fee (between 0.7% and 1.5% of the value of the designated fund) as consideration for the guaranteed withdrawal benefit. Each year the Benefit Base is evaluated and increased to equal the value of the designated funds, if higher. While poor market performance can decrease the designated fund value, it will not affect the Benefit Base. The Benefit Base is never decreased solely due to negative performance of the designated funds.

The participant selects a date between ages 55 and 80 to begin taking permitted withdrawals from the designated funds. The amount of the permitted withdrawals is a percentage of the Benefit Base. The percentage varies by the age of the participant and the number of covered lives. The Contingent Annuity benefit guarantees that the participant (or younger second life) will receive a fixed payment for life, after the assets in the designated funds are depleted. If the funds are depleted, the company continues to make annuity payments in an amount equal to the guaranteed withdrawal benefit for the life of the participant (or the joint lives of the participant and spouse). The guaranteed benefit payments protect the participant from both longevity risk (that the participant will outlive the assets in the designated funds) and market risk (that the value of the designated funds will decrease due to market performance).

¹ In some states, Great-West SecureFoundation is filed as an individual fixed deferred annuity contract.
The Public Policy Benefit: Contingent Annuities Respond to the Need for Products that Mitigate the Longevity Risk of Outliving One’s Available Resources

Contingent Annuities, like other annuities, are a means of securing guaranteed lifetime income. The current Administration has encouraged guaranteed lifetime income products as a key component in the quest to make financial security in retirement a reality for more Americans. “We need to do more to give families better choices to reach a secure retirement,” including promoting the availability of guaranteed lifetime income products. Report of White House Task Force on the Middle Class (February, 2010). Contingent Annuities are one of the “better choices” for guaranteed lifetime income because they overcome some of the reasons for consumer resistance to other forms of annuities while providing similar benefits at lower cost.

Ever-increasing life expectancies and the gradual disappearance of lifetime defined benefit pension plans mean that more and more Americans face an elemental “longevity risk” – the risk that they will outlive their financial resources in retirement. Even as this risk becomes more pronounced, many people remain reluctant to purchase traditional annuities, even those with a Guaranteed Minimum Withdrawal Benefit feature. In the case of immediate lifetime annuities, they may be deterred by the prospect that an earlier than anticipated death will diminish the estate they leave to their heirs. In addition, both immediate and deferred annuities generally require the owner to surrender the ability to choose investments. Further, people who otherwise are attracted to the longevity protections offered by a deferred variable annuity with a Guaranteed Minimum Withdrawal Benefit may be deterred by the cost of such products.

Instead, many Americans would prefer a pure form of longevity protection, combined with the ability to retain control over their investments. Contingent fixed payout annuities, such as those offered by Great-West and other insurance companies, address this demand by providing reasonably priced protection against longevity risk without requiring the contract owner to cede his retirement savings. Contingent Annuities provide a financial safety net against the exhaustion of retirement savings. Contingent Annuities can also help a person maintain more of his assets outside the Contingent Annuity contract than would be the case with a traditional deferred or immediate annuity, so they allow for larger estate transfers in the event of premature death. Contract owners also retain some control over the selection of the funds in which to invest, although the choices available are necessarily constrained to assure only low to moderate risk exposure, such as with Great-West’s choice of either target date funds or a balanced portfolio. Contingent Annuities provide sensible, cost-efficient protection against the risk of outliving one’s available resources. The evident appeal of Contingent Annuities to a much broader base of consumers makes them a valuable means of expanding the use of guaranteed lifetime income products in retirement planning, a result with clear social benefit in these times when both the fear and the actual possibility of outliving one’s resources are problems that will increasingly afflict both individuals and society at large. Moreover, the pooling of longevity risk is a core function of the life insurance industry, and doing so through annuities is squarely within the special capabilities of the industry.
Contingent Annuities are Essentially Similar to Other Established Annuity Products and Meet the Traditional Definitions of Annuities

A large number of deferred variable annuities sold today contain a Guaranteed Lifetime Withdrawal Benefit (GLWB) that operates essentially the same way as a Contingent Annuity. Both offer annuitants, in exchange for a premium, the guarantee of lifetime income in the form of periodic payments in the event a pool of assets is depleted.\(^2\) The possibility of depletion is the “contingency” that triggers the annuity payments in each case.\(^3\) Once the post-depletion payment phases start, the results in each case are indistinguishable and plainly meet the definition of “annuity.”

### a. Variable Annuities with GLWB are Materially the Same as Contingent Annuities

A Guaranteed Lifetime Withdrawal Benefit (GLWB) can be offered through either a traditional variable annuity or a Contingent Annuity. The parallels between variable annuities with GLWBs and Contingent Annuities are compelling. A variable annuity with a GWLB allows contract owners, either as retirement plan participants or individual owners, options to invest in variable annuity sub-accounts of an insurance company separate account. There is a “benefit base” which typically increases with each contribution during the accumulation phase. After reaching a certain age, the contract owner may begin a withdrawal phase during which periodic withdrawals in an amount determined by reference to the benefit base are made from the accumulated assets. If the point is reached where the assets are depleted, payments equal to the former withdrawal amount and paid from the insurance company general account commence and continue for the remainder of the annuitant’s life.

Actuarial assumptions for Contingent Annuities are not adjusted merely because the accumulation vehicle is different. Since the general account is exposed to the same risk in each case, the reserving methodology that Great-West uses is the same for Contingent Annuities and variable annuities with a GLWB and follows Actuarial Guideline 43 (AG VACARVM).

A GLWB offered as an element of a Contingent Annuity works in all material respects the same way as a GLWB offered through a variable annuity, except that the Contingent Annuity investment options are generally through mutual funds or other investment vehicles in which the insurance company does not have any ownership interest through a separate account. We believe that there is no plausible reason that a variable annuity GLWB that guarantees lifetime payments from an insurance company general account when investments have been accumulated

\(^2\) In the case of deferred annuities with a GLWB, asset depletion is measured by reference to the contract’s cash value, which is based on assets held by the insurer, typically in an insulated separate account. In a Contingent Annuity, depletion is measured by the “account value” of assets (most frequently in mutual funds) not held by the insurer, but rather by a sponsor financial institution. The contract owner owns those assets, not the insurer.

\(^3\) The generic definition of the term “contingent annuity” is an annuity that does not begin making payments to the annuitant or the beneficiary until a certain stated event occurs.
in a separate account should be classified as an annuity for insurance law purposes, while Contingent Annuity lifetime benefits paid out of the general account should be classified any differently merely because the accumulation vehicle is not through a separate account. We believe that the public policy, legal and actuarial factors all compel the conclusion that these two products are properly in the same classification and should be regulated alike as annuities.

b. Definition of “Annuity”

The core concept of an annuity is an obligation to make periodic payments and this is reflected universally in the definitions found in the codes of those states that set forth a statutory definition, for example (emphases supplied):

“‘Annuities’ encompass all agreements to make periodic payments * * * where the making or continuance of all or of some of such payments, or the amount of any such payment, is dependent upon the continuance of human life.” Ariz. Rev. Stat. Ann. § 20-254.01.

“‘Annuities’ means all agreements to make periodical payments where the making or continuance of all or some of the series of the payments, or the amount of the payment, is dependent upon the continuance of human life or is for a specified term of years.” Conn. Gen. Stat. § 38a-1.

“‘Annuity’ is a contract * * * under which obligations are assumed as to periodic payments for specific term or terms or where the making or continuance of all or some such payments, or the amount of any such payment, is dependent upon continuance of human life.” Del. Code Ann. tit. 18 § 2902.

“‘Annuity’ means an agreement to make periodic payments for which the making or continuance of all or some of a series of the payments, or the amount of a payment, depends on the continuance of a human life.” Md. Code Ann., Insurance, § 1-101.

“‘Annuity’ is a contract * * * under which an insurer obligates itself to make periodic payments for a specified period of time, such as for a number of years, or until the happening of an event, or for life, or for a period of time determined by any combination thereof.” N.J. Stat. Ann. § 17B-17.5.

“‘Annuities,’ means all agreements to make periodical payments for a period certain or where the making or continuance of all or some of a series of such payments, or the amount of any such payment, depends upon the continuance of human life * * *.” NY INS §1113(a)(2)

“‘Annuities,’ meaning all agreements to make periodical payments, whether in fixed or variable dollar amounts, or both, at specified intervals.” N.C. Gen. Stat. 58-17-15(2).

“‘Annuity’ or ‘annuity policy’ means any agreement to make periodic payments, whether

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4 Colorado, Great-West’s domiciliary state, does not have a statutory definition of annuity.
fixed or variable in amount, where the making of all or some of such payments, or the amount of any such payment, is dependent upon the continuance of human life * * *.” Or. Rev. Stat. § 731.154.

“‘Annuity’ means each contract or agreement to make periodic payments, whether in fixed or variable dollar amounts, or both, at specified intervals.” S.C. Code Ann. § 38-1-20(7).

Similarly, the NAIC Glossary of Insurance Terms defines annuity thus: “Annuity – contract sold by insurance companies that pays a monthly (or quarterly, semiannual, or annual) income benefit for the life of a person (annuitant), for the lives of two or more persons, or for a specified period of time.” [http://www.naic.org/consumer_glossary.htm](http://www.naic.org/consumer_glossary.htm).

The definition as set forth in the treatises and case law is alike in focusing on the obligation to make periodic payments as the defining concept of an annuity. Black and Skipper state that “[i]n the broadest sense, an annuity is simply a series of periodic payments” and while “[l]ife insurance has as its principal mission the creation of a fund, [ t]he annuity, on the contrary, has as its basic function the systematic liquidation of a fund.” Kenneth Black, Jr. and Harold D. Skipper, Jr., Life & Health Insurance 161-62 (13th ed. 2000).

Summarizing the common law concept of annuity, it has been said that an annuity is “a right to receive fixed, periodic payments, for a specified period of time’ and an annuity contract is

a contract under which, in exchange for the payment of a premium or premiums, the recipient thereof is bound to make future payments, typically at regular intervals, in amounts, to payees, and conditions specified in the parties’ agreement. The determining characteristic of an annuity is that the annuitant has an interest only in the periodic payments and not in any principal fund or source from which they may be derived.


“Inherent in the concept of an annuity is a transfer of cash or property from one party to another in return for a promise to pay a specific periodic sum for a stipulated time interval ***. Samuel v. Commissioner, 306 F.2d 682, 687 (1st Cir. 1962).

Clearly, Contingent Annuities fall comfortably within the established definitions of annuities.

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5 Annuities are thus easily distinguished from periodic payments in repayment of a debt. “The purchaser of an annuity surrenders all rights to the money paid, and therefore installment payments of a debt, or payments of interest on a debt, do not constitute an annuity.” 4 Am. Jur. 2d Annuities, § 2 (2008).
Contingent Annuities Protect Primarily Against Longevity Risk, Not Asset Value Risk

While annuities may be structured to allow periodic payments over a fixed period, such as twenty years, the predominant paradigm is that payments will extend for the lifetime of the annuitant. In this most common form, annuities exist specifically to address the annuitant’s longevity risk by offsetting the diminishment of other resources with guaranteed lifetime payments.

The IRS has addressed the status of Contingent Annuities in numerous private letter rulings, including PLRs 200949007 (July 30, 2009), 200949036 (July 30, 2009), 201001016 (Sept. 14, 2009), 201105004 (Nov. 2, 2010), 201105005 (Nov. 2, 2010). In each instance, the IRS has determined that Contingent Annuities are annuities for tax purposes.

In PLRs 200949007, 200949036 and 201001016, the annuitant or insurance company requesting the ruling provided the IRS with an actuarial analysis of the contract, which showed that such contracts are far more sensitive to the risk of the owner’s longevity than to market risk affecting the value of the assets, and that the predominant risk “insured against,” therefore, is the longevity risk, while the market risk protection is incidental by comparison.

With that actuarial evidence in hand, the IRS was clear that the fundamental “insurance” provided by such arrangements is insurance against longevity risk. Thus, in analyzing a group Contingent Annuity contract, the IRS stated:

> [T]he relationship between any individual market loss in the Account and any eventual periodic payments under the Certificate is too tenuous and too contingent on a number of factors for the payments to be considered compensation for any given market loss. **Withdrawals of principal, not just losses, will contribute significantly to depletion of the Account; in fact the arrangement is structured primarily to insure against longevity risk, not market risk, and, should Taxpayer live long enough, he could eventually begin to receive the Monthly Benefit whether or not losses were sustained. Finally the amount of compensation Taxpayer may receive under the Certificate depends on how long he lives, and is not tied to the amount of the losses.** **The contract is structured, not as reimbursement for market losses, but rather as a contingent, deferred annuity that begins to pay benefits on the occurrence of an event the timing of which may be influenced by market performance.**

PLR 200949007 (emphasis added).

What is dispositive is that, by virtue of the guarantee of a lifetime income stream Contingent Annuities serve the primary economic function of a life annuity contract, namely, to protect the holder against longevity risk. And because they in fact do predominantly protect the annuitant against longevity risk, just like any ordinary lifetime annuity, they should be recognized as annuities for insurance law purposes and regulated accordingly.
Contingent Annuities Are Not Financial Guaranty Insurance

Although the LATF Draft Memo asserts that several state insurance departments have found that Contingent Annuities are not annuities for insurance law purposes, to our knowledge only one state, New York, has stated such a conclusion in a writing that is publicly available. New York OGC Op. No. 09-06-11. In that Opinion, the New York Insurance Department concluded that Contingent Annuities insure against loss in the value of specific assets due to market fluctuation. The Opinion, however, was issued before any of the IRS letter rulings were published and therefore without the benefit of the reasoning and conclusions of those rulings.

Most importantly, the New York Opinion fails to recognize that the most significant characteristic of Contingent Annuities is the essential and direct connection to longevity. In fact, the Opinion’s description of such contracts misstates their nature by describing the annuity payout as solely due to diminishment of the “value of the account,” without acknowledging the critical fact that that will always be dependent primarily on the longevity of the contract owner and the cumulative effect of the monthly distributions from the account during his life. Indeed, the Opinion does not mention, much less come to grips with, New York's statutory definition of annuities: “Annuities, means all agreements to make periodical payments for a period certain or where the making or continuance of all or some of a series of such payments, or the amount of any such payment, depends upon the continuance of human life * * *." NY INS §1113(a)(2).

The failure to acknowledge the primacy of the longevity factor leads to the erroneous conclusion that depletion of the account constitutes “changes in value of specific assets or commodities * * * or price levels in general” under N.Y. Ins. L. § 6901(a)(1). The withdrawals from the account are not “changes in the value of specific assets or commodities * * * or price levels in general,” as contemplated by the financial guaranty insurance statute. Rather, they constitute the removal of assets from the account. The withdrawals therefore are not the kind of “changes in value” that relate to financial guaranty insurance. Yet it is the withdrawals and the number of them through time that are the primary and most actuarially significant factors in account depletion, and those in turn depend on longevity. If the contract owner dies early, the account will never have been depleted by withdrawals. If the contract owner survives for a long time, the depletion of the account by withdrawals is a virtual certainty.

Thus, it is incorrect for the New York Department to conclude that “[t]he Contract comes within the definition of financial guaranty insurance because it purports to provide indemnification for ‘financial loss’ resulting from ‘changes in the value of specific assets’” since payments “commence only when and if the decline in value occurs.” (Emphasis added.) In fact, it is not any purported decline in value that precipitates the insurance company’s payout, rather it is, by definition, the depletion of the assets — which is primarily a function of longevity and the removal of assets from the account. The assets so removed are then available to be used to pay for the life needs of the owner.

Because the contract protects primarily against depletion of assets by replacing the asset withdrawals when the account is exhausted with payments from the insurer, it has precisely the same fundamental character as any other life annuity, that is, protection against the risk that one will exhaust his financial resources in retirement.
Moreover, the fact that the cumulative amount of benefits ultimately received from the insurer depends on how long the contract owner lives also shows that the contract does not indemnify for “financial loss” resulting from “changes in value of specific assets.” There is no relationship between such changes in value and the eventual number of payments, which is by far the prime determinant of the cumulative amount of the payments. The predominant operative factor determining the number of payments, and hence the ultimate payout, is longevity. Thus, again, the product works exactly like a life annuity and not like financial guaranty insurance.

Financial guaranty insurance, by contrast, has no mortality risk factor whatsoever. Mortality risk is a wholly alien concept to financial guaranty insurance. Assuming financial guaranty insurance could be written on market risk, only market risk would be factored into the underwriting and reserving. Mortality risk is absolutely critical to the underwriting and reserving for Contingent Annuities.

There is some element of market risk that exists with respect to Contingent Annuities (as well as variable annuities with a GLWB). But Contingent Annuities do not reimburse for market losses. Rather, market risk impacts the timing of when the payment source for the periodic benefit shifts to the insurance company. Indeed an individual can suffer no loss ever in the investment assets and still receive payments from the insurance company – depending entirely on how long he lives. Plus, even if there were a loss, the ultimate payout amount could be much less or much more, depending again on how long the person lives. Financial guaranty insurance, on the other hand, is strictly tied to the amount of the loss and there is no longevity factor. Or, stated in terms of the insurance law definition of annuities, financial guaranty insurance does not provide periodic payments where the making or continuance of such payments, or the ultimate amount of such payments, is dependent upon the continuance of human life. A lifetime series payments is the very hallmark of an annuity contract.

For the foregoing reasons, we think that there is no viable basis for categorizing Contingent Annuities as market risk financial guaranty insurance. Rather, Contingent Annuities are in the same species as variable annuities with a GWLB, and both are annuities.

**Conclusion**

Contingent Annuities are in our view properly categorized as annuities and therefore constitute bona fide life insurance products. They predominately provide longevity risk protection (i.e., protection against the risk that a person will exhaust his financial resources in retirement), which is the essential element of an annuity contract, and the longevity risk component is a vastly more significant component than the market risk component. Such a combination of primary longevity risk protection and secondary market risk protection is the economic signature that distinguishes annuities from other forms of insurance and other types of financial instruments, and justifies treating them as annuity contracts.

The foregoing analysis is intended as a summary of what Great-West considers the major points that compel characterization of Contingent Annuities as annuities. It is not meant to be a comprehensive or fully detailed analysis of all the legal or actuarial issues that may relate to the
question. Great-West would be willing to provide more expansive treatment of any issues that may still be of concern to the LATF. If you would find this helpful, please contact Beverly A. Byrne at 303-737-3817 or beverly.byrne@gwl.com.

Sincerely,

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