January 26, 2012

Mr. Felix Schirripa
Chief Actuary, New Jersey Department of Banking and Insurance
Chair, NAIC Contingent Annuities Working Group
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Re: Examination of the New York OGC Opinion on Contingent Annuities

Dear Mr. Schirripa and Ms. Cook,

Great-West Life & Annuity Insurance Company ("Great-West") respectfully submits this letter to the National Association of Insurance Commissioners ("NAIC") Contingent Deferred Annuity (A) Subgroup ("Subgroup") to express our views on New York OGC Opinion No. 09-06-11 (June 1, 2009) (the "Opinion") and its potential influence in analyzing the legal viability of contingent deferred annuities ("Contingent Annuities"). Great-West remains a strong advocate for Contingent Annuities representing a feasible construct for delivering guaranteed lifetime withdrawal benefits, a lifetime annuity historically offered through a variable annuity contract. Great-West shared many of its legal and public policy views in our April 28, 2011 letter to the NAIC Life Actuarial Task Force ("LATF Letter"), attached. The LATF Letter contained a discussion of why Contingent Annuities are not financial guaranty insurance; this letter expands on that analysis in light of the January 19, 2012 Subgroup call.

Fundamentally, it is Great-West's position that:

- Contingent Annuities showcase the fundamental characteristics of annuities because the payments are dependent on the longevity of the annuitant as opposed to the indemnification of market loss;
- the Opinion does not provide a persuasive legal precedent as to whether a Contingent Annuity should be categorized as financial guaranty insurance or an annuity for state insurance regulatory purposes; and
- as discussed in the LATF Letter, general legal definitions of annuities, across many jurisdictions, clearly capture Contingent Annuities.
Much of the discussion concerning whether Contingent Annuities are properly
categorized as annuities, or whether they may instead be financial guaranty insurance, refers to
the Opinion as the precedent for arguing that Contingent Annuities are really financial guaranty
insurance, at least in New York and the half dozen or so states that have financial guaranty
statutes essentially the same as New York’s. Given the influence the Opinion may have, it is
important to examine whether its reasoning and analysis are strong enough for it to constitute a
persuasive precedent. Such examination demonstrates that the Opinion is flawed and that its
analysis is incomplete and in part based on a misapplication of critical terms.

Although the debate on the proper classification of Contingent Annuities has been going
on for some time, to date New York is the only state that has stated that Contingent Annuities are
not annuities in a writing that is publicly available. The Opinion is not just the leading, but the
only published precedent for the proposition that Contingent Annuities are actually financial
guaranty insurance. As will be shown below, the Opinion should be accorded little if any
precedential value.

In the Opinion, the New York Insurance Department concluded that Contingent
Annuities insure against loss in the value of specific assets due to market fluctuation. Based on
that conclusion the department held that Contingent Annuities are market risk financial guaranty
insurance under the New York statute, and as such they are a form of financial guaranty
insurance that is illegal in New York. The Opinion, however, was issued before the debate had
evolved very far, and in particular before any of the pertinent IRS private letter rulings (“PLRs”)
were published and before the American Academy of Actuaries Contingent Annuities Working
Group report was issued, and therefore without the benefit of the reasoning and conclusions of
those analyses. The PLRs and Academy’s report provide sound reasoning for characterizing
Contingent Annuities as annuity contracts for state insurance law purposes. New York did not
have these materials during its deliberations prior to issuance of the opinion.

As to the Opinion itself, interestingly, it does not mention the definition of “annuity.”
Under New York law, an annuity is defined as an agreement “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

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1 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), 201105005 (Feb. 4, 2011), 201117012 (Mar. 17, 2011), 201117013 (Mar. 17,
2011). The IRS has determined that Contingent Annuities are annuities for tax purposes using analysis based
principally on state insurance law, including traditional definitions of an annuity, and a careful examination of the
conceptual and operation differences between annuities and financial guaranty insurance and the discrete risks
covered by each.

2 The American Academy of Actuaries Contingent Annuity Working Group provided a report to the NAIC’s Life
Insurance and Annuities (A) Committee on October 28, 2011 which concluded in part that contingent annuities are
annuities, noting that: “A contingent annuity is very different than financial guaranty insurance. A contingent
annuity does not insure the covered assets, protect against loss of the covered assets, or promise that a specific
amount of covered assets will be maintained upon occurrence of a market decline. The contingent annuity provides
insurance protection with respect to a specified life, guaranteeing lifetime income payments to the purchaser
following depletion of the covered assets while that purchaser is still living irrespective of the performance of the
covered assets.”
the amount of any such payment, depends on the continuance of human life * * * .” N.Y. Ins. Law § 1113(a)(2). This is exactly the agreement that is made under a Contingent Annuity – to make periodical payments for life once the triggering contingency occurs, i.e., the assets in the covered account are depleted. Because the Opinion starts and stops with the statutory definition of financial guaranty insurance, it offers no explanation why the product is not in fact an annuity, even though it fits perfectly the definition of “annuity.” The omission of any discussion of the definition, and the legal and actuarial characteristics, of annuities is significant enough to call into question its persuasiveness.

There is also a clear misapplication of one of the key terms of the definition of financial guaranty insurance. The Opinion attempts to apply the definition of “market risk” financial guaranty insurance, which is indemnification for “changes in the value of specific assets or commodities, financial or commodity indices, or price levels in general.” N.Y. Ins. Law § 6901(a)(1)(D). In context, “changes in value” here plainly refers to changes due to market fluctuations. It does not refer to the depletion of a pool of assets due to the fact that the owner removes some of them to be put to use for life needs. Yet the Opinion does not distinguish between changes in the value of assets due to market fluctuation and reduction of the amount of assets due to withdrawals. Instead it conflates the two and treats them as if they were the same thing.

To be sure, the Opinion cites some earlier OGC opinions dealing generally with financial guaranty insurance, it does not cite the one that is most probative. OGC Opinion No. 95-31 (NILS), 5-31-95 (Westlaw) (May 31, 1995), addresses a “guaranty of mutual fund performance” and finds it to be impermissible market risk financial guaranty insurance under Section 6901(a)(1)(D) – the same section Contingent Annuites were found to fall under in the 2009 Opinion. In the 1995 case, a mutual fund proposed to enter a “guaranty agreement” with a corporate parent to assure that at a specified maturity date an investor could redeem his interests in the fund for at least the total amount that had been invested. If the actual redemption value was less than the amount invested, the guarantor would pay the investor the difference between the two. This was found to be financial guaranty insurance because it indemnified the investor in the case of a market loss. There are, however, major contrasts between that guaranty and a Contingent Annuity. The payment on the guaranty was dependent solely on market risk. There was no longevity factor at all. The amount of the loss payable was determined solely by, and was exactly the amount of, the actual market decline in value relative to total investment. Depletion of the fund due to withdrawals was not a factor. The total amount to be paid by the guarantor had nothing to do with the length of a life. And there were no “periodical payments * * * where the making or continuance of all or some of a series of such payments, or the amount of any such payment, depends on the continuance of human life * * *” as is the case with annuities. The conclusion in OGC Opinion No. 95-31 that the guaranty constituted financial guaranty insurance surely was correct because the guaranty was nothing other than a guaranty of market performance. Had that opinion been cited and analyzed in the Contingent Annuity Opinion, the material distinctions between financial guaranty insurance and Contingent Annuities would have been apparent.

Most importantly, the Opinion does not consider that the most significant characteristic of Contingent Annuites 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 due to depletion of the “value of the account,” without acknowledging the critical fact the annuity payout is only triggered by depletion of the account, and that the depletion of the account 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. Of course, 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 market loss, the ultimate payout amount could be much less or much more than that, depending again on how long the person lives. Thus, 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, and no amount will have been paid under the Contingent Annuity contract even if there was market loss in some amount due to “changes in the value” of the assets. On the other hand, if the contract owner survives for a long time, the depletion of the account by withdrawals is a virtual certainty, irrespective of market performance – indeed the account can be depleted even if the assets have appreciated in value.

With financial guaranty insurance, on the other hand, 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. Nor is there any essential relationship between market “changes in value” and the eventual number of payments, which is by far the prime determinant of the cumulative amount of the payout. The predominant factor determining the number of payments, and hence the ultimate payout, is longevity. Thus, again, the product works exactly like a life annuity and nothing at all like financial guaranty insurance.

In short, financial guaranty insurance, by contrast, has no mortality risk factor whatsoever. Mortality risk is a concept wholly alien to financial guaranty insurance. On the other hand, mortality risk is absolutely critical to the underwriting and reserving for Contingent Annuities.$^3$

Thus, the Opinion is incorrect on its face 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.” In fact, it is not any purported decline in market 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 withdrawal of assets from the account.

In sum, a lifetime series of payments is the very hallmark of an annuity contract. Financial guaranty insurance does not support a person for a lifetime, in an ultimate amount dependent on the duration of the life. A Contingent Annuity insures against a person’s outliving their resources. Market risk financial guaranty insurance insures against a specific instance of

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3 Indeed, longevity risks are not compatible with financial guaranty insurance. For example, the drafting note under Section 1.A.(2)(a) in the NAIC Financial Guaranty Insurance Guideline states that if a surety insurer was authorized to sell guaranty insurance contracts, the financial guaranty insurance policies insuring the guaranteed investment contracts issued by life insurers cannot have obligations associated with the continuance with human life.
financial loss, not the using up of one’s finances. In addition, an analysis of the legal differences between annuities and financial guaranty insurance illuminates the actuarial distinctions of writing Contingent Annuity and financial guaranty insurance. The drastic differences of reserving and risk-based capital requirements between life insurance companies and financial guaranty insurance companies are stark. Life insurance company expertise, familiarity and actuarial assumptions of mortality (longevity risk) naturally comport with guaranteed lifetime withdrawal benefit offerings as opposed to financial guaranty insurance companies which are positioned squarely to insure market risk.

All of the reasons above demonstrate that in its reasoning the Opinion is flawed. It fails to properly apply the definition of market risk financial guaranty insurance, does not address the most essential characteristics of Contingent Annuities, and fails to adequately consider the fundamental distinctions between financial guaranty insurance and Contingent Annuities. These deficiencies lead to the erroneous conclusion that Contingent Annuities are market risk financial guaranty insurance. In truth, Contingent Annuities are clearly like other life annuities, all with the central characteristic being a series of payments based upon a human lifetime. For these reasons, the New York Opinion is not a reliable guide to the analysis of Contingent Annuities and does not constitute a persuasive precedent.

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Great-West appreciates the opportunity to share this analysis with the Subgroup. Should you have any questions concerning the topics in this letter, please direct them to Beverly A. Byrne at 303-737-3817 or beverly.byrne@gwl.com.

Sincerely,

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President and CEO
Great-West Life & Annuity Insurance Company