2012 Summer National Meeting  
Atlanta, GA

CONTINGENT DEFERRED ANNUITY (A) WORKING GROUP  
Saturday, August 11, 2012  
7:30 – 10:00 a.m.  
Atlanta Marriott Marquis—Marquis Ballroom C—Marquis Level

ROLL CALL

Ted Nickel, Chair       Wisconsin       Bruce R. Ramge/Holly Blanchard       Nebraska  
Suzetta Furlong        Florida         Michael Humphreys                   Tennessee  
Jim Mumford            Iowa            Tomasz Serbinowski                  Utah  
Jason Lapham           Kansas

AGENDA

1. Consider Adoption of June 27 Meeting Minutes—Ted Nickel (WI)  

2. Presentations  
   a. Opening Remarks—Ted Nickel (WI)  
   b. Consumer Representatives—Birny Birnbaum (Center for Economic Justice)  
   c. NAIC Suitability in Annuity Transactions Model Act (Model #275)—Jolie Matthews (NAIC)  
   d. Life Insurance Industry—Adam Scaramella (Vice President & Corporate Counsel, Prudential); Tim Bennett (Vice President & Actuary, Transamerica Companies); Keith Mancini (Senior Counsel, Great-West Life & Annuity Insurance Company)  
   e. NAIC Standard Nonforfeiture Law for Individual Deferred Annuities (Model #805)—Tomasz Serbinowski (UT)  
   f. U.S. Department of Labor—Joe Canary (Director, Office of Regulations and Interpretations, Employee Benefits Security Administration)

3. Public Comment

4. Any Other Matters Brought Before the Working Group—Ted Nickel (WI)

5. Adjournment
The Contingent Deferred Annuities (A) Working Group met in Washington, DC, June 27, 2012. The following Working Group members participated: Ted Nickel, Chair (WI); Jim Mumford (IA); Jason Lapham (KS); Bruce R. Rame (NE); Julie Mix McPeak (TN); and Nancy Askerlund and Tanji Northrup (UT). Also participating were: Peg Brown (CO); Bob Chester (CT); Carol Guidry (LA); Rosann Grandy (MT); Bruce Boreman (NE); Michael Campanelli (NY); and Sandra Dodson (TX).

1. Presentations on Contingent Deferred Annuities

Commissioner Nickel explained that the Working Group was continuing the work started by the Contingent Deferred Annuity (A) Subgroup. The Subgroup concluded that contingent deferred annuities (CDAs) are life insurance products subject to state insurance laws and regulations. Commissioner Nickel reminded the Working Group of its charge to “evaluate the adequacy of existing laws and regulations applicable to the solvency and consumer protections of annuities as such laws are applied to CDAs.” He further explained that the Working Group plans to examine CDAs from a variety of perspectives, with the following presentations intended to illuminate the structure, design, operation and financial nature of CDAs.

   a. U.S. Government Accountability Office Presentation

Nima Patel Edwards (U.S. Government Accountability Office—GAO) explained that the GAO has started a study of the regulatory structures that apply to lifetime retirement income products, including CDAs, at the request of the U.S. Senate Special Committee on Aging. The preliminary objectives of the study are to: 1) identify the characteristics of recently developed retirement products that aim to guarantee income for the life of retirees; and 2) determine how these products are regulated and the extent to which they raise any consumer protection or other regulatory issues.

The GAO plans to contact federal agencies, the state departments of insurance and insurance companies in conducting the research for this study. She said the GAO is still in the information-gathering stage and hopes to release its report in the fall.

   b. American Academy of Actuaries Presentation

Cande Olsen (Actuarial Resources Corporation), representing the American Academy of Actuaries’ (AAA) Contingent Annuity Work Group, gave a presentation on CDAs. She provided an overview of CDAs and addressed issues of solvency and risk management.

Ms. Olsen explained that CDAs are designed to establish a lifetime income floor for purchasers at or near retirement, while still allowing individuals to take advantage of potential market returns. She said that a CDA is essentially a stand-alone guaranteed lifetime withdrawal benefit (GLWB), and offers many of the same benefits and risks as GLWBs issued as part of variable annuity contracts with living benefits. Ms. Olsen identified varying contractual structures through which CDAs can operate and highlighted that a stand-alone CDA has a less complex fee structure than a variable annuity with a GLWB.

Ms. Olsen said that the issuance of CDAs necessitates strong, comprehensive risk-management practices for insurers with complementary regulatory oversight. She outlined and explained the risks to insurers issuing CDAs, which includes longevity risk, policyholder behavior risk, market risk and operational risks. Ms. Olsen explained how insurers manage each type of risk. She said that, with the exception of operational risk, insurers generally follow similar risk-management techniques for CDAs as for GLWBs.

Ms. Olsen explained that operational risk is the risk that company operations that relate to CDAs will not be executed as expected and can be split into two categories: 1) management of third-party issues; and 2) other operational risks that apply to all annuity products and would be managed similarly for CDAs. Third-party issues are managed by the insurer through a complete description of the rights and roles of the parties involved. She suggested that the states might want to inquire into third-party requirements before product filings are approved, which is similar to requirements for synthetic guaranteed investment contracts (GICs). She said that regulatory oversight of a company’s risk-management practices is important and that regulators are able to review insurers’ risk-management programs at the time of policy form approval.
Ms. Olsen also said that the regulatory framework in place for GLWBs is appropriate for CDAs, which includes the NAIC model laws for reserves and risk-based capital, *Actuarial Guideline XLIII—CARVM for Variable Annuities (AG 43)* and C-3 Phase II (C3P2), which all explicitly cover GLWBs and CDAs. Ms. Olsen explained that the AG43 and C3P2 calculation will be different for CDAs than for variable annuities with a GLWB rider, because the calculation for the latter takes into account the revenue and benefit stream of both the variable annuity and the GLWB rider. Mr. Mumford asked whether this difference was significant. Ms. Olsen said that it was just an observation.

Ms. Olsen discussed a concern raised by regulators that poor market performance could result in a large number of CDA benefits being triggered at the same time. She explained the ways that insurers manage the risk of poor market performance; i.e., through holding reserves and risk-based capital, along with a properly executed hedging strategy. She explained further that the likelihood that a large number of CDA benefits would be triggered at once would require the occurrence of a specific series of events that are not likely to occur. There would need to be a concentration of policyholders of similar issue age and similar covered funds who have survived and are in the withdrawal stage, and all covered funds are exhausted due to withdrawals or poor market performance.

Ms. Olsen said that CDAs provide an alternative for consumers to secure a guaranteed lifetime income and encouraged regulators to continue to learn about CDAs to resolve regulatory concerns. Ms. Olsen said that both insurers and regulators need resources, knowledge and training in risk management practices in order to manage and regulate CDAs and GLWBs and the AAA Contingent Annuity Work Group is willing to assist the CDA Working Group going forward.

c. Insured Retirement Institute/American Council of Life Insurers Presentation

Lee Covington (Insured Retirement Institute—IRI), Keith Mancini (Great-West Life and Annuity Insurance Company), Wade Wenger (Transamerica Capital Management), Paul Graham (American Council of Life Insurers—ACLI) and Elizabeth Dietrich (Prudential Annuities) gave a joint presentation on the industry perspective on CDAs.

Mr. Covington pointed out that there is a retirement crisis that policymakers are focused on. Traditional sources of guaranteed retirement income, like Social Security and defined benefits, are in decline. He pointed out that people are afraid of outliving their assets. Mr. Covington said that consumers want longevity protection and insurers are the only providers of GLWBs. CDAs offer consumers the opportunity to overcome these retirement income challenges.

Mr. Mancini said that CDAs are similar to GLWB riders and guaranteed minimum income benefits (GMIBs). He said that the insurance industry has demonstrated the ability to manage the risks associated with CDAs. The financial and actuarial risks associated with CDAs are similar to GLWBs and GMIBs, and the operational risks of CDAs are similar to the risk managed for synthetic GICs. Mr. Mancini said that, currently, CDAs are subject to regulatory oversight by state insurance regulators, the U.S. Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA), which together provide adequate consumer safeguards.

Mr. Mancini gave an overview of CDA products and explained the product features and benefits of GLWBs and GMIBs compared to CDAs. Ms. Dietrich explained the consumer protections that exist throughout the life cycle of a CDA: from pre-sale/point of sale, through accumulation and withdrawal phases to post-sale annuity payout phase. She pointed out that there are consumer protections that apply to covered assets in separately managed accounts. She explained that the regulations that apply to investment advisors and broker-dealer firms associated with the CDAs include marketing rules, suitability reviews and disclosure requirements. Ms. Dietrich said that these rules apply to all insurance company products, including CDAs.

Director Ramge said he is concerned about a consumer being harmed by the behavior of an investment manager that is outside the control of the consumer and does not follow the terms of a CDA contract. Mr. Wenger explained that, with Transamerica’s products, consumers are involved in fund choices and the terms of the contract are clearly disclosed.

The Working Group discussed that CDAs offered through an ERISA retirement plan are exempt from registration with the SEC. ERISA requires a fiduciary duty and all assets are held in trust for the benefit of plan participants.

Mr. Graham explained the solvency framework for CDAs and explained what insurance companies are doing to manage the risks. He explained that there are seven principles of regulatory solvency framework for insurance, of which reserves, capital adequacy, and solvency are one. AG43 and C3P2 are broadly drafted to include products that are not under the control of the...
insurer, like CDAs. Under AG43 and C3P2, all risks inherent in a product must be reserved for and it is the company’s job to figure out what the risks are and reserve for them.

Mr. Graham reviewed the risk profile of CDAs and highlighted the management techniques used to manage the risks, which are similar to those used with GLWBs and GMIBs. He said that risks associated with outside assets are managed similar to risks associated with synthetic GICs.

Mr. Boreman asked about consumer behavior and the fact that a consumer who does not make maximum withdrawals will end up paying more, even though that person is less likely to get the CDA benefit. Mr. Mancini suggested that there might be tax reasons or other reasons involving a customer’s complete asset portfolio that might legitimize a consumer taking “inefficient withdrawals.”

Mr. Graham discussed enterprise risk management (ERM), which is a framework for strategic decision-making, risk-management activities and governance. He explained that a key consideration with an insurer’s ERM framework is risk diversification and risk capacity. Monoline enterprises take on significant risk concentration and regulators would have the ability to disallow filings by monoline CDA insurers. Mr. Graham also described the Own Risk and Solvency Assessment (ORSA), which is one element of a broader ERM framework. Mr. Graham said that the existing regulatory framework and ERM are appropriate and sufficient regulation for CDAs.

Mr. Covington requested that the Working Group reiterate the decision made by the Contingent Deferred Annuity (A) Subgroup that CDAs are annuity products sold by life insurers and that the states have the regulatory authority in place to approve CDA filings and that they do not need to wait for the Working Group’s final recommendations to the Life Insurance and Annuities (A) Committee. He said he wants the states to realize that whatever recommendations the Working Group might make with respect to the regulation of CDAs can be made by the states at a future time and there is no need to wait for a Working Group recommendation before approving CDA filings.

d. SEC Presentation

Susan Nash (SEC) prefaced her presentation by noting that her remarks express her views and do not necessarily reflect those of the SEC, the SEC commissioners or other members of the SEC staff. She said that the SEC has received some CDA filings. The registration forms used to file these types of products dictate what information needs to be filed with the SEC and provided to investors in a prospectus. Ms. Nash said that the CDA registrations that have come in to the SEC have used Form S-1 or Form S-3. She explained that these forms require the issuer to disclose material information about the issuer and its financial condition and material information about the contract, including benefits (including computation of benefit base and income payments) and ways that benefits can be lost (such as through excess withdrawals). She said that information about contract termination provisions, fees and charges, and risks are also included. CDA prospectuses are subject to the SEC’s “plain English” rule. These disclosures relate to the CDA, but there are also concurrent requirements on the distribution channels for the CDAs, such as investment advisers and broker-dealers. Also, some CDAs relate to assets, such as mutual funds, that are securities registered with the SEC, to which SEC regulations apply. The SEC has the authority to bring civil actions, but not criminal actions, which would be the purview of the U.S. Department of Justice.

e. FINRA Presentation

Larry Kosciulek (FINRA) explained that FINRA is the regulatory authority for its members, which includes approximately 4,400 brokerage firms, 163,000 branch offices and 630,000 registered securities representatives. FINRA regulations ensure that anyone who sells a securities product has been officially tested, qualified and licensed; every securities product advertisement used is truthful, and not misleading; any securities product promoted or sold to an investor is suitable for that investor's needs; and investors receive complete disclosure about the investment product before purchase. FINRA conducts regular exams of its members and can fine, suspend or expel firms or individual brokers from the business. FINRA frequently requires firms to return money to investors who have been harmed. FINRA does not have authority over entities that are not their members, such as investment advisors, who are subject to state and SEC oversight.

2. Discussion of Next Steps

Mr. Boreman indicated that guidance or a checklist for state form reviewers regarding what they should be looking for with CDAs would be helpful. Mr. Mumford agreed. In New York, there is a derivative use plan process that includes information about the risk-management strategy a company uses and must be updated periodically. Mr. Covington suggested the Working
Group to look into the ORSA process reviewed in the IRI presentation to determine if that process might address the regulator’s concerns.

Commissioner Nickel said that the Working Group plans to have additional presentations at the Summer National Meeting from consumer representatives and representatives of guaranty funds, as well as discussions about suitability issues. Commissioner Nickel said he hopes the Working Group will have a recommendation to present to the Life Insurance and Annuities (A) Committee by the Fall National Meeting.

Having no further business, the Contingent Deferred Annuities (A) Working Group adjourned.