Introduction

- Recap of June 27 Presentation
- CDA Product Overview
- Product Design and Pricing
- Consumer Withdrawal Behavior
- Suitability
- Conclusions
Recap of June 27 Presentation

- Contingent Deferred Annuities (CDAs) offer protection similar to that provided by Guaranteed Lifetime Withdrawal Benefits (GLWBs) and Guaranteed Minimum Income Benefits (GMIBs)

- The insurance industry has demonstrated the ability to manage the risks associated with CDAs
  - Financial / Actuarial Risks of CDAs are similar to those managed for GLWBs/GMIBs
  - Operational Risk of CDAs is similar to that managed for Synthetic Guaranteed Investment Contracts (GICs)

- Today’s three pronged regulatory oversight and requirements of State Insurance Regulators, SEC, and FINRA provide adequate consumer safeguards for CDAs

- U.S Insurance Financial Solvency Regulatory Framework & Enterprise Risk Management are appropriate and sufficient for CDAs
CDA Product Overview
CDA Product Overview

- Most commonly a living benefit added to mutual funds or Separately Managed Accounts (SMAs)
- Protection is similar to that provided by GLWBs and GMIBs
- Individual begins taking annual income amount – a percentage of the highest locked-in daily/anniversary value of the account
- If Covered Asset Account value reaches zero, insurer assumes obligation to continue annual income amount payments for life or joint lives
- Primary distinction between a CDA and a Variable Annuity with a GLWB / GMIB is that the protected assets are held external to the issuing life insurer
Contingent Deferred Annuities

How it works

Provides a guaranteed basis for lifetime income based on the value of the covered assets administered at partner’s platform

- Basis for Lifetime Income
- Covered Asset Account Value
## Products Features and Benefits

<table>
<thead>
<tr>
<th>Primary consumer need addressed:</th>
<th>VA GLWB / GMIB</th>
<th>CDA</th>
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<tbody>
<tr>
<td></td>
<td>Longevity risk protection</td>
<td>Longevity risk protection</td>
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<table>
<thead>
<tr>
<th>Guarantees:</th>
<th>Lifetime income benefit</th>
<th>Lifetime income benefit</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Death benefit</td>
<td>No death benefit (but protected assets remain in owner’s estate)</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Fee structure*:</th>
<th>Base annuity M&amp;E&amp;A fee</th>
<th>CDA product fee</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Annual administrative fee</td>
<td>Cancellation fee may apply</td>
</tr>
<tr>
<td></td>
<td>Contingent Deferred Sales Charge</td>
<td></td>
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<tr>
<td></td>
<td>GLWB rider fee</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Underlying assets:</th>
<th>Client selects among funds and asset allocation models made available by insurance company</th>
<th>Client selects among funds and asset allocation models which meet insurance company guidelines for permitted asset classes and investment types</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Held on insurance company Separate Account platform</td>
<td>Held on asset manager platform</td>
</tr>
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</table>

*Fee structure of insurance product only. Other fees may apply for investment management and/or advisory services, for both VA and CDA products.
Product Design & Pricing
Pricing techniques generally project many financial outcomes over thousands of economic scenarios ("stochastic pricing"), which include:

- Multiple economic scenario paths based on asset allocation (underlying assets, equity allocation, etc.)
- Assumptions about customer behavior including withdrawals, surrenders, mortality within each path
- Administration and other expenses
- Required reserves and capital
- Insurance company needs to earn enough revenue in the majority of scenarios to cover cost of benefits, expenses, reserves/capital, and provide a return on investment to the company to adequately compensate it for the risk taken

Industry pricing generally assumes a mixture of consumer behavior, based on experience and observed trends

Withdrawal behavior assumptions

- Some start withdrawals immediately
- Some delay for specified number of years (2, 5, 10, etc.)
- Some consumers take maximum withdrawal amount
- Some take more or less than the maximum amount or do not take a withdrawal every year
Fees and withdrawals are just a part of a product’s overall design

- Other features such as asset location, investment restrictions, annuitization options, death benefits, etc. comprise a product design

Reductions in fees at a given age or based on consumer withdrawal activity will lead to increased product cost and/or decreased benefits

- Simple example for illustrative purposes only
  - Insurance company needs to collect 1% annual fee over an assumed 20 year period for a total of 20% in fees, to cover cost of guarantee and adequately compensate it for risk
  - If fees limited to 10 years, insurance company would need to charge 2% to receive same 20% in total fees it needs

- Forced consumer behavior (i.e. mandated withdrawal start dates) will also increase cost of product and may be contrary to consumer needs

- CDA Design constraints would be inconsistent with other forms of insurance without design constraints
  - Annuities, including those with guaranteed living benefits
  - Life insurance premiums are not required to cease at a given age
  - Other insurance contracts not required to lower rates to individuals with no claims
Consumer Withdrawal Behavior
According to a LIMRA study, 60% of all VA GLWB policyholders were under age 65.

LIMRA found that an owner’s attained age and source of funds (qualified or non-qualified) were key drivers of withdrawal activity where the percentage of policyholders taking withdrawals increases with age.

Based on owners who purchased the VA GLWB in 2007, the percentage who began taking withdrawals over the next 4 years:

<table>
<thead>
<tr>
<th>Issue Age</th>
<th>IRA</th>
<th>Non-Qualified</th>
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<tbody>
<tr>
<td>60</td>
<td>25%</td>
<td>20%</td>
</tr>
<tr>
<td>65</td>
<td>35%</td>
<td>31%</td>
</tr>
<tr>
<td>70</td>
<td>74%</td>
<td>35%</td>
</tr>
</tbody>
</table>

Individual circumstances and overall financial goals influence withdrawal behaviors.

Source: Guaranteed Living Benefits Utilization - 2010 Data, LIMRA, 2012
Consumer Use of Lifetime Income Benefits

- Reasons Why Consumer May Not Trigger Benefits
  - Lock In *future* income needs
  - Other sources of income
  - Tax impact & optimal use of various sources of income
  - Product features may increase income for delayed withdrawals

- Most product designs offer increased income opportunities for consumers who do not take withdrawals immediately
  - Periodic “step-ups” or “ratchets” increase guaranteed withdrawal amount if the covered account value increases—usually annually or quarterly; income base “roll-up” rates may also apply
  - Increased withdrawal rates for starting withdrawals at higher ages

- Opportunity to terminate the benefit if it no longer meets their needs
- Consumers want and have purchased flexibility; forced utilization takes away a consumer’s choice & shouldn’t be mandated
- Consumers view this insurance as a “safety net” for “peace of mind” to protect them when they need it
  - Homeowners insurance protects insurers in the event of a catastrophe
  - Life insurance protects heirs in the event of an untimely death
  - CDAs protect consumers from retirement income depletion due to longevity and market movements
Consumer Protections: Suitability
## Life Cycle: Consumer Protections

<table>
<thead>
<tr>
<th>Pre-sale / Point of sale</th>
<th>Post-sale Accumulation and withdrawal phases</th>
<th>Post-sale Annuity payments phase</th>
</tr>
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<tbody>
<tr>
<td>- Product is state approved/SEC registered (if applicable)</td>
<td></td>
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<tr>
<td>- Agent is authorized to sell (insurance licensing &amp; FINRA registration, if applicable)</td>
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<td></td>
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<tr>
<td>- Agent training requirements</td>
<td></td>
<td></td>
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<tr>
<td>- Product marketing material authorized under insurance law and FINRA guidelines</td>
<td></td>
<td></td>
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<tr>
<td>- State Insurance and FINRA suitability review</td>
<td></td>
<td></td>
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<tr>
<td>- Prospectus / State Disclosure</td>
<td></td>
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<tr>
<td>- Annuity Buyer’s Guide, if applicable</td>
<td></td>
<td></td>
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<tr>
<td>- Delivery of contract / certificate</td>
<td></td>
<td></td>
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<tr>
<td>- Updated prospectus delivery</td>
<td></td>
<td></td>
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<tr>
<td>- Quarterly / Annual Statement delivery</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Consumer begins taking annual income amount from covered asset account</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Client assets are exhausted and investment product ceases</td>
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<td></td>
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<tr>
<td>- Annuity certificate continues and payments from insurance company General Account continue the income stream for life</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Updated prospectus delivery</td>
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Prior to annuity payments phase, consumer protections associated with the covered asset account continue to apply.
State Suitability Requirements

- **Purpose***
  - Establish a regulatory framework that holds insurers responsible for ensuring that annuity transactions are suitable.
  - Require **producer training** on provision of annuities, both in general and for product sold.
  - Where feasible and rational, establish state standards consistent with FINRA suitability standards.

- **Obligations of Insurance Producers and Insurers**
  - Reasonable efforts to obtain the consumer's suitability information
  - Reasonable grounds to believe the transaction being recommended is suitable

- **Suitability Information**
  - Information that is reasonably appropriate to determine the suitability of a recommendation
    - Age
    - Annual income
    - Financial situation and needs, including financial resources used for funding annuity
    - Financial experience
    - Financial objectives
    - Intended use of annuity
    - Financial time horizon
    - Existing assets, including investment and life insurance holdings
    - Liquidity needs
    - Liquid net worth
    - Risk tolerance
    - Tax status

*Source: Suitability in Annuity Transactions Model Regulation Executive Summary – September 2010 (Commissioners Sullivan and Hamm – Chair and Vice Chair of the Life Insurance and Annuities Committee).*
State Suitability Requirements

- Additional Basis for Recommendation
  - Consumer has been **reasonably informed of the annuity features** (e.g., surrender period and charge, tax penalties if consumers sells/exchanges/surrenders/annuitizes the annuity, mortality and expense fees, advisory fees);
  - The consumer would **benefit from certain features** of the annuity, such as tax-deferred growth, annuitization or death or living benefits;
  - **Annuity as a whole**, its subaccounts, riders and enhancements, if any, are suitable for the particular consumer based on suitability information;
  - In case of exchange or replacement, the **exchange or replacement is suitable** including taking into consideration:
    - any surrender changes, new surrender periods, loss of benefits, increased fees or charges;
    - whether consumer would benefit from product enhancements and improvements; and
    - whether consumer has had another annuity exchange or replacement, in particular within the preceding 36 months.

- FINRA “Safe Harbor” Suitability Compliance*
  - Sales in compliance with FINRA rules would comply with the NAIC suitability regulation

* Source: Suitability in Annuity Transactions Model Regulation Executive Summary – September 2010 (Commissioners Sullivan and Hamm – Chair and Vice Chair of the Life Insurance and Annuities Committee).
State Suitability Requirements

- Insurer Supervision System
  - Maintaining procedures to inform producers of regulation’s requirements
  - Establishing training standards
  - Providing product-specific training and materials
  - Maintaining procedures to review each recommendation prior to issuance (may employ a screening system, which may be electronic, to identify sales warranting additional review)
  - Maintaining procedures to detect unsuitable recommendations (may include consumer canvassing, systematic surveys, programs of internal monitoring, and applying sampling procedures)
  - Annual reporting to senior management

- Contracting with third-party to perform functions
  - Insurer remains responsible
  - Supervision of third-party includes
    - Monitoring/auditing
    - Obtaining annual certificates of compliance from senior manager charged with oversight
    - Several companies utilize robust trending monitoring
FINRA Rule 2111 – Suitability

- General Principles
  - Fundamental responsibility for fair dealing
  - Promote ethical sales practices and high standards of professional conduct
- Three main suitability obligations
  - Reasonable-basis suitability
  - Consumer-specific suitability
  - Quantitative suitability
- Consumer-specific suitability
  - Reasonable basis to believe that a recommended transaction or investment strategy involving a security is suitable
  - Determination based on the information obtained through reasonable diligence to ascertain the consumer’s investment profile
  - Investment profile includes, but not limited to:
    - Age
    - Other Investments
    - Financial situation and needs
    - Tax Status
    - Investment objectives
    - Investment experience
    - Investment time horizon
    - Liquidity needs
    - Risk tolerance
    - Other information the consumer may disclose
- A broker’s recommendation (a suggestion that a consumer take action or refrain from taking action regarding a security or investment strategy) is a triggering event for application of the rule
State Suitability Requirements

- Suitability rules are applicable for CDA recommendations
- Suitability requirements are sufficient so that the insurance needs and financial objectives of consumers purchasing Contingent Deferred Annuities are appropriately addressed:
  - Insurer responsible for ensuring CDA transactions are suitable
  - Insurance producer training for CDAs
  - Information obtained to determine the suitability of a CDA recommendation
  - Informed of various features of the CDA
  - Basis to believe consumer would benefit from certain features of the CDA
  - Third party contracting
Conclusions

- CDA design mandates to reduce/stop/discount fees will lead to increased product cost and/or decreased benefits
- CDA design mandates to force consumer behavior may be contrary to why a consumer purchased a CDA (e.g., withdrawal flexibility and control of assets) and will lead to increased product cost and/or decreased benefits
- Consumers view this insurance as “peace of mind” to protect them when they needed it
- Suitability rules are applicable for CDA recommendations
- Suitability requirements provide sufficient obligations on insurance producers and insurers on the sale of CDAs
- Suitability requirements are sufficient so that the insurance needs and financial objectives of the consumer are appropriately addressed