CDA Working Group Recommendations to the A Committee

CDA Definition

The proposed definition, as agreed to by the working group reads: “Contingent Deferred Annuity” means an annuity contract that establishes a life insurer’s obligation to make periodic payments for the annuitant’s lifetime at the time designated investments, which are not owned or held by the insurer, are depleted to a contractually-defined amount due to contractually-permitted withdrawals, market performance, fees and/or other charges.

Financial Regulation of CDAs

- The adequacy of existing laws and regulations applicable to the solvency of annuities, as such laws are applied to CDAs, should be referred by the A Committee to the NAIC Committees, Task Forces or Working Groups with the appropriate subject matter expertise. The working group recommends review of the following issues:
  - Reserving requirements;
  - RBC requirements for CDAs; and
  - Financial reporting requirements for CDAs, including possible changes to the Annual Statement Blank.

The working group acknowledges the American Academy of Actuaries findings that capital and reserving requirements as set forth in AG43 and C3P2 are applicable to CDAs. However, the working group notes that AG43 and C3P2 are Principles Based guidelines that are subject to credits for a “clearly defined hedging strategy” and therefore evaluation of the capital and reserving requirements for CDAs should be ongoing at the NAIC level, and states will need to monitor the actuarial assumptions, hedge effectiveness, and the adequacy of risk management techniques used by insurers issuing CDAs.

- The Working Group recommends that the A Committee direct the appropriate NAIC Committee, Task Force, or Working Group to develop a comprehensive NAIC-level company evaluation process in order to provide states with a basis for determining whether the company being evaluated has the capability to write CDAs. This evaluation process should include considerations of rating agency reports, statutory financial strength and stability, risk management capability, the plan for CDA operations, modeling information for CDA reserves and required capital calculations, general business indicators such as complaint ratios and state examination results, hedging policies and other factors. This process would result in a recommendation to the states and help supplement a state’s evaluation of form filings.

Rationale: Both the potential market size and the risks associated with CDAs, including operational risk, require prudent regulators to perform due diligence regarding a company’s capability to safely write this business. Rather than each state independently performing such reviews, a collaborative process would be more efficient, create uniformity, and give
confidence to states that the companies wishing to write CDAs possess the requisite risk mitigation systems, while maintaining each state’s ability to make its own determinations.

- Like other guaranteed benefits, including guarantees offered in connection with variable annuities, reserves for CDAs should be reported in the general accounts statement.

- The working group recommends that the A Committee direct the appropriate NAIC Committee, Task Force or Working Group to review the definition of CDA, as proposed by the CDA Working Group, and determine whether amendments to the Life and Health Insurance Guaranty Association Model Act (#520) are needed and warranted.

**Non-Financial Recommendations**

- The Working Group recommends that CDAs should be filed with state regulators as CDAs, not variable or fixed annuities. This may also necessitate changes to the SERFF and/or SBS systems making CDAs a distinct type of insurance (TOI).

  **Rationale:** CDAs share characteristics of both fixed and variable annuities; however, they do not fit neatly into either category and should not be designated as one or the other.

- CDAs should be registered as securities under federal law, as they are a considered a derivative of a security. Federal securities law will apply to CDAs, which includes the requirement that these products be sold by a securities licensed agent, meaning FINRA registered broker-dealers or licensed investment advisors.

- The working group agrees that the same producer licenses required to sell variable annuities should be required to sell CDAs.

**Non-Financial Regulation of CDAs Specific to NAIC Models**

With respect to the application of non-financial regulations to CDAs, the Working Group has focused its recommendations on whether clarifications may need to be made to specific NAIC models with respect to their application to CDAs, given that they share characteristics of both fixed and variable annuities, but do not fit neatly into one or the other category. While some models arguably already apply (or do not apply) to CDAs, certainty for state regulators should be the goal, where possible. To that end, the Working Group recommends that the A Committee consider making referrals to the appropriate NAIC groups to consider revisions to the following:

- **Annuity Disclosure Model Regulation (#245):** The working group recommends revising this model to exempt CDAs.
**Rationale:** This model does not apply to products that are also registered securities, like CDAs, and by its terms does not apply to variable annuities. The SEC prospectus preempts all other state disclosures, with the exception of the buyer’s guide. The requirement that buyer’s guides be provided at the time of sale probably shouldn’t apply to CDAs because the buyer’s guide doesn’t contain any information about CDAs and would be confusing.

- **Suitability in Annuity Transactions Model Regulation (#275):** The working group recommends to the A Committee that the model currently applies to the sale of CDAs and therefore be revised to specifically reference the sale of CDAs. The model should also make clear that the one-time, 4 hour training requirement and the product specific training requirement include CDAs.

  **Rationale:** This model has a safe harbor intended to prevent duplicative suitability standards being applied to sales of variable annuities through FINRA broker dealers. FINRA has said that it does not apply its variable annuity suitability rules to CDAs, only its general rules, which do not provide the same protections as the Suitability Model. While the working group agrees that the Suitability Model applies to the sale of CDAs in its current form, revisions to the model would make its application clear.

  Addressing the producer training requirements may require addressing the lines of authority required for the sale of CDAs—life and/or variable. The model currently requires producer training only for producers with a life line of authority.

- **The Advertisements of Life Insurance and Annuities Model Regulation (#570):** The working group recommends to the A committee that the model currently applies to CDAs and therefore be revised to specifically reference CDAs.

  **Rationale:** This model arguably already applies to CDAs. However, just as Section 3 of this model already contains language requiring its interpretation so as to avoid conflict with federal disclosure requirements with respect to variable contracts, similar language should be considered for CDAs.

- **Standard Nonforfeiture Law for Individual Deferred Annuities (#805):** The working group recommends to the A Committee that the Standard Nonforfeiture Law for Individual Deferred Annuities not apply to CDAs and the model be revised to make this clear.

  **Rationale:** While this model arguably applies to CDAs (because they are not specifically exempted), how to apply the law and to what aspect of CDAs is unclear. Amending the model to specifically exclude CDAs would avoid any possible confusion.

- **Life Insurance and Annuities Replacement Model Regulation (#613):** The working group recommends to the A Committee that this model regulation currently applies to CDAs and be amended to make clear that it applies to CDAs.
Rationale: This model arguably already applies to CDAs. However, the model’s definition of “registered contract” currently refers only to variable life insurance policies and variable annuity contracts.

- **Synthetic Guaranteed Investment Contracts Model Regulation (#695):** The working group recommends that the model be reviewed to clarify the relationship of this model to CDAs.

  Rationale: Synthetic GICs arguably share certain characteristics with CDAs and this model should be reviewed to determine whether revisions are necessary to clarify this relationship.

- **Producer Licensing Model Act (#218):** The working group recommends amending this model to make clear that the same licenses that are required to sell variable annuities are required to sell CDAs. It may also be appropriate to develop a separate line of authority not only for CDAs, but also for future products that do not fit neatly within existing definitional framework. (See recommendation for Suitability Model #275)

  Rationale: Like variable annuities, CDAs are registered as securities under federal law (they are considered a derivative of a security), and federal securities law requires that these products be sold by a securities licensed agents, meaning FINRA registered broker-dealers or licensed investment advisors.

- **Whitepaper:** The working group recommends that the A Committee assign the appropriate NAIC committee, Task Force or Working Group with the development of a whitepaper that can serve as a reference for states interested in modifying their annuity laws to clarify their applicability to CDAs. The whitepaper should include information similar to that of the working group’s recommendations above, but with additional detail.

- **Other Laws:** To the extent there are additional state consumer protection or market regulation laws which apply to annuities that the working group did not specifically address, the working group recommends that states presume those laws would apply to CDAs unless, upon analysis, application of the regulation to CDAs is unworkable or unwarranted.