Conference Call

CONTINGENT DEFERRED ANNUITY (A) WORKING GROUP
Friday, October 24, 2014
2:00 p.m. EDT/1:00 p.m. CDT/12:00 p.m. MDT/11:00 a.m. PDT

and

Friday, Oct 31, 2014
2:00 p.m. EDT/1:00 p.m. CDT/12:00 p.m. MDT/11:00 a.m. PDT

ROLL CALL

Ted Nickel, Chair                  Wisconsin
Robert Chester                    Connecticut
Jim Mumford                       Iowa
Jason Lapham                       Kansas
Bruce R. Ramge                     Nebraska

Roger A. Sevigny/Keith Nyhan      New Hampshire
Joseph Torti III/Elizabeth Dwyer   Rhode Island
Michael Humphreys                  Tennessee
Tomasz Serbinowski                Utah

AGENDA


2. Discuss Oct. 15 Draft *Annuity Disclosure Model Regulation* (#245); *Suitability in Annuity Transactions Model Regulation* (#275); *Advertisements of Life Insurance and Annuities Model Regulation* (#570); and *Life Insurance and Annuities Replacement Model Regulation* (#613) —Commissioner Ted Nickel (WI)

3. Discuss Issue of Nonforfeiture / Cancellation Benefits as They Relate to CDAs—Commissioner Ted Nickel (WI)

4. Discuss Plan For Fall National Meeting—Commissioner Ted Nickel (WI)

5. Discuss Any Other Matters Brought Before the Committee—Commissioner Ted Nickel (WI)

6. Adjournment
The NAIC solicits comments on this draft. Underlining and overstrikes show the changes from the existing model. Comments should be sent by email to Jennifer Cook at jcook@naic.org by September 5, 2014.

ANNuity DISCOlSO tHEt MODEL REGULATION

The NAIC amended this model during the 2013 Fall National Meeting. These amendments were adopted as guidelines under the NAIC’s model laws process. The December 2013 Guideline Amendments are highlighted in grey.

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Section 1. Purpose

The purpose of this regulation is to provide standards for the disclosure of certain minimum information about annuity contracts to protect consumers and foster consumer education. The regulation specifies the minimum information which must be disclosed, the method for disclosing it and the use and content of illustrations, if used, in connection with the sale of annuity contracts. The goal of this regulation is to ensure that purchasers of annuity contracts understand certain basic features of annuity contracts.

Section 2. Authority

This regulation is issued based upon the authority granted the commissioner under Section [cite any enabling legislation and state law corresponding to Section 4 of the NAIC Unfair Trade Practices Act].

Section 3. Applicability and Scope

This regulation applies to all group and individual annuity contracts and certificates except:

A. Immediate and deferred annuities that contain no non-guaranteed elements;

B. (1) Annuities used to fund:

NOTE TO WORKING GROUP: CONSIDERED ADDING THE PHRASE “INCLUDING CONTINGENT DEFERRED ANNUITIES” AFTER “ANNUITIES” IN B(1), BUT THIS EXEMPTION FOR ERISA PLANS SEEMS BROAD ENOUGH AS IS TO INCLUDE CONTINGENT DEFERRED ANNUITIES AND THIS SAME LANGUAGE IS IN THE SUITABILITY MODEL. ALSO, WE DO NOT WANT TO CREATE A SITUATION WHERE, UNLESS CDAS ARE SPECIFICALLY INCLUDED, IT IS PRESUMED THEY ARE EXCLUDED.

(a) An employee pension plan which is covered by the Employee Retirement Income Security Act (ERISA);

(b) A plan described by Sections 401(a), 401(k) or 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer,
(c) A governmental or church plan defined in Section 414 or a deferred compensation plan of a state or local government or a tax exempt organization under Section 457 of the Internal Revenue Code; or

(d) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor.

(2) Notwithstanding Paragraph (1), the regulation shall apply to annuities used to fund a plan or arrangement that is funded solely by contributions an employee elects to make whether on a pre-tax or after-tax basis, and where the insurance company has been notified that plan participants may choose from among two (2) or more fixed annuity providers and there is a direct solicitation of an individual employee by a producer for the purchase of an annuity contract. As used in this subsection, direct solicitation shall not include any meeting held by a producer solely for the purpose of educating or enrolling employees in the plan or arrangement;

C. Non-registered variable annuities issued exclusively to an accredited investor or qualified purchaser as those terms are defined by the Securities Act of 1933 (15 U.S.C. Section 77a et seq.), the Investment Company Act of 1940 (15 U.S.C. Section 80a-1 et seq.), or the regulations promulgated under either of those acts, and offered for sale and sold in a transaction that is exempt from registration under the Securities Act of 1933 (15 U.S.C. Section 77a et seq.).

D. (1) Transactions involving variable annuities and other registered products, including contingent deferred annuities, in compliance with Securities and Exchange Commission (SEC) rules and Financial Industry Regulatory Authority (FINRA) rules relating to disclosures and illustrations, provided that compliance with Section 5 shall be required after January 1, 2014, unless, or until such time as, the SEC has adopted a summary prospectus rule or FINRA has approved for use a simplified disclosure form applicable to variable annuities or other registered products.

Drafting Note: States should be aware that the provision in paragraph (1) above requiring transactions involving variable annuities and other registered products to comply with the requirements of Section 5 of the regulation after Jan. 1, 2014 unless the U.S. Securities and Exchange Commission (SEC) adopts a summary prospectus rule or the Financial Industry Regulatory Authority (FINRA) approves for use a simplified disclosure form applicable to variable annuities or other registered products could be preempted by the National Securities Markets Improvement Act of 1996 (NSMIA). NSMIA prohibits the States from making laws establishing record-making or record-keeping requirements for broker-dealers. Given this, in adopting this regulation, States may want to omit the language in paragraph (1) above that eliminates the exemption for these transactions after Jan. 1, 2014 and, as a consequence, would require broker-dealers to comply with Section 5 of this regulation unless or until the SEC or FINRA takes the delineated action. States should consider only adopting the language from paragraph (1) above that exempts transactions involving variable annuities and other registered products in compliance with the SEC and FINRA rules relating to disclosures and illustrations from having to comply with the regulation.

(2) Notwithstanding Subsection D(1), the delivery of the Buyer’s Guide is required in sales of variable annuities, and when appropriate, in sales of other registered products.

Drafting Note: The requirement to provide a Buyer’s Guide would not be appropriate for contingent deferred annuities until the NAIC adopts a Buyer’s Guide that specifically addresses contingent deferred annuities.

(3) Nothing in this subsection shall limit the commissioner’s ability to enforce the provisions of this regulation or to require additional disclosure.

E. Structured settlement annuities;

F. [Charitable gift annuities; and]

G. [Funding agreements].

Drafting Note: States that regulate charitable gift annuities should exempt them from the requirements of this regulation. States that recognize or regulate funding agreements as annuities should exempt them from the requirements of this regulation.

Section 4. Definitions
For the purposes of this regulation:

A. “Buyer’s Guide” means the National Association of Insurance Commissioner’s approved Annuity Buyer’s Guide.

B. [“Charitable gift annuity” means a transfer of cash or other property by a donor to a charitable organization in return for an annuity payable over one or two lives, under which the actuarial value of the annuity is less than the value of the cash or other property transferred and the difference in value constitutes a charitable deduction for federal tax purposes, but does not include a charitable remainder trust or a charitable lead trust or other similar arrangement where the charitable organization does not issue an annuity and incur a financial obligation to guarantee annuity payments.]

C. “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.

C. “Contract owner” means the owner named in the annuity contract or certificate holder in the case of a group annuity contract.

D. “Determinable elements” means elements that are derived from processes or methods that are guaranteed at issue and not subject to company discretion, but where the values or amounts cannot be determined until some point after issue. These elements include the premiums, credited interest rates (including any bonus), benefits, values, non-interest based credits, charges or elements of formulas used to determine any of these. These elements may be described as guaranteed but not determined at issue. An element is considered determinable if it was calculated from underlying determinable elements only, or from both determinable and guaranteed elements.

E. [“Funding agreement” means an agreement for an insurer to accept and accumulate funds and to make one or more payments at future dates in amounts that are not based on mortality or morbidity contingencies.]

F. “Generic name” means a short title descriptive of the annuity contract being applied for or illustrated such as “single premium deferred annuity.”

G. “Guaranteed elements” means the premiums, credited interest rates (including any bonus), benefits, values, non-interest based credits, charges or elements of formulas used to determine any of these, that are guaranteed or have determinable elements at issue. An element is considered guaranteed if all of the underlying elements that go into its calculation are guaranteed.

H. “Illustration” means a personalized presentation or depiction prepared for and provided to an individual consumer that includes non-guaranteed elements of an annuity contract over a period of years.

I. “Market Value Adjustment” or “MVA” feature is a positive or negative adjustment that may be applied to the account value and/or cash value of the annuity upon withdrawal, surrender, contract annuitization or death benefit payment based on either the movement of an external index or on the company’s current guaranteed interest rate being offered on new premiums or new rates for renewal periods, if that withdrawal, surrender, contract annuitization or death benefit payment occurs at a time other than on a specified guaranteed benefit date.

J. “Non-guaranteed elements” means the premiums, credited interest rates (including any bonus), benefits, values, dividends, non-interest based credits, charges or elements of formulas used to determine any of these, that are subject to company discretion and are not guaranteed at issue. An element is considered non-guaranteed if any of the underlying non-guaranteed elements are used in its calculation.

K. “Structured settlement annuity” means a “qualified funding asset” as defined in section 130(d) of the Internal Revenue Code or an annuity that would be a qualified funding asset under section 130(d) but for the fact that it is not owned by an assignee under a qualified assignment.
Section 5. Standards for the Disclosure Document and Buyer’s Guide

A. (1) Where the application for an annuity contract is taken in a face-to-face meeting, the applicant shall at or before the time of application be given both the disclosure document described in Subsection B and the Buyer’s Guide, if any.

(2) Where the application for an annuity contract is taken by means other than in a face-to-face meeting, the applicant shall be sent both the disclosure document and the Buyer’s Guide no later than five (5) business days after the completed application is received by the insurer.

(a) With respect to an application received as a result of a direct solicitation through the mail:

(i) Providing a Buyer’s Guide in a mailing inviting prospective applicants to apply for an annuity contract shall be deemed to satisfy the requirement that the Buyer’s Guide be provided no later than five (5) business days after receipt of the application.

(ii) Providing a disclosure document in a mailing inviting a prospective applicant to apply for an annuity contract shall be deemed to satisfy the requirement that the disclosure document be provided no later than five (5) business days after receipt of the application.

(b) With respect to an application received via the Internet:

(i) Taking reasonable steps to make the Buyer’s Guide available for viewing and printing on the insurer’s website shall be deemed to satisfy the requirement that the Buyer’s Guide be provided no later than five (5) business days after receipt of the application.

(ii) Taking reasonable steps to make the disclosure document available for viewing and printing on the insurer’s website shall be deemed to satisfy the requirement that the disclosure document be provided no later than five (5) business days after receipt of the application.

(c) A solicitation for an annuity contract provided in other than a face-to-face meeting shall include a statement that the proposed applicant may contact the insurance department of the state for a free annuity Buyer’s Guide. In lieu of the foregoing statement, an insurer may include a statement that the prospective applicant may contact the insurer for a free annuity Buyer’s Guide.

(d) Where the Buyer’s Guide and disclosure document are not provided at or before the time of application, a free look period of no less than fifteen (15) days shall be provided for the applicant to return the annuity contract without penalty. This free look shall run concurrently with any other free look provided under state law or regulation.

B. At a minimum, the following information shall be included in the disclosure document required to be provided under this regulation:

(1) The generic name of the contract, the company product name, if different, and form number, and the fact that it is an annuity;

(2) The insurer’s legal name, physical address, website address and telephone number;

(3) A description of the contract and its benefits, emphasizing its long-term nature, including examples where appropriate:

(a) The guaranteed and non-guaranteed elements of the contract, and their limitations, if any, including for fixed indexed annuities, the elements used to determine the index-based
interest, such as the participation rates, caps or spread, and an explanation of how they operate;

(b) An explanation of the initial crediting rate, or for fixed indexed annuities, an explanation of how the index-based interest is determined, specifying any bonus or introductory portion, the duration of the rate and the fact that rates may change from time to time and are not guaranteed;

(c) Periodic income options both on a guaranteed and non-guaranteed basis;

(d) Any value reductions caused by withdrawals from or surrender of the contract;

(e) How values in the contract can be accessed;

(f) The death benefit, if available and how it will be calculated;

(g) A summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract; and

(h) Impact of any rider, including, but not limited to, a guaranteed living benefit or long-term care rider;

(4) Specific dollar amount or percentage charges and fees shall be listed with an explanation of how they apply; and

(5) Information about the current guaranteed rate or indexed crediting rate formula, if applicable, for new contracts that contains a clear notice that the rate is subject to change.

C. Insurers shall define terms used in the disclosure statement in language that facilitates the understanding by a typical person within the segment of the public to which the disclosure statement is directed.

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The NAIC solicits comments on this draft. Underlining and overstrikes show the changes from the existing model. Comments should be sent by email to Jennifer Cook at jcook@naic.org by September 5, 2014.

SUITABILITY IN ANNUITY TRANSACTIONS
MODEL REGULATION

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Section 1. Purpose
A. The purpose of this regulation is to require insurers to establish a system to supervise recommendations and to set forth standards and procedures for recommendations to consumers that result in transactions involving annuity products so that the insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed.

B. Nothing herein shall be construed to create or imply a private cause of action for a violation of this regulation.

Drafting Note: The language of subsection B comes from the NAIC Unfair Trade Practices Act. If a State has adopted different language, it should be substituted for subsection B.

Section 2. Scope
This regulation shall apply to any recommendation to purchase, exchange or replace an annuity made to a consumer by an insurance producer, or an insurer where no producer is involved, that results in the purchase, exchange or replacement recommended.

Section 3. Authority
This regulation is issued under the authority of [insert reference to enabling legislation].

Drafting Note: States may wish to use the Unfair Trade Practices Act as enabling legislation or may pass a law with specific authority to adopt this regulation.

Section 4. Exemptions
Unless otherwise specifically included, this regulation shall not apply to transactions involving:

A. Direct response solicitations where there is no recommendation based on information collected from the consumer pursuant to this regulation;

B. Contracts used to fund:
(1) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);

NOTE TO WORKING GROUP: THIS EXEMPTION FOR ERISA PLANS SEEMS BROAD ENOUGH AS IS TO INCLUDE CONTINGENT DEFERRED ANNUITIES. SIMILAR LANGUAGE IS IN THE SUITABILITY MODEL. ALSO, WE DO NOT WANT TO CREATE A SITUATION WHERE, UNLESS CDAS ARE SPECIFICALLY INCLUDED, IT IS PRESUMED THEY ARE EXCLUDED.

(2) A plan described by sections 401(a), 401(k), 403(b), 408(k) or 408(p) of the Internal Revenue Code (IRC), as amended, if established or maintained by an employer;

(3) A government or church plan defined in section 414 of the IRC, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under section 457 of the IRC;

(4) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;

(5) Settlements of or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process; or

(6) Formal prepaid funeral contracts.

Section 5. Definitions

A. “Annuity” means an annuity, including a contingent deferred annuity, that is an insurance product under State law that is individually solicited, whether the product is classified as an individual or group annuity.

B. “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.

C. “Continuing education credit” or “CE credit” means one continuing education credit as defined in [insert reference in State law or regulations governing producer continuing education course approval].

D. “Continuing education provider” or “CE provider” means an individual or entity that is approved to offer continuing education courses pursuant to [insert reference in State law or regulations governing producer continuing education course approval].

E. “FINRA” means the Financial Industry Regulatory Authority or a succeeding agency.

F. “Insurer” means a company required to be licensed under the laws of this state to provide insurance products, including annuities.

G. “Insurance producer” means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities.

H. “Recommendation” means advice provided by an insurance producer, or an insurer where no producer is involved, to an individual consumer that results in a purchase, exchange or replacement of an annuity in accordance with that advice.

I. “Replacement” means a transaction in which a new policy or contract is to be purchased, and it is known or should be known to the proposing producer, or to the proposing insurer if there is no producer, that by reason of the transaction, an existing policy or contract has been or is to be:

(1) Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer or otherwise terminated;
(2) Converted to reduced paid-up insurance, continued as extended term insurance, or otherwise reduced in value by the use of nonforfeiture benefits or other policy values;

(3) Amended so as to effect either a reduction in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid;

(4) Reissued with any reduction in cash value; or

(5) Used in a financed purchase.

Drafting Note: The definition of “replacement” above is derived from the NAIC Life Insurance and Annuities Replacement Model Regulation. If a State has a different definition for “replacement,” the State should either insert the text of that definition in place of the definition above or modify the definition above to provide a cross-reference to the definition of “replacement” that is in State law or regulation.

1. “Suitability information” means information that is reasonably appropriate to determine the suitability of a recommendation, including the following:

   (1) Age;

   (2) Annual income;

   (3) Financial situation and needs, including the financial resources used for the funding of the annuity;

   (4) Financial experience;

   (5) Financial objectives;

   (6) Intended use of the annuity;

   (7) Financial time horizon;

   (8) Existing assets, including investment and life insurance holdings;

   (9) Liquidity needs;

   (10) Liquid net worth;

   (11) Risk tolerance; and

   (12) Tax status.

Section 6. Duties of Insurers and of Insurance Producers

A. In recommending to a consumer the purchase of an annuity or the exchange of an annuity that results in another insurance transaction or series of insurance transactions, the insurance producer, or the insurer where no producer is involved, shall have reasonable grounds for believing that the recommendation is suitable for the consumer on the basis of the facts disclosed by the consumer as to his or her investments and other insurance products and as to his or her financial situation and needs, including the consumer’s suitability information, and that there is a reasonable basis to believe all of the following:

   (1) The consumer has been reasonably informed of various features of the annuity, such as the potential surrender period and surrender charge, potential tax penalty if the consumer sells, exchanges, surrenders or annuitizes the annuity, mortality and expense fees, investment advisory
fees, potential charges for and features of riders, limitations on interest returns, insurance and investment components and market risk;

**Drafting Note:** If a State has adopted the NAIC Annuity Disclosure Model Regulation, the State should insert an additional phrase in paragraph (1) above to explain that the requirements of this section are intended to supplement and not replace the disclosure requirements of the NAIC Annuity Disclosure Model Regulation.

(2) The consumer would benefit from certain features of the annuity, such as tax-deferred growth, annuitization or death or living benefit;

(3) The particular annuity as a whole, the underlying subaccounts to which funds are allocated at the time of purchase or exchange of the annuity, and riders and similar product enhancements, if any, are suitable (and in the case of an exchange or replacement, the transaction as a whole is suitable) for the particular consumer based on his or her suitability information; and

(4) In the case of an exchange or replacement of an annuity, the exchange or replacement is suitable including taking into consideration whether:

   (a) The consumer will incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death, living or other contractual benefits), or be subject to increased fees, investment advisory fees or charges for riders and similar product enhancements;

   (b) The consumer would benefit from product enhancements and improvements; and

   (c) The consumer has had another annuity exchange or replacement and, in particular, an exchange or replacement within the preceding 36 months.

B. Prior to the execution of a purchase, exchange or replacement of an annuity resulting from a recommendation, an insurance producer, or an insurer where no producer is involved, shall make reasonable efforts to obtain the consumer's suitability information.

C. Except as permitted under subsection D, an insurer shall not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity is suitable based on the consumer’s suitability information.

D. (1) Except as provided under paragraph (2) of this subsection, neither an insurance producer, nor an insurer, shall have any obligation to a consumer under subsection A or C related to any annuity transaction if:

   (a) No recommendation is made;

   (b) A recommendation was made and was later found to have been prepared based on materially inaccurate information provided by the consumer;

   (c) A consumer refuses to provide relevant suitability information and the annuity transaction is not recommended; or

   (d) A consumer decides to enter into an annuity transaction that is not based on a recommendation of the insurer or the insurance producer.

(2) An insurer’s issuance of an annuity subject to paragraph (1) shall be reasonable under all the circumstances actually known to the insurer at the time the annuity is issued.
E. An insurance producer or, where no insurance producer is involved, the responsible insurer representative, shall at the time of sale:

(1) Make a record of any recommendation subject to section 6A of this regulation;

(2) Obtain a customer signed statement documenting a customer’s refusal to provide suitability information, if any; and

(3) Obtain a customer signed statement acknowledging that an annuity transaction is not recommended if a customer decides to enter into an annuity transaction that is not based on the insurance producer’s or insurer’s recommendation.

F. (1) An insurer shall establish a supervision system that is reasonably designed to achieve the insurer’s and its insurance producers’ compliance with this regulation, including, but not limited to, the following:

(a) The insurer shall maintain reasonable procedures to inform its insurance producers of the requirements of this regulation and shall incorporate the requirements of this regulation into relevant insurance producer training manuals;

(b) The insurer shall establish standards for insurance producer product training and shall maintain reasonable procedures to require its insurance producers to comply with the requirements of section 7 of this regulation;

(c) The insurer shall provide product-specific training and training materials which explain all material features of its annuity products to its insurance producers;

(d) The insurer shall maintain procedures for review of each recommendation prior to issuance of an annuity that are designed to ensure that there is a reasonable basis to determine that a recommendation is suitable. Such review procedures may apply a screening system for the purpose of identifying selected transactions for additional review and may be accomplished electronically or through other means including, but not limited to, physical review. Such an electronic or other system may be designed to require additional review only of those transactions identified for additional review by the selection criteria;

(e) The insurer shall maintain reasonable procedures to detect recommendations that are not suitable. This may include, but is not limited to, confirmation of consumer suitability information, systematic customer surveys, interviews, confirmation letters and programs of internal monitoring. Nothing in this subparagraph prevents an insurer from complying with this subparagraph by applying sampling procedures, or by confirming suitability information after issuance or delivery of the annuity; and

(f) The insurer shall annually provide a report to senior management, including to the senior manager responsible for audit functions, which details a review, with appropriate testing, reasonably designed to determine the effectiveness of the supervision system, the exceptions found, and corrective action taken or recommended, if any.

(2) (a) Nothing in this subsection restricts an insurer from contracting for performance of a function (including maintenance of procedures) required under paragraph (1). An insurer is responsible for taking appropriate corrective action and may be subject to sanctions and penalties pursuant to section 8 of this regulation regardless of whether the insurer contracts for performance of a function and regardless of the insurer’s compliance with subparagraph (b) of this paragraph.

(b) An insurer’s supervision system under paragraph (1) shall include supervision of contractual performance under this subsection. This includes, but is not limited to, the following:
(i) Monitoring and, as appropriate, conducting audits to assure that the contracted function is properly performed; and

(ii) Annually obtaining a certification from a senior manager who has responsibility for the contracted function that the manager has a reasonable basis to represent, and does represent, that the function is properly performed.

(3) An insurer is not required to include in its system of supervision an insurance producer’s recommendations to consumers of products other than the annuities offered by the insurer.

G. An insurance producer shall not dissuade, or attempt to dissuade, a consumer from:

(1) Truthfully responding to an insurer’s request for confirmation of suitability information;

(2) Filing a complaint; or

(3) Cooperating with the investigation of a complaint.

H. (1) Sales made in compliance with FINRA requirements pertaining to suitability and supervision of annuity transactions shall satisfy the requirements under this regulation. This subsection applies to FINRA broker-dealer sales of variable annuities, contingent deferred annuities and fixed annuities if the suitability and supervision is similar to those applied to variable annuity sales. However, nothing in this subsection shall limit the insurance commissioner’s ability to enforce (including investigate) the provisions of this regulation.

Drafting Note: Non-compliance with FINRA requirements means that the broker-dealer transaction is subject to compliance with the suitability requirements of this regulation.

(2) For paragraph (1) to apply, an insurer shall:

(a) Monitor the FINRA member broker-dealer using information collected in the normal course of an insurer’s business; and

(b) Provide to the FINRA member broker-dealer information and reports that are reasonably appropriate to assist the FINRA member broker-dealer to maintain its supervision system.

Section 7. Insurance Producer Training

A. An insurance producer shall not solicit the sale of an annuity product unless the insurance producer has adequate knowledge of the product to recommend the annuity and the insurance producer is in compliance with the insurer’s standards for product training. An insurance producer may rely on insurer-provided product-specific training standards and materials to comply with this subsection.

B. (1) (a) An insurance producer who engages in the sale of annuity products shall complete a one-time four (4) credit training course approved by the department of insurance and provided by the department of insurance-approved education provider.

(b) Insurance producers who hold a life insurance line of authority on the effective date of this regulation and who desire to sell annuities shall complete the requirements of this subsection within six (6) months after the effective date of this regulation. Individuals who obtain a life insurance line of authority on or after the effective date of this regulation may not engage in the sale of annuities until the annuity training course required under this subsection has been completed.

(2) The minimum length of the training required under this subsection shall be sufficient to qualify for at least four (4) CE credits, but may be longer.

(3) The training required under this subsection shall include information on the following topics:
The types of annuities and various classifications of annuities;
Identification of the parties to an annuity;
How fixed, variable, and indexed and contingent deferred annuity contract provisions affect consumers;
The application of income taxation of qualified and non-qualified annuities;
The primary uses of annuities; and
Appropriate sales practices, replacement and disclosure requirements.

Providers of courses intended to comply with this subsection shall cover all topics listed in the prescribed outline and shall not present any marketing information or provide training on sales techniques or provide specific information about a particular insurer’s products. Additional topics may be offered in conjunction with and in addition to the required outline.

A provider of an annuity training course intended to comply with this subsection shall register as a CE provider in this State and comply with the rules and guidelines applicable to insurance producer continuing education courses as set forth in [insert reference to State law or regulations governing producer continuing education course approval].

Annuity training courses may be conducted and completed by classroom or self-study methods in accordance with [insert reference to State law or regulations governing producer continuing education course approval].

Providers of annuity training shall comply with the reporting requirements and shall issue certificates of completion in accordance with [insert reference to State law or regulations governing producer continuing education course approval].

The satisfaction of the training requirements of another State that are substantially similar to the provisions of this subsection shall be deemed to satisfy the training requirements of this subsection in this State.

An insurer shall verify that an insurance producer has completed the annuity training course required under this subsection before allowing the producer to sell an annuity product for that insurer. An insurer may satisfy its responsibility under this subsection by obtaining certificates of completion of the training course or obtaining reports provided by commissioner-sponsored database systems or vendors or from a reasonably reliable commercial database vendor that has a reporting arrangement with approved insurance education providers.
The purpose of this regulation is to set forth minimum standards and guidelines to assure a full and truthful disclosure to the public of all material and relevant information in the advertising of life insurance policies and annuity contracts.

Section 2. Definitions

For the purpose of this regulation:

A. (1) “Advertisement” means material designed to create public interest in life insurance or annuities or in an insurer, or in an insurance producer; or to induce the public to purchase, increase, modify, reinstate, borrow on, surrender, replace or retain a policy including:

Comment: See drafting note caveat immediately following the definition of “insurance producer” in this section.

(a) Printed and published material, audiovisual material and descriptive literature of an insurer or insurance producer used in direct mail, newspapers, magazines, radio and television scripts, telemarketing scripts, billboards and similar displays, and the Internet or any other mass communication media.

(b) Descriptive literature and sales aids of all kinds, authored by the insurer, its insurance producers, or third parties, issued, distributed or used by the insurer or insurance producer; including but not limited to circulars, leaflets, booklets, web pages, depictions, illustrations and form letters;

(c) Material used for the recruitment, training and education of an insurer’s insurance producers which is designed to be used or is used to induce the public to purchase, increase, modify, reinstate, borrow on, surrender, replace or retain a policy;

(d) Prepared sales talks, presentations and materials for use by insurance producers.

(2) “Advertisement” for the purpose of this regulation shall not include:

(a) Communications or materials used within an insurer’s own organization and not intended for dissemination to the public;
Communications with policyholders other than material urging policyholders to purchase, increase, modify, reinstate or retain a policy; and

A general announcement from a group or blanket policyholder to eligible individuals on an employment or membership list that a policy or program has been written or arranged; provided the announcement clearly indicates that it is preliminary to the issuance of a booklet explaining the proposed coverage.

B. “Annuity” means an annuity, including a contingent deferred annuity, that is an insurance product under State law that is individually solicited, whether the product is classified as an individual or group annuity.

C. “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.

BD. “Determinable policy elements” means elements that are derived from processes or methods that are guaranteed at issue and not subject to company discretion, but where the values or amounts cannot be determined until some point after issue. These elements include the premiums, credited interest rates (including any bonus), benefits, values, non-interest based credits, charges or elements of formulas used to determine any of these. These elements may be described as guaranteed but not determined at issue. An element is considered determinable if it was calculated from underlying determinable policy elements only, or from both determinable and guaranteed policy elements.

CE. “Guaranteed policy elements” means the premiums, benefits, values, credits or charges under a policy, or elements of formulas used to determine any of these that are guaranteed and determined at issue.

DF. “Insurance producer” means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance.

Drafting Note: Each jurisdiction may wish to revise the definition of “insurance producer” to reference the definition in that jurisdiction’s licensing law. This definition from the NAIC Producer Licensing Model Act, which also defines the terms “sell,” “solicit,” and “negotiate,” should be used. This term and words related thereto should not be included in life advertising regulations unless “insurance producer” also is statutorily defined and the definitions are identical.

EG. “Insurer” means any individual, corporation, association, partnership, reciprocal exchange, inter-insurer, Lloyd’s, fraternal benefit society, and any other legal entity which is defined as an “insurer” in the insurance code of this state or issues life insurance or annuities in this state and is engaged in the advertisement of a policy.

FH. “Nonguaranteed elements” means the premiums, credited interest rates (including any bonus), benefits, values, non-interest based credits, charges or elements of formulas used to determine any of these, that are subject to company discretion and are not guaranteed at issue. An element is considered nonguaranteed if any of the underlying nonguaranteed elements are used in its calculation.

GI. “Policy” means any policy, plan, certificate, including a fraternal benefit certificate, contract, agreement, statement of coverage, rider or endorsement which provides for life insurance or annuity benefits.

HJ. “Preneed funeral contract or prearrangement” means an arrangement by or for an individual before the individual’s death relating to the purchase or provision of specific funeral or cemetery merchandise or services.
Section 3. Applicability

A. This regulation shall apply to any life insurance or annuity advertisement intended for dissemination in this state. In variable contracts registered products where disclosure requirements are established pursuant to federal regulation, this regulation shall be interpreted so as to eliminate conflict with federal regulation.

B. All advertisements, regardless of by whom written, created, designed or presented, shall be the responsibility of the insurer, as well as the producer who created or presented the advertisement. Insurers shall establish and at all times maintain a system of control over the content, form and method of dissemination of all advertisements of its policies. A system of control shall include regular and routine notification, at least once a year, to agents, brokers and others authorized by the insurer to disseminate advertisements of the requirement and procedures for company approval prior to the use of any advertisements that is not furnished by the insurer and that clearly sets forth within the notice the most serious consequence of not obtaining the required prior approval.

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LIFE INSURANCE AND ANNUITIES REPLACEMENT MODEL REGULATION

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Section 1. Purpose and Scope

A. The purpose of this regulation is:

(1) To regulate the activities of insurers and producers with respect to the replacement of existing life insurance and annuities.

(2) To protect the interests of life insurance and annuity purchasers by establishing minimum standards of conduct to be observed in replacement or financed purchase transactions. It will:

(a) Assure that purchasers receive information with which a decision can be made in his or her own best interest;

(b) Reduce the opportunity for misrepresentation and incomplete disclosure; and

(c) Establish penalties for failure to comply with requirements of this regulation.

B. Unless otherwise specifically included, this regulation shall not apply to transactions involving:

(1) Credit life insurance;

(2) Group life insurance or group annuities where there is no direct solicitation of individuals by an insurance producer. Direct solicitation shall not include any group meeting held by an insurance producer solely for the purpose of educating or enrolling individuals or, when initiated by an individual member of the group, assisting with the selection of investment options offered by a single insurer in connection with enrolling that individual. Group life insurance or group annuity certificates marketed through direct response solicitation shall be subject to the provisions of Section 7;

(3) Group life insurance and annuities used to fund prearranged funeral contracts;

(4) An application to the existing insurer that issued the existing policy or contract when a contractual change or a conversion privilege is being exercised; or, when the existing policy or contract is being replaced by the same insurer pursuant to a program filed with and approved by the commissioner; or, when a term conversion privilege is exercised among corporate affiliates.
(5) Proposed life insurance that is to replace life insurance under a binding or conditional receipt issued by the same company;

(6) (a) Policies or contracts used to fund (i) an employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA); (ii) a plan described by Sections 401(a), 401(k) or 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer; (iii) a governmental or church plan defined in Section 414, a governmental or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under Section 457 of the Internal Revenue Code; or (iv) a nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor.

(b) Notwithstanding Subparagraph (a), this regulation shall apply to policies or contracts used to fund any plan or arrangement that is funded solely by contributions an employee elects to make, whether on a pre-tax or after-tax basis, and where the insurer has been notified that plan participants may choose from among two (2) or more insurers and there is a direct solicitation of an individual employee by an insurance producer for the purchase of a contract or policy. As used in this subsection, direct solicitation shall not include any group meeting held by an insurance producer solely for the purpose of educating individuals about the plan or arrangement or enrolling individuals in the plan or arrangement or, when initiated by an individual employee, assisting with the selection of investment options offered by a single insurer in connection with enrolling that individual employee;

(7) Where new coverage is provided under a life insurance policy or contract and the cost is borne wholly by the insured’s employer or by an association of which the insured is a member;

(8) Existing life insurance that is a non-convertible term life insurance policy that will expire in five (5) years or less and cannot be renewed;

(9) Immediate annuities that are purchased with proceeds from an existing contract. Immediate annuities purchased with proceeds from an existing policy are not exempted from the requirements of this regulation; or

(10) Structured settlements.

C. Registered contracts shall be exempt from the requirements of Sections 5A(2) and 6B with respect to the provision of illustrations or policy summaries; however, premium or contract contribution amounts and identification of the appropriate prospectus or offering circular shall be required instead.

Section 2. Definitions

A. “Annuity” means an annuity, including a contingent deferred annuity, that is an insurance product under State law that is individually solicited, whether the product is classified as an individual or group annuity.

B. “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.

AC. “Direct-response solicitation” means a solicitation through a sponsoring or endorsing entity or individually solely through mails, telephone, the Internet or other mass communication media.

BD. “Existing insurer” means the insurance company whose policy or contract is or will be changed or affected in a manner described within the definition of “replacement.”
“Existing policy or contract” means an individual life insurance policy (policy) or annuity contract (contract) in force, including a policy under a binding or conditional receipt or a policy or contract that is within an unconditional refund period.

“Financed purchase” means the purchase of a new policy involving the actual or intended use of funds obtained by the withdrawal or surrender of, or by borrowing from values of an existing policy to pay all or part of any premium due on the new policy. For purposes of a regulatory review of an individual transaction only, if a withdrawal, surrender or borrowing involving the policy values of an existing policy is used to pay premiums on a new policy owned by the same policyholder and issued by the same company within four (4) months before or thirteen (13) months after the effective date of the new policy, it will be deemed prima facie evidence of the policyholder’s intent to finance the purchase of the new policy with existing policy values. This prima facie standard is not intended to increase or decrease the monitoring obligations contained in Section 4A(5) of this regulation.

“Illustration” means a presentation or depiction that includes non-guaranteed elements of a policy of life insurance over a period of years as defined in [insert reference to state law equivalent to the NAIC Life Insurance Illustrations Model Regulation].

“Policy summary,” for the purposes of this regulation;

1. For policies or contracts other than universal life policies, means a written statement regarding a policy or contract which shall contain to the extent applicable, but need not be limited to, the following information: current death benefit; annual contract premium; current cash surrender value; current dividend; application of current dividend; and amount of outstanding loan.

2. For universal life policies, means a written statement that shall contain at least the following information: the beginning and end date of the current report period; the policy value at the end of the previous report period and at the end of the current report period; the total amounts that have been credited or debited to the policy value during the current report period, identifying each by type (e.g., interest, mortality, expense and riders); the current death benefit at the end of the current report period on each life covered by the policy; the net cash surrender value of the policy as of the end of the current report period; and the amount of outstanding loans, if any, as of the end of the current report period.

“Producer,” for the purpose of this regulation, shall be defined to include agents, brokers and producers.

“Replacing insurer” means the insurance company that issues or proposes to issue a new policy or contract that replaces an existing policy or contract or is a financed purchase.

“Registered contract” means a variable annuity contract or variable life insurance policy subject to the prospectus delivery requirements of the Securities Act of 1933.

“Replacement” means a transaction in which a new policy or contract is to be purchased, and it is known or should be known to the proposing producer, or to the proposing insurer if there is no producer, that by reason of the transaction, an existing policy or contract has been or is to be:

1. Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer or otherwise terminated;

2. Converted to reduced paid-up insurance, continued as extended term insurance, or otherwise reduced in value by the use of nonforfeiture benefits or other policy values;

3. Amended so as to effect either a reduction in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid;

4. Reissued with any reduction in cash value; or

5. Used in a financed purchase.
“Sales material” means a sales illustration and any other written, printed or electronically presented information created, or completed or provided by the company or producer and used in the presentation to the policy or contract owner related to the policy or contract purchased.
September 4, 2014

Ms. Jennifer Cook  
Health and Life Counsel  
National Association of Insurance Commissioners  
1100 Walnut Street, Suite 1500  
Kansas City, MO 64106


Dear Ms. Cook:

NAIFA appreciates the opportunity to provide comments on the draft Guidelines for the Financial Solvency and Market Conduct Regulation of Insurers Who Offer Contingent Deferred Annuities (“Draft Guidance Document”). NAIFA commends the Working Group for developing this document and for giving interested parties opportunity to offer suggestions for consideration.

Founded in 1890 as The National Association of Life Underwriters (NALU), NAIFA is one of the nation’s oldest and largest associations representing the interests of insurance professionals from every Congressional district in the United States. NAIFA members assist consumers by focusing their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. NAIFA’s mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

After reviewing the Draft Guidance Document, NAIFA believes the Draft will help to provide an important framework for insurance departments on how to regulate the marketing and sale of contingent-deferred annuities (CDA). To ensure regulators are provided with guidance in determining the licensing requirements to sell CDAs, we propose the Draft be amended to include the recommendation of the Producer Licensing Task Force that States should require the variable line of authority license to sell CDA products.\(^1\) The Draft should also reflect that the Task Force Chair noted that training on CDAs should be addressed by the agents and the companies rather than the NAIC.\(^2\)

In Section III, B. Application of NAIC Model Laws and Regulations, we recommend ending the paragraph regarding the Producer Licensing Model Act (pg. 7 of the Draft) with the following sentence:

\(^{1}\) http://www.naic.org/meetings1408/committees_ex_pltf_2014_summer_nm_summary.pdf?1409072960108  
\(^{2}\) https://secure.naic.org/secure/minutes/aug14/ex_prodLic_tf.pdf (password and ID required for access)
At the request of the A Committee, the Producer Licensing (EX) Task Force reviewed aspects of CDA licensing and unanimously approved a recommendation that States should require the variable line of authority license for producers selling CDAs. The Task Force Chair also suggested that training on CDAs should be addressed by the agents and companies rather than the NAIC.

We appreciate the efforts of the Working Group in developing the Draft and we thank regulators for taking our views into consideration. Please feel free to contact me if you have any questions.

Sincerely,

Steve Kline
Director – State Government Relations
National Association of Insurance and Financial Advisors
2901 Telestar Court
Falls Church, VA 22042
(703) 770-8187
skline@naifa.org
September 5, 2014

Via E-Mail

Commissioner Ted Nickel, Chair
Contingent Deferred Annuities (A)
Working Group
c/o Jennifer Cook (jcook@naic.org)
National Association of Insurance Commissioners
444 North Capitol Street, NW
Suite 701
Washington, DC 20001

Re: Exposure of draft Guidelines for the Financial Solvency and Market Conduct Regulation of Insurers who offer Contingent Deferred Annuities (the “CDA Guidelines”).

Dear Commissioner Nickel:

On behalf of the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA), I am submitting this comment letter on the draft CDA Guidelines.

In Section III.B. of the draft Guidelines, there is a discussion of the NAIC Life and Health Insurance Guaranty Association Model Act (“NAIC GA Model Act”). In particular, that discussion includes the following statements:

“The working group found that the issue of guaranty association coverage would likely vary from state to state. On one hand, a CDA is sold by life companies and would seem to be covered under guaranty funds like other life products. On the other hand, some guaranty funds exclude coverage for products that involve the transfer of investment risks or guarantees of employer retirement plans. CDAs would arguably fit into these categories. Each state should review its guaranty fund coverage laws to determine whether CDAs are covered by those funds”.

The above quoted language seems to suggest that there is significant variation among the states with respect to the coverage of contingent deferred annuities (“CDAs”). NOLHGA is not aware of any basis for reaching such a conclusion. To the contrary, most state guaranty association laws have been updated to be substantially consistent with the NAIC GA Model Act. Based on our experience, we would expect that same level of substantial consistency to exist among the states with respect to the coverage of CDAs. Moreover, in July 2012 NOLHGA provided its member guaranty associations with a comprehensive briefing on its findings regarding the
coverage of CDAs. That briefing was similar to the briefing that NOLHGA provided the CDA Working Group on November 29, 2012. Since that time we have not received any indication from our members that they disagree with NOLHGA’s analysis or that there will be a significant split among the states with respect to the coverage of CDAs. While NOLHGA agrees that each guaranty association will need to decide for itself the question of coverage for CDAs under its own governing law in effect at the time an issuer of a CDA becomes insolvent and is placed under an order of liquidation (just as coverage decisions are made for all insurance products), we do not believe that it would be appropriate to conclude that the coverage of CDAs will vary substantially from state to state.

We also would note that the Receivership & Insolvency (E) Task Force (RITF), during a teleconference held yesterday, approved a memorandum on guaranty association coverage in response to its charge regarding CDAs (copy of memorandum enclosed). The findings and conclusions in the RITF memorandum are consistent with NOLHGA’s analysis presented to the Contingent Deferred Annuities (A) Working Group in 2012 and to the RITF at the recent Louisville NAIC meeting.

Thank you for providing us with the opportunity to submit comments. We would be happy to answer any questions you may have.

Very truly yours,

William P. O’Sullivan
Sr. Vice President & General Counsel
To: Commissioner Julie Mix McPeak (TN), Chair, Life Insurance and Annuities (A) Committee and Commissioner Ted Nickel (WI), Chair, Contingent Deferred Annuity (A) Working Group

From: Jim Mumford (IA), Chair, Receivership & Insolvency (E) Task Force

Date: September 4, 2014

Re: Response to 2014 Charge Regarding Contingent Deferred Annuities

The Receivership & Insolvency (E) Task Force (RITF) was requested to provide input regarding the definition of contingent deferred annuities (CDAs) developed by the Contingent Deferred Annuities (A) Working Group and adopted by the Life Insurance and Annuities (A) Committee requiring changes to the Life and Health Insurance Guaranty Association Model Act ("Model Act").

After a presentation and input by the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) representatives, phone conversations with some RITF members and NOLHGA experts, and discussion by the members of the RITF and interested parties at an open meeting, it is the RITF findings that CDAs would fall within the definition of “annuity” in the Model Act and be subject to the same provisions for coverage, group and individual, and subject to the same limitations and broad exclusions, as other annuities. This is based on the assumption that CDAs are considered annuities under state law and the issuer is a member insurer under state guaranty association law.

Subject to the fact that individual state guaranty associations have the ultimate decision of what contracts are covered, RITF believes that, in those states that meet the above assumptions, CDAs should be covered annuities, both in the pre-payout phase and the pay-out phase, subject to all of the other statutory limits and exclusions that apply generally to annuities. This is based on the fact that there is no reason that CDAs defined as annuities by relevant state law would fall outside the scope of “annuities” described as covered in the Model Act, and CDAs would not be subject to any Model Act provision that would specifically exclude CDAs from coverage. The fact that most states have guaranty association laws substantially similar to the Model Act, and the fact that NOLHGA establishes task forces for multi-state insolvencies comprised of interested guaranty association representatives that make recommendations concerning guaranty association coverage of contracts and policies issued by an insolvent insurer, lead to the conclusion that CDAs would be treated in most states as contracts coming within the scope of annuities covered by guaranty associations under the Model Act.

If you have any questions please contact NAIC staff, Jane Koenigsman, jkoenigsman@naic.org.
September 5, 2014

Commissioner Ted Nickel, Chair
Contingent Deferred Annuities (A) Working Group
Wisconsin Office of the Commissioner of Insurance
125 South Webster Street
Madison, Wisconsin 53703-3474

Via email: ted.nickel@wisconsin.gov

Re: Draft Guidelines for the Financial Solvency and Market Conduct Regulation of Insurers who offer Contingent Deferred Annuities (“CDAs”)
Draft Revisions to Annuity Disclosure Model Regulation (#245); Suitability in Annuity Transactions Model Regulation (#275); Advertisements of Life Insurance and Annuities Model Regulation (#570); Life Insurance and Annuities Replacement Model Regulation (#613)

Dear Commissioner Nickel:

On behalf of our members, the American Council of Life Insurers (“ACLI”) and the Insured Retirement Institute (“IRI”) appreciate the opportunity to comment on (a) the draft Guidelines for the Financial Solvency and Market Conduct Regulation of Insurers who offer Contingent Deferred Annuities (the “Guidelines”) exposed for public comment by the NAIC Contingent Deferred Annuities (A) Working Group (the “Working Group”) on August 5, 2014, and (b) the draft revisions to the NAIC Annuity Disclosure Model Regulation (#245), the NAIC Suitability in Annuity Transactions Model Regulation (#275), the NAIC Advertisements of Life Insurance and Annuities Model Regulation (#570), and the NAIC Life Insurance and Annuities Replacement Model Regulation (#613) (collectively, the “Consumer Protection Models”) re-exposed for comment by the Working Group on August 16, 2014.

We greatly appreciate the Working Group’s efforts to develop the Draft Guidelines, and believe it provides a helpful foundation for resolving questions individual states may have about the regulatory framework for CDAs. We have enclosed as Attachment A to this letter a mark-up of the
Draft Guidelines in which we propose what we believe are necessary and appropriate clarifications. In Part 1 of this letter, we describe and explain the substantive changes we are recommending.¹

We also greatly appreciate the efforts of the NAIC staff to develop the draft revisions to the Consumer Protection Models. While we continue to believe that NAIC drafting notes or alternatively interpretative guidance in the CDA Guideline Document could serve the purpose of explaining how these regulations apply to CDAs, we acknowledge that the Working Group has requested public input on technical revisions to these models. We have enclosed as Attachment B to this letter a mark-up of the relevant sections of each of the Consumer Protection Models, which reflect an alternate approach to that taken in the draft revisions exposed for comment by the Working Group on March 29, 2014. In Part 2 of this letter, we describe and explain our proposed approach.

As a preliminary matter, we’d like to briefly reiterate the comments we made regarding consumers’ retirement income challenges during the in-person meeting of the Working Group on August 16 at the NAIC Summer 2014 National Meeting (the “Summer Meeting”).

Seventy-nine million Baby Boomers today face immediate and unprecedented retirement income challenges that simply did not exist in earlier generations. The number of 60-64 year old Americans has increased substantially in recent years, as have the odds that a 65 year old will live to see age 90. Simply put, individuals today are living longer than their parents and grandparents and can no longer rely on traditional pension plans and Social Security to fund their retirement. As a result, American consumers must take a much longer-term approach to planning and saving in order to support themselves through retirements that can span 20-30 years or more.

There are a wide variety of products currently available in the market to help consumers effectively manage these risks, and CDAs represent another such option. They include many of the same key features as traditional annuities, and operate and afford protections similar to guaranteed lifetime withdrawal benefits. The key distinction is that the assets do not reside with the insurer. CDAs are a way to make lifetime income guarantees available to consumers who, for any number of reasons, may choose not to purchase traditional annuities.

With this context in mind, ACLI and IRI respectfully offer the following comments on the draft Guidelines and the draft revisions to the Consumer Protection Models:

¹ Please note that, in addition to the substantive changes described in this letter, the enclosed mark-up suggests using more consistent terminology throughout the Draft Guidelines (e.g., benefit base, policyholder, Covered Investments, etc.), and includes a number of grammatical changes and other non-substantive revisions. These suggested changes are not discussed in this letter.
Part 1: Comments on Draft Guidelines for the Financial Solvency and Market Conduct Regulation of Insurers who offer Contingent Deferred Annuities

Executive Summary

Our mark-up includes an alternate version of the second paragraph of the Executive Summary, which we believe more precisely describes the purpose of the Guidelines. In addition, we continue to prefer (as we indicated in our remarks at the Summer Meeting) the NAIC finalize its positions on important charges before final issuance of the Guidelines. We appreciate that the Working Group has expressed a desire to issue the Guidelines in the near-term to reflect the work that has already been completed, and to revise the Guidelines when the remaining work is completed. We remain committed to working with the various NAIC groups to provide technical input and assistance in the evaluation and adoption of recommendations relating to their charges. We have provided suggested language to clarify this plan.

Furthermore, regardless of whether or not the Working Group decides to wait for this work to be completed before issuing the Guidelines, we respectfully urge the Working Group, as part of its charge, to continue coordinating with the other NAIC committees and working groups responsible for these important tasks to ensure their timely completion. We believe this is a critical assignment, and we stand ready to do whatever we can to help the Working Group fulfill this charge.

Section I.A and B – Classification of CDAs and Definition of CDAs

It is our understanding that the Working Group’s goal in developing the Guidelines was to provide clear and straightforward guidance for the states. We share that goal, and to that end, our suggested revisions to these sections would remove some of the procedural background information that states would not need in order to determine how to regulate CDAs. With our suggested changes, we believe these sections will provide greater clarity as to the NAIC’s position on the classification and definition of CDAs.

Section I.C – Features of a CDA

We believe it will be very helpful to the state insurance departments to have a concise description of the product included in the Draft Guidelines. Our mark-up includes an alternative version of this section to better reflect the design of CDA products currently available in the market. In addition, we believe our mark-up is appropriately broad that it should encompass new CDA product designs in the future.
Section I.D – Federal Regulation of CDAs

As we indicated in our remarks at the Summer Meeting, we have offered suggested revisions to this section to more accurately reflect the technical nuances of the federal securities laws. In particular, we have provided language to clarify that, while insurers often do register their CDAs with the SEC, some products are not registered because they qualify for an exemption from the registration requirements in the federal securities laws. The most common exemption is for annuities that fund certain retirement plans.

Section II – Financial Regulation of CDAs

As with our comments on Section I.C (as described above), many of our suggested changes in Section II.A are intended to more concisely describe how CDAs work, and to be appropriately broad so as to avoid the need to revise the Guidelines to reflect future CDA product designs.

In addition, we note that Sections B., C., and D. are currently listed as “In Development.” While we are hopeful that the work on these items will be completed in the near future, if the Working Group chooses to issue the Guidelines prior to the NAIC completing all charges, we believe it would be appropriate to provide more specificity in these sections as to the current status of this work and the Working Group’s plans to revise the Guidelines when the work is completed. Our mark-up offers suggested language that we believe would provide such specificity.

Section III.B – Non-Financial Regulation of CDAs – Application of NAIC Model Laws and Regulations

This section is intended to provide guidance as to how states can interpret or amend their laws and regulations to clarify their application to CDAs based on the conclusions reached by various NAIC committees, task forces and working groups as to how eight different model laws and regulations apply to CDAs. To date, the necessary work has been completed with respect to two of those eight models – the Producer Licensing Model Act (#218) and the Life and Health Insurance Guaranty Association Model Act (#520). – and our mark-up reflects the conclusions reached by the groups charged with reviewing those Models (the Producer Licensing Task Force and the Receivership and Insolvency Task Force, respectively).

With respect to the other Models included in this section of the draft Guidelines, the applicable NAIC groups are still considering whether to recommend any changes to those Models. However, as reflected in the CDA Working Group’s April 2013 report to the A Committee, the Working Group has already reached conclusions as to whether the Models apply to CDAs. Therefore, our mark-up offers
proposed changes to more clearly delineate the Working Group’s conclusions, and added language indicating that the NAIC is considering whether and how each Model should be revised.

To assist states in interpreting or revising the Models, we have incorporated suggested language on: (a) interpretative guidance clarifying the applicability of existing laws and regulations to CDAs and (b) revisions to existing laws and regulations. Our suggested language with respect to the Consumer Protection Models is consistent with the revisions we are recommending to those Models, as described in greater detail in Part 2 below.

Part 2: Comments on Draft Revisions to Annuity Disclosure Model Regulation (#245); Suitability in Annuity Transactions Model Regulation (#275); Advertisements of Life Insurance and Annuities Model Regulation (#570); Life Insurance and Annuities Replacement Model Regulation (#613)

Given that the Consumer Protection Models can, in their current forms, be interpreted in a manner consistent with the CDA Working Group’s conclusions as to their applicability to CDAs, it seems clear that revising these Models to specifically reference the product is unnecessary. Furthermore, we remain concerned that revising these Models to address CDAs could create a presumption that the Models will also have to be revised to address existing or future innovative product solutions. Such a process would significantly interfere with the industry’s ability to develop and sell new products that can help consumers better prepare for retirement.

Nevertheless, we acknowledge that the Working Group request for input on revisions to the Consumer Protection Models, and we have therefore in response to this request developed proposed revisions to each Model to clarify whether and how they apply to CDAs. While the March 29, 2014 draft revisions exposed for public comment purport to accomplish this objective by explicitly defining and indicating whether CDAs are or are not covered, our recommendations take a different approach. We recommend that the Models be revised to generally define what types of products are covered or excluded from each Model. We believe our suggestions provide an effective and efficient way to achieve the desired outcome (i.e., clarity as to whether and how each Model applies to CDAs).

Conclusion

Again, ACLI and IRI appreciate the opportunity to comment on the draft Guidelines and the draft revisions to the Consumer Protection Models. In closing, we’d like to reiterate our appreciation to the CDA Working Group, Chairman Nickel, and the staff at the NAIC and the Wisconsin Office of the Commissioner of Insurance for all their hard work in developing these drafts. With our suggested revisions, we believe the Draft Guidelines will be a very effective tool for insurance departments to consult as they consider how to regulate CDAs in their states. Furthermore, we believe our
proposed revisions to the Consumer Protection Models provide the most simple, effective and efficient way to incorporate the Working Group's determinations regarding the applicability of the Consumer Protection Models to CDAs.

We hope you find our comments helpful. Please feel free to contact the undersigned if you have any questions or would like to discuss this matter further.

Sincerely,

Jason Berkowitz
Vice President, Regulatory Affairs and Compliance
Insured Retirement Institute (IRI)
202-469-3014
jberkowitz@irionline.org

Kelly Ireland
Senior Counsel, Insurance Regulation
American Council of Life Insurers (ACLI)
202-624-2387
kellyireland@acli.com

cc: Richard Wicka, Deputy Chief Legal Counsel, Wisconsin Office of the Commissioner of Insurance
Jennifer Cook, Health & Life Policy Counsel, NAIC
Jolie Matthews, Senior Health & Life Policy Counsel, NAIC

Enclosures
GUIDELINES FOR THE FINANCIAL SOLVENCY AND MARKET CONDUCT REGULATION OF INSURERS WHO OFFER CONTINGENT DEFERRED ANNUITIES

Executive Summary

In late-2012, the Life Insurance and Annuities (A) Committee (the “A Committee”) charged the Contingent Deferred Annuity (“CDA”) Working Group with evaluating the adequacy of existing laws and regulations with regard to CDAs and whether additional solvency and consumer protection standards were required. The CDA Working Group determined that CDAs do not easily fit into the categories of fixed or variable annuities and, therefore, do not always easily fit in existing laws and regulations governing annuities.

The CDA Working Group developed these guidelines to serve as a reference for states interested in modifying their annuity laws to clarify their applicability to help states determine how to apply their existing annuity laws and rules to CDAs or, if necessary, how to amend their existing annuity laws and rules to clarify how they apply to CDAs. These guidelines set forth what the NAIC’s views as to whether certain consumer protection and financial solvency model laws and regulations apply to CDAs. At the time these guidelines are being issued, the Financial Condition (E) Committee, the Life Risk-Based Capital (E) Working Group, and the Life Actuarial (A) Task Force are still working to develop should be applied to CDAs and what model laws and regulations that would not apply to CDAs. The guidelines outline what revisions, additions, and regulatory interpretations may be necessary for a state to clarify how existing state laws governing annuities apply to these products. These guidelines also includes a checklist and regulatory guidance developed by the Life Risk Based Capital (E) Working Group for states to use in evaluating the reserving and capital requirements for CDAs, and a checklist for reviewing the risk management capabilities of insurers seeking to offer CDAs in their state. In addition, several other NAIC Committees and Working Groups are still working to determine whether certain NAIC model laws and regulations need to be revised to clarify how they apply to CDAs, and if so, how this should be accomplished. The CDA Working Group will issue a revised version of these guidelines when this work is complete. These guidelines are intended to provide a general framework for the regulation of CDAs while work on specific issues involving CDAs continues at the NAIC.

In the course of completing its charges, the CDA Working Group met with and heard testimony from the life industry, interested trade groups, consumer representatives, the U.S. Securities and Exchange Commission (“SEC”), the Financial Industry Regulatory Authority (“FINRA”), the U.S. Department of Labor, the American Academy of Actuaries (“AAA”), U.S.
Government Accountability Office and the National Organization of Life & Health Guaranty Associations (“NOLHGA”) among other interested parties. These guidelines are based on the information provided by these parties and the working group’s CDA Working Group’s review of existing NAIC model laws and regulations.

I. Background

A. Classification of CDAs

CDAs are hybrid products which on their face appear to have elements of both annuities and financial guarantee products. The CDA subgroup reviewed CDAs to determine how the product should be classified. In March 2012, the A Committee adopted the recommendations of the CDA subgroup that CDAs were a hybrid life product best written by life insurers. The NAIC has determined that CDAs are annuities best written by life insurers, and are therefore subject to state laws and regulations applicable to annuities.1

B. Definition of CDAs

During the course of its review, the working group determined that CDAs did not neatly fit into the categories of fixed or variable annuities. In this regard, while a CDA in its accumulation phase resembles a variable annuity, a CDA more resembles a fixed annuity in its payout phase. The working group determined that a distinct definition of CDAs was needed for regulators, the industry, and consumers. The NAIC has adopted a definition of CDA’s CDA’s as “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.”2 Regulators should consider using this definition when determining whether a product is properly classified as a CDA under their laws and regulations. Regulators may wish to include this definition in their statutes and regulations and use it in determining whether an annuity product would be considered a CDA.

C. Features of a CDA

CDAs are hybrid products which transfer both investment risk and longevity risk to the insurers who issue them. A CDA can be generally thought of as a living benefit added to an underlying retirement account. The underlying account is not held or managed by the insurer but is instead held by a related or unrelated third party entity. While the insurer may contractually restrict the type of investment assets and products related to a CDA, it does not control the investments in the underlying account. An example of this would be a CDA attached to a mutual fund held in an individual or employer-sponsored retirement account. The CDA issuer can contractually limit

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1 Adopted by NAIC Executive Committee and Plenary, March 6, 2012.
2 CDA Working Group Recommendations to the Life and Annuities (A) Committee, April 7, 2013, p. 1.
the CDA’s attachment to certain types of mutual funds, but would have no control over the assets that make up that mutual fund.

A CDA has three distinct phases during its lifespan. First, the CDA goes through an accumulation phase. This phase occurs from the time the CDA is purchased until the time the participant decides to take withdrawals from the separately managed account. The amount of the CDA benefit base is determined by the value of the assets in the underlying account. As those assets increase in value (for example through investment gains or additional deposits), the CDA benefit base amount increases. Depending on the product design, the benefit base is calculated on a daily, monthly or annual basis. The more frequently the benefit base calculation is made, the more likely a consumer will realize investment gains in the benefit base.

Once a benefit base amount has been set, the CDA guarantees that the benefit amount can never decrease due to investment losses. In other words, should the underlying assets decrease in value due to poor market performance, the CDA’s benefit amount does not decline. This allows the insured to mitigate the risk that retirement payouts will decrease due to market conditions. The insurer assumes some of the market risk of the underlying asset by guaranteeing payments based on the underlying assets peak level, which may be greater than the actual amount of funds held at withdrawal, the second phase of a CDA.

The withdrawal phase occurs when the participant begins to draw funds from the separately managed account most typically upon retirement. During the withdrawal phase no benefit payments are made under the CDA and the insured is receiving income solely from the funds in their underlying account. The CDA contract sets a maximum periodic withdrawal amount that a participant may take. The withdrawal amount is a set percentage of the benefit base; for example five percent of the benefit base per year. Withdrawals at or below those permitted by the contract do not affect the benefit base level established during the accumulation phase. However, should a participant withdraw funds above the contractually permitted amount, the amount of benefits available under the CDA decreases, potentially all the way to zero. During the withdrawal phase, an insured still maintains the investments in an underlying fund. Thus, the amount of funds available to the insured may also decrease during the withdrawal phase due to market conditions. However, like in the accumulation phase, decreases in funds due to market changes do not reduce benefits. It is likely that most insurers will address this issue by limiting the type of assets an insured may hold in the underlying account during the withdrawal phase to those with low volatility.

The third and final phase is the payout or settlement phase. Upon exhaustion of the underlying account, the CDA begins making periodic benefit payments until the insured’s death. The amount of those payments is a percentage of the benefit base amount set during the accumulation phase less any penalties or reductions for withdrawals above the contractual limits during the withdrawal phase. If there are no penalties or reductions imposed, the periodic benefit payment is equal to the contractually permitted withdrawal amount during the withdrawal phase. In this
way, the CDA guarantees level lifetime income payments during retirement. It is the working
group’s understanding that CDA products sold to date do not include a death benefit. Since an
insured is limited in the amount of periodic withdrawals he or she may take during the
withdrawal phase, whether or not a CDA will reach the payout or settlement phase is a function
of the performance of the underlying investment assets and the insured’s longevity³.

For the CDA products that the working group reviewed, the fee for the CDA policy was
calculated as a percentage of the underlying assets or benefit base. Generally, the fee is not paid
directly from the insured but instead deducted and paid by the administrator of the underlying
fund.

CDAs are products which provide policyholders protection from outliving their assets due to
living beyond a normal life expectancy and/or market performance. A CDA can be generally
thought of as a guaranteed lifetime withdrawal benefit (GLWB) added to an investment, such as
a mutual fund or managed account, that is neither owned nor maintained by the insurer
(“Covered Investments”). Like traditional variable annuities with a GLWB, the insurer may
contractually restrict the type of covered investments eligible for use with a CDA.

A CDA has three distinct phases during the life of the contract. The following is a description of
a typical CDA product available in the market today. The initial phase is the accumulation
period which is measured from the date the CDA is issued until the time the policyholder begins
taking withdrawals from the Covered Investments, typically after reaching a specified age.
During the accumulation period, a “benefit base” maintained under the CDA tracks increases in
the value of the Covered Investments which may occur through investment gains or additional
deposits. Depending on the design of the CDA, the CDA benefit base may also increase due to
contractual features. The CDA benefit base is a notional amount that does not have cash value.
Depending on the product design, the CDA benefit base is calculated on a daily, monthly or
annual basis. The more frequently the CDA benefit base calculation is made, the more likely a
policyholder will realize increases in the CDA benefit base. The CDA benefit base will not
decrease in value if the corresponding Covered Investments decline due to poor market
performance. The “guaranteed withdrawal amount” under the CDA is based on a specified
percentage of the value of the CDA benefit base at the time distributions begin, typically normal
retirement age.

Once the guaranteed withdrawal amount is determined, the CDA guarantees that it will never
decrease due to declines in the value of Covered Investments as a result of investment losses.
This allows the policyholder to mitigate the risk that withdrawal amounts will decrease due to
market conditions. The insurer assumes some of the market risk of the Covered Investments by
 guaranteeing periodic withdrawal amounts based on the CDA benefit base, which may be greater

³ For some CDA products an insured may elect to purchase spousal benefits so in these instances the CDA would be
subject to the longevity of both spouses.
than the actual value of the Covered Investments at the time of withdrawal, the second phase of a CDA.

The second phase of the CDA occurs when the policyholder begins taking periodic withdrawals from the Covered Investments after reaching a specified age described in the CDA. Some product designs may allow policyholders to elect to begin withdrawals at an earlier or later age, in which case, the withdrawal percentage may be adjusted accordingly. Withdrawals are first taken from the Covered Investments. Annual withdrawals at or below the guaranteed withdrawal amount under the CDA do not impact the guaranteed withdrawal amount available in future years, i.e., they are not cumulative. However, should a policyholder take withdrawals in excess of the annual guaranteed withdrawal amount, a reduction in the guaranteed withdrawal amount available in the future years will likely result. Certain withdrawals in excess of the guaranteed withdrawal amount may result in termination of the CDA. Depending on the design of the CDA, withdrawals in excess of the guaranteed withdrawal amount may result in a pro rata reduction of the CDA benefit base and/or guaranteed withdrawal amount. During the withdrawal phase, the fluctuation in value of the Covered Investments due to market performance will not impact the guaranteed withdrawal amount available under the CDA. Decreases in the value of the Covered Investment during the withdrawal phase could have the effect of triggering the guaranteed payments under the CDA. Consequently, for risk management purposes, insurers will typically offer CDAs in connection with on Covered Investments that can be effectively hedged.

The third and final phase of the CDA is the payout or settlement phase. Upon exhaustion of the Covered Investments, the insurer will begin making periodic payments equal to the guaranteed withdrawal amount under the CDA for the remainder of the policyholder’s lifetime. In this way, the CDA guarantees level lifetime income payments during retirement. It is the CDA Working Group’s understanding that CDA products sold to date do not include a death benefit. Since a policyholder is limited in the amount of periodic withdrawals he or she may take during the withdrawal phase for purposes of preserving the guarantee, whether or not a CDA will reach the payout or settlement phase is a function of the performance of the Covered Investments, increases to the CDA benefit base (as applicable), policyholder behavior and the insured’s longevity.

For the CDA products that the CDA Working Group reviewed, the fee for the CDA was calculated as a percentage of the Covered Investments or CDA benefit base. Generally, the fee is deducted from the Covered Investments.

D. Federal Regulation of CDAs

There is a question as to whether CDAs are required to be registered as securities with the Securities and Exchange Commission (“SEC”) under the Securities Act of 1933. The SEC has not taken a position regarding whether CDAs are required to be registered as securities this question. However, based on information received from the SEC shared with the working group,
It is the working group’s understanding that a product that is a derivative of a guarantee associated with a registered security (e.g., a retail mutual fund that is registered with the SEC under the Investment Company Act of 1940) is also considered a security requiring registration unless a registration exemption applies. Since a CDA’s value derives from the value of an underlying registered security, it would appear that CDAs need to be registered with the SEC. It is the working group’s understanding, based on its discussions with the life industry, that insurers have been registering CDA products with the SEC to date. Companies unless the CDA qualifies for one of the designated exemptions from SEC registration in the federal securities laws. An important exemption, for instance, is the exemption from SEC registration for annuities that fund certain retirement plans. CDAs structured as group annuities offered to 401(k) plans and similar plans typically rely on this exemption. Insurers should continue to discuss registration requirements for CDA products with the SEC.

Products registered with the SEC may only be sold by a registered financial professional through a FINRA licensed broker dealer or a registered investment advisor⁴. Sales of CDAs by broker dealers through broker-dealers are subject to FINRA’s general suitability requirements. Investment advisors owe a fiduciary duty to their clients in recommending any investment product and a CDA purchase would be required to be made through a broker dealer. Registered CDAs are subject to SEC disclosure requirements, including the delivery of a prospectus, and FINRA’s advertising and marketing rules.

II. Financial Regulation of CDAs

A. Risk Management

The design of CDAs and their attachment to funds relationship to investments outside of the insurer’s control create unique risks that necessitate strong and comprehensive risk management practices by insurers. These risks included longevity risk, market risk, policyholder behavior risk, and third party risk.

Longevity risk is one of the main risks that CDAs transfer from the policyholder insured to the insurer. This is the risk that policyholders will live longer than expected and trigger the CDA lifetime income benefit by depleting the funds in their retirement account outlive their investments as a result of living beyond their normal life expectancy and/or market performance. Under the CDA, the insurer is guaranteeing a lifetime withdrawal benefit in the event the Covered Investments are depleted during the policyholder’s lifetime. This risk can be managed by the insurer through product design, risk pooling, and risk management techniques that are similar to those used in other life products with longevity risk. Regulators reviewing an insurer’s handling of longevity risk should look to the company’s insurer’s actuarial opinions to ensure that insurers are it is properly reserving for longevity risk.

¹⁴ Investment advisors who manage less than $100 million in assets must register in the state of their principal place of business and investment advisors managing assets of $100 million or greater must register with the SEC.
Another risk that is transferred to the insurer from the insured under a CDA is market risk. The market risk associated with a CDA is that the amount of benefit to the insured varies according to the market performance of the underlying assets. For example, a large downturn in the stock market would lower the value of the funds Covered Investments underlying the CDA while but the CDA benefit base would remain locked in at a higher value, thus increasing the likelihood that a CDA will reach the payout phase. Insurers can manage the market risk by developing comprehensive hedging strategies similar to those used to manage the market risk associated with other life and annuity products; that is, investing in an offsetting position in related assets to those in which the insurer incurs the market risk, i.e., derivatives etc. Of course, hedging cannot offset all market risks and is only a method for mitigating losses and will vary depending upon hedge effectiveness. Regulators may wish to review an insurer’s hedging strategy to verify that it is comprehensive, it appropriately addresses the insurer’s market risks, and that an insurer is making reasonable assumptions regarding the effectiveness of the hedging strategy. An insurer must have a “Clearly Defined Hedging Strategy” to take credit for hedging in reserve (pursuant to Actuarial Guideline 43 (“AG 43”)) and risk based capital calculations (pursuant to C-3Phase 2 (“C3P2”))

CDA issuers also incur risks based on policyholder behavior, including lapse rates, investment decisions, withdrawal timing and amounts, and the timing of withdrawals. In this regard, the value of the CDA to an insured and, correspondingly, the level of risk assumed by the insurer, are in many ways governed by policyholder behavior. For example, because CDAs take away some of the downside market risks of the insured’s investments, a CDA may encourage an insured to invest in riskier investments. An insured can place his or her assets in more volatile investments because if the investments increase in value, the increase is added to the CDAs benefit base, if the investments decrease in value, the benefit base is locked in at the portfolio’s peak. Thus, from the insured’s risk perspective, investment increases mean a higher benefit base and investment losses mean the CDA reaches the payout phase sooner.

Similarly, whether the payout phase will be reached also will depend in part on policyholder behavior, and in particular, when the policyholder commences withdrawals and whether the policyholder takes the maximum allowable withdrawal amount every period of the withdrawal phase in order to draw down the underlying funds and trigger the settlement and ultimately triggers the payout phase of the CDA. To maximize benefits, the insured would take the allowable withdrawal limit absent a liquidity need. To take full advantage of the guarantee, the policyholder would take the maximum allowable withdrawal limit each year.

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5 Please note that the Life Actuarial (A) Task Force is reviewing AG 43 and the Life Risk-Based Capital (E) Working Group is reviewing C3P2 as to how they would apply to CDAs.
Insurers can manage policyholder behavioral risk through product design including limiting the investment assets that an insured may hold in the underlying portfolio, limiting withdrawals amounts, types of investments an insured may use with the CDA, assigning withdrawal percentages to specific age groups during the withdrawal phase, varying fees in accordance with the risk level of the underlying investments Covered Investments, and decreasing benefits for withdrawals above those allowed under the policy the assigned withdrawal percentages. Regulators should review CDA products with a balanced view; ensuring that CDAs are designed to manage policyholder behavior risks while not being overly restrictive in how insured’s policyholders may use and gain value from a CDA.

Insurers who offer CDAs must also manage third party relationships and risks. Insurers establish the functionality of the CDA benefit base, its terms and conditions and work with third party non-insurers who manage the underlying assets Covered Investments. These third parties may collect the insurer’s fee on behalf of the insurer, provide information regarding the Covered Investments’ assets performance (for determining the CDA benefit base), and to notify the insurer if the insured policyholder changes the assets contained in the underlying account (to determine if the insured-policyholder is invested in assets allowed under the CDA contract). If an insurer does not receive timely information from the third party asset manager, it will be difficult for the insurer to administer the CDA. Insurers will need to contract with these third-parties to clarify each party’s roles and responsibilities.

The Financial Condition (E) Committee is developing a checklist for state regulators to use in reviewing the risk management program of insurers wishing to offer CDAs. Regulators may also wish to consider reviewing the insurer’s risk management program within the framework of The Own Risk and Solvency Assessment (“ORSA”) Model Act as well.

B. Financial Risk Management Checklist
[In Development] The NAIC has not yet completed its work with respect to the development of a risk management checklist for CDAs. This document will be updated when the risk management checklist is complete.

C. Reserve Requirements
[In Development] The NAIC has not yet completed its analysis as to whether applicable reserve requirements should be modified with respect to CDAs. This document will be updated when the NAIC completes this work.

D. Capital Requirements
[In Development] The NAIC has not yet completed its analysis as to whether applicable capital requirements should be modified with respect to CDAs. This document will be updated when the NAIC completes this work.

III. Non-Financial Regulation of CDAs
The working group examined existing consumer protection laws and regulations to determine how CDAs best fit within the current regulations that apply to fixed and variable annuities. In conducting this review, the working group determined that CDAs do not fit neatly into either one of these categories. For example, the value of a CDA is determined, in part, by the market performance of the underlying assets, similar to how the value of a variable annuity is determined by the performance of a separate portfolio. Further, CDAs, if registered with the SEC, are subject to federal securities regulation. On the other hand, a CDA resembles a fixed annuity in that a CDA benefit consists of fixed, periodic payments upon annuitization. Additional confusion has been caused by CDA products being filed with states as both fixed and variable annuities. Because a CDA shares qualities of both a fixed and variable annuity, the working group concluded that a CDA should not be classified in either category but instead belongs in its own category.

A. Filing Requirements

Because CDAs do not fall easily into existing annuity categories, the working group recommends that CDAs be filed with states as “Contingent Deferred Annuities” and not as fixed or variable annuities. Based on this recommendation, “Contingent Deferred Annuities” has been added as a filing category in the System for Electronic Rate and Form Filing (“SERFF”). In this regard, a group and individual category has been established for CDAs under type of insurance. (A07G Group Annuities – Special / A07G.003 Contingent Deferred and A07I Individual Annuities – Special / A.07I.003 Contingent Deferred.)

B. Application of NAIC Model Laws and Regulations

The CDA Working Group recognizes that states may wish to issue formal interpretive guidance and/or amend their existing annuity laws and rules to clarify how they apply to CDAs. The NAIC’s views as to the applicability of certain NAIC Model Laws and Regulations to CDAs are outlined below, along with recommendations about how states could interpret and/or amend their existing annuity laws and rules. Because CDAs do not fit neatly within existing categories, the working group reviewed which non-financial model acts and regulations should apply, or not apply, to CDAs. The working group’s findings and how states may wish to amend their laws to apply to CDAs are outlined below.

Producer Licensing Model Act (#218)

The Producer Licensing Model Act governs the qualification requirements and procedures for licensing insurance producers. Because CDAs are registered as securities, the working group reached a preliminary conclusion that the requirements for selling variable annuities should be applied to CDAs but determined that further review was warranted. As such, the working group recommended that this model be reviewed to determine if the license required to sell variable annuities would be appropriate for the sale of CDAs or whether revisions were necessary to apply the model act for the sale of CDAs.
The Producer Licensing (EX) Task Force has reviewed this Model and determined that “producers selling CDAs should be required to obtain a securities and variable lines license.” The Task Force did not recommend any revisions to the Model. For CDAs that are registered as securities, regulators should verify that producers have the requisite licenses and registration required to sell securities.

Recommended Language for States Wishing to Issue Interpretive Guidance:

“The [insert name of insurance department] has determined that producers must obtain a securities and variable lines license in order to sell Contingent Deferred Annuities (as defined by the NAIC).”

Annuity Disclosure Model Regulation (#245)

The Annuity Disclosure Model Regulation requires insurers who sell annuities to provide a disclosure document and a buyer’s guide in connection with the sale of an annuity. The model applies broadly to all annuity contracts but exempts specific types of annuities including those registered with the SEC and those covered by ERISA. The working group recommended that CDAs continue to be registered as securities and, as such, the working group found that the exemption in the annuity disclosure model regulation for registered products would apply to CDAs issued to employer-sponsored retirement plans, whether or not covered by ERISA. CDAs generally fall within one of these two categories, and therefore, the CDA Working Group has determined that CDAs should be covered by these exemptions.

The Under the Model Regulation does provide that, the NAIC buyer’s guide is required to be provided in the sales of variable annuities “and when appropriate, in sales of other registered products.” Currently, the NAIC does not have a buyer’s guide which addresses CDAs and providing the current buyer’s guide for fixed and variable annuities in connection with sales of CDAs will likely cause confusion. Therefore, the CDA Working Group concluded that it would not be appropriate to require that the current buyer’s guide be provided in connection with sales of CDAs.

The CDA Working Group believes states can interpret their existing annuity disclosure laws and rules to exclude CDAs without revision. States that choose not to revise their existing laws and rules may wish to consider issuing formal interpretive guidance to insurers to clarify that the existing laws and rules do not apply to CDAs.

Recommended Language for States Wishing to Issue Interpretive Guidance:

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6 Minutes of Producer Licensing (EX) Task Force Meeting, August 17, 2014.
7 NAIC Annuity Disclosure Model Regulation (#245), Sections 2B.(1)(a) and (b), and Section 3D.(1).
“With respect to Contingent Deferred Annuities (as defined by the NAIC) ("CDAs"), the [insert name of insurance department] has determined that (1) where disclosure requirements are established pursuant to federal regulation, CDAs fall within the scope of “other registered products” for the purposes of [Sections 3.D(1) and 3.D(2)], and (2) CDAs are exempt from the requirement under [Section 5.A] to deliver a Buyer’s Guide until such time an NAIC Buyers Guide is amended to include specific disclosure information about the product.”

Recommended Language for States Wishing to Revise their Annuity Disclosure Regulation:

Section 3.D(1): Strike the phrase “variable annuities and other” in the first sentence, which will then read “Transactions involving registered products in compliance with…”

NOTE: The NAIC is currently considering changes to the Model to clarify that CDAs are covered by the exemptions for registered products and products covered by ERISA plans, and that CDAs are exempt from the buyer’s guide delivery requirement until such time as a buyer’s guide is amended to include specific information about CDAs, which is inapplicable, for CDAs may confuse consumers. Therefore, the working group concluded that the requirement to provide a buyer’s guide would not be appropriate for CDAs.

States should review their annuity disclosure regulations to determine if they need to revise the regulation to make clear the disclosure requirements do not apply to CDAs. The NAIC is currently considering changes to the model regulation that would clarify that the exemption for registered products would include CDAs. Alternatively, the model’s exemptions for registered products and products covered by ERISA plans may be broad enough for states to interpret existing law to exclude CDAs without revision to existing regulations. States may wish to consider issuing guidance to insurers that the regulation does not apply if revisions to the regulations regarding CDAs are not contemplated.

Suitability in Annuity Transactions Model Regulations (Model # 275)

The CDA Working Group has working group determined that the Suitability in Annuity Transactions Model Regulations Regulation should apply to CDAs, and that suitability review for the sale of CDAs is an important consumer protection for these products. The working-group CDA Working Group has concluded that the existing list of “suitability information” included in Section I of the Act-Model contains all the information that is needed to examine the suitability of a CDA sale, and that additional factors do are not need required to be added to specifically address CDAs. It should be noted that among the one of the categories of suitability information to be considered is the existing assets of the consumer-investor, “including investment and life insurance holdings.” The working-group CDA Working Group determined that, as a part of

8 Please note that section references are to the NAIC Annuity Disclosure Model Regulation. States that choose to issue interpretive guidance should revise the recommended language to refer to the corresponding sections in their annuity disclosure laws or regulations.
suitability review, it was important that the insured’s underlying assets be suitable for the addition of a CDA. For example, the addition of a CDA to a certificate of deposit may be unsuitable because the fees for the CDA might absorb an unreasonable amount of the certificate of deposits rate of return undermining the insured’s investment goals. The working group used with a CDA. The CDA Working Group concluded that the category for existing investment assets would encompass suitability review of the investment funds underlying to be used with the CDA.

It should also be noted that section H.1 of the suitability model act has this Model provides a “safe harbor” provision that provides under which sales made in compliance with FINRA requirements pertaining to suitability and supervision of annuity transactions” satisfy the requirements of the Model. While FINRA’s suitability requirements currently apply only to variable annuities, the Model extends the safe harbor to any sales of fixed annuities that are made in compliance with the FINRA rules. Following the same reasoning, sales of CDAs made in compliance with FINRA’s suitability rules would also be covered by the safe harbor.

The CDA Working Group believes states can interpret their existing annuity suitability laws and rules to apply to CDAs without revision. States that choose not to revise their existing laws and rules may wish to consider issuing formal interpretive guidance to insurers to clarify that the existing laws and rules do apply to CDAs.

Recommended Language for States Wishing to Issue Interpretive Guidance:

“With respect to Contingent Deferred Annuities (as defined by the NAIC) (“CDAs”), the [insert name of insurance department] has determined that (1) sales of CDAs through FINRA broker-dealers shall be treated like fixed annuities and variable annuities for the purposes of applying the exemption under [Section 6.H(1)] if FINRA rule based suitability and supervision requirements are applied, and (2) the producer training requirements set forth in [Section 7] apply to CDAs unless otherwise exempted. Insurer standards for product specific training in [Section 7.A] apply to CDAs and [Section 7.B(3)] training must include how CDA contract provisions impact customers.”

Recommended Language for States Wishing to Revise their Annuity Suitability Regulation:

Section 6.H(1): Strike the phrase “variable annuities and fixed” in the second sentence, which will then read “This subsection applies to FINRA broker-dealer sales of annuities if…”

Section 7.B(3)(c): Strike the phrase “fixed, variable and indexed” from this clause, which will then read “How annuity contract provisions affect consumers.”

9 Please note that section references are to the NAIC Suitability in Annuity Transactions Model Regulation. States that choose to issue interpretive guidance should revise the recommended language to refer to the corresponding sections in their annuity suitability laws or regulations.
NOTE: The NAIC is currently considering changes to the Model to clarify that CDAs are subject to the Model, and that the FINRA safe harbor applies to sales of CDAs made in compliance with FINRA’s suitability rules.

The working group has recommended that this section of the model be revised to include CDAs in the safe harbor provision because if FINRA’s variable annuity suitability rules are applied to CDAs or CDA specific suitability rules are developed by FINRA in the future, that suitability review would be considered to be in compliance with the model act.

That being said, FINRA indicated to the working group that it will not apply the suitability rule for variable annuities to CDAs. Because FINRA is not currently applying specific annuity suitability rules to the sale of CDAs, the working group believes CDAs fall outside the “safe harbor” provision and sales of CDAs would be governed by the suitability requirements of the model act. This interpretation will avoid any regulatory gaps between state and federal law. The safe harbor provision may be applicable in the future if FINRA applies specific annuity suitability rules to CDAs.

**Life and Health Insurance Guaranty Association Model Act (#520)**

The working group reviewed the issue of guaranty fund coverage but did not determine whether CDAs are covered under state guaranty funds. The National Organization of Life & Health Guaranty Associations ("NOLHGA") testified before the working group that their review of CDAs was not complete but stated that it appeared that CDAs were eligible for coverage under the Model Act subject to a number of caveats and possible limitations. The working group also notes NOLHGA’s statement that individual guaranty fund coverage is ultimately a state by state determination.

The working group found that the issue of guaranty association coverage would likely vary from state to state. On one hand, a CDA is sold by life companies and would seem to be covered under guaranty funds like other life products. On the other hand, some guaranty funds exclude coverage for products that involve the transfer of investment risks or guarantees of employer retirement plans. CDAs would arguably fit into these categories. Each state should review its guaranty fund coverage laws to determine whether CDAs are covered by those funds.

The A committee has tasked the Receivership and Insolvency (E) Task Force with determining whether revisions to the model act are needed and warranted to address CDAs. The Receivership and Insolvency (E) Task Force (RITF) has determined that, assuming CDAs are considered annuities under state law and the issuer is a member insurer under state guaranty association law, CDAs would fall within the definition of “annuity” in the Model and be subject to the same provisions for coverage, group and individual, and subject to the same limitations and broad exclusions, as other annuities.

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10 Memorandum from Receivership and Insolvency (E) Task Force to A Committee, September 4, 2014.
input by the National Organization of Life and Health Guaranty Associations (NOLHGA) representatives, phone conversations with some RITF members and NOLHGA experts, and discussion by the members of the RITF.

Subject to the fact that individual state guaranty associations always have the ultimate decision of what contracts are covered, RITF has determined that, in those states that meet the above assumptions, CDAs should be covered annuities, both in the pre-payout phrase and the pay-out phrase, subject to all of the other statutory limits and exclusions that apply generally to annuities.

Advertisements of Life Insurance and Annuities Model Regulation (#570)

The Advertisements of Life Insurance and Annuities Model Regulations set forth standards for the advertisement of life products. The working group CDA Working Group has determined that this Model is applicable to CDAs. regulation should also be applied to CDAs. This regulation currently applies to “annuities” which may be broad enough to include application to CDAs. The working group has recommended that the regulation be amended to specifically include CDAs to make clear the regulation would apply to these products. Section 3 A. of the Model states that, for “variable contracts” where federal regulations establish disclosure requirements, this regulation is to be interpreted to avoid conflicts with federal regulation. The working group CDA Working Group believes this section should also apply to CDAs which are registered and subject to federal disclosure requirements. States should review their existing regulations and consider clarifying their regulations or issuing guidance that this regulation would apply to CDAs. States may also wish to clarify that application of these regulations.

The CDA Working Group believes states can interpret their existing annuity advertisement laws and rules to apply to CDAs without revision. States that choose not to revise their existing laws and rules may wish to consider issuing formal interpretive guidance to insurers to clarify that the existing laws and rules do apply to CDAs, and that application of their existing rules to registered CDAs is not intended to conflict with federal disclosure requirements to avoid issues of preemption.

Recommended Language for States Wishing to Issue Interpretive Guidance:

“The [insert name of insurance department] has determined that registered annuities, including Contingent Deferred Annuities (as defined by the NAIC) (“CDAs”), where disclosure requirements are established pursuant to federal regulation, are within the scope of [Section 3.A].”

Recommended Language for States Wishing to Revise their Annuity Illustrations Regulation:

Please note that section references are to the NAIC Advertisements of Life Insurance and Annuities Model Regulation. States that choose to issue interpretive guidance should revise the recommended language to refer to the corresponding sections in their annuity advertisement laws or regulations.
Section 3.A: Strike the word “variable” in the second sentence, which will then read “In contracts where disclosure requirements are established pursuant to federal regulation…”

**NOTE:** The NAIC is currently considering changes to the Model to clarify that CDAs are subject to the Model.

**Life Insurance and Annuities Replacement Model Regulation (#613)**

The Life Insurance and Annuities Replacement Model Regulation regulates insurers and producers with respect to the replacement of existing life insurance plans and annuity contracts. The working group concluded that the model regulation should be amended to make clear it applies to CDAs. The model regulation—The CDA Working Group has determined that the Model is applicable to CDAs. The Model exempts “registered contracts” with respect to the provision of illustrations and policy summaries because those products are subject to federal prospectus and disclosure requirements. “Registered contracts” is defined in the regulation as a variable annuity contract or variable life insurance policy “subject to the prospectus delivery requirements of the Securities Act of 1933.”

The CDA Working Group believes states can interpret their existing annuity replacement laws and rules to apply to CDAs without revision. States that choose not to revise their existing laws and rules may wish to consider issuing formal interpretive guidance to insurers to clarify that the existing laws and rules do apply to CDAs.

**Recommended Language for States Wishing to Issue Interpretive Guidance:**

“The [insert name of insurance department] has determined that the definition of ‘registered annuities’ includes any registered annuity, including Contingent Deferred Annuities (as defined by the NAIC), that is subject to the prospectus delivery requirements of the Securities Act of 1933.”

**Recommended Language for States Wishing to Revise their Annuity Replacement Regulation:**

Section 2.1: Strike the word “variable” in two places in this section, which will then read “‘Registered contract’ means an annuity contract or life insurance policy subject to …”

**NOTE:** Because registered contracts are defined narrowly as variable products, the working group concluded that the term “registered contracts” should be amended to include NAIC is currently considering changes to the Model to clarify that the term “registered contract” includes registered CDAs that are subject to federal prospectus requirements.

**Synthetic Guaranteed Investment Contracts Model Regulation (#695)**

The Synthetic Guaranteed Investment Contracts Model Regulation prescribes terms and conditions under which life insurance companies can issue contracts that “establish the insurer’s
obligation by reference to a segregated portfolio of assets that is not owned by the insurer.” The Working Group made no findings regarding whether this model regulation would apply to CDAs but did note that CDAs share certain characteristics with Synthetic Guaranteed Investment Contracts. For example, the obligations under the CDA are tied to a separately managed investment account. The Working Group recommended that this model regulation be subject to further review to clarify its relationship to CDAs. The Committee has tasked that Life Actuarial Task Force with reviewing this model and its relations to CDAs and further guidance will be forthcoming from this group.

**Standard Nonforfeiture Law for Individual Deferred Annuities (#805)**

The Standard Nonforfeiture Law for Individual Deferred Annuities sets requirements and minimum values for surrender benefits due to a contract holder upon non-payment or cancellation of an annuity contract. The law applies broadly to individual annuities unless specifically exempted. Because the law broadly applies to annuities and CDAs are not specifically exempted, this law would arguably apply to CDAs. However, the Working Group determined that it was unclear how nonforfeiture benefits would be calculated for CDAs under the current law as CDAs do not contain paid-up annuity, cash surrender, or death benefits, for example. Therefore, the Working Group recommended that the current model be amended to specifically exclude CDAs as there is no method in the law for calculating nonforfeiture benefits as they would apply to CDAs. Thus, inclusion of CDAs in this model would cause confusion. The Working Group made no recommendations as to whether nonforfeiture benefits should be required for CDAs. The A Committee is considering whether a referral is appropriate for further review of the application of nonforfeiture benefits to CDAs.
Proposed Amendments to NAIC Model Regulations to Address CDAs

Model 245- ANNUITY DISCLOSURE MODEL REGULATION

Section 3. Applicability and Scope
This regulation applies to all group and individual annuity contracts and certificates except:

D. (1) Transactions involving variable annuities and other registered products in compliance with Securities and Exchange Commission (SEC) rules and Financial Industry Regulatory Authority (FINRA) rules relating to disclosures and illustrations, provided that compliance with Section 5 shall be required after January 1, 2014, unless, or until such time as, the SEC has adopted a summary prospectus rule or FINRA has approved for use a simplified disclosure form applicable to variable annuities or other registered products.

Drafting Note: States should be aware that the provision in paragraph (1) above requiring transactions involving variable annuities and other registered products to comply with the requirements of Section 5 of the regulation after Jan. 1, 2014 unless the U.S. Securities and Exchange Commission (SEC) adopts a summary prospectus rule or the Financial Industry Regulatory Authority (FINRA) approves for use a simplified disclosure form applicable to variable annuities or other registered products could be preempted by the National Securities Markets Improvement Act of 1996 (NSMIA). NSMIA prohibits the States from making laws establishing record-making or record-keeping requirements for broker-dealers. Given this, in adopting this regulation, States may want to omit the language in paragraph (1) above that eliminates the exemption for these transactions after Jan. 1, 2014 and, as a consequence, would require broker-dealers to comply with Section 5 of this regulation unless or until the SEC or FINRA takes the delineated action. States should consider only adopting the language from paragraph (1) above that exempts transactions involving variable annuities and other registered products in compliance with the SEC and FINRA rules relating to disclosures and illustrations from having to comply with the regulation.

Drafting Note: Contingent Deferred Annuities shall be exempt from the requirement to deliver a Buyers Guide until such time an NAIC Buyers Guide is amended to include specific disclosure information about the product.
Model 275 - SUITABILITY IN ANNUITY TRANSACTIONS MODEL REGULATION

Section 6. Duties of Insurers and of Insurance Producers

H. (1) Sales made in compliance with FINRA requirements pertaining to suitability and supervision of annuity transactions shall satisfy the requirements under this regulation. This subsection applies to FINRA broker-dealer sales of variable annuities and fixed annuities if the suitability and supervision is similar to those applied to variable annuity sales. However, nothing in this subsection shall limit the insurance commissioner's ability to enforce (including investigate) the provisions of this regulation.

Drafting Note: Non-compliance with FINRA requirements means that the broker-dealer transaction is subject to compliance with the suitability requirements of this regulation.

Section 7. Insurance Producer Training

A. An insurance producer shall not solicit the sale of an annuity product unless the insurance producer has adequate knowledge of the product to recommend the annuity and the insurance producer is in compliance with the insurer's standards for product training. An insurance producer may rely on insurer-provided product-specific training standards and materials to comply with this subsection.

B. (1) (a) An insurance producer who engages in the sale of annuity products shall complete a one-time four (4) credit training course approved by the department of insurance and provided by the department of insurance-approved education provider.

(b) Insurance producers who hold a life insurance line of authority on the effective date of this regulation and who desire to sell annuities shall complete the requirements of this subsection within six (6) months after the effective date of this regulation. Individuals who obtain a life insurance line of authority on or after the effective date of this regulation may not engage in the sale of annuities until the annuity training course required under this subsection has been completed.

(2) The minimum length of the training required under this subsection shall be sufficient to qualify for at least four (4) CE credits, but may be longer.

(3) The training required under this subsection shall include information on the following topics:

(a) The types of annuities and various classifications of annuities;

(b) Identification of the parties to an annuity;

(c) How fixed, variable and indexed annuity contract provisions affect consumers;

(d) The application of income taxation of qualified and non-qualified annuities;

(e) The primary uses of annuities; and

(f) Appropriate sales practices, replacement and disclosure requirements.

(4) Providers of courses intended to comply with this subsection shall cover all topics listed in the prescribed outline and shall not present any marketing information or provide training on sales techniques or provide specific
information about a particular insurer's products. Additional topics may be offered in conjunction with and in addition to the required outline.

(5) A provider of an annuity training course intended to comply with this subsection shall register as a CE provider in this State and comply with the rules and guidelines applicable to insurance producer continuing education courses as set forth in [insert reference to State law or regulations governing producer continuing education course approval].

(6) Annuity training courses may be conducted and completed by classroom or self-study methods in accordance with [insert reference to State law or regulations governing producer continuing education course approval].

(7) Providers of annuity training shall comply with the reporting requirements and shall issue certificates of completion in accordance with [insert reference to State law or regulations governing to producer continuing education course approval].

(8) The satisfaction of the training requirements of another State that are substantially similar to the provisions of this subsection shall be deemed to satisfy the training requirements of this subsection in this State.

(9) An insurer shall verify that an insurance producer has completed the annuity training course required under this subsection before allowing the producer to sell an annuity product for that insurer. An insurer may satisfy its responsibility under this subsection by obtaining certificates of completion of the training course or obtaining reports provided by commissioner-sponsored database systems or vendors or from a reasonably reliable commercial database vendor that has a reporting arrangement with approved insurance education providers.

**Model 570 - ADVERTISEMENTS OF LIFE INSURANCE AND ANNUITIES MODEL REGULATION**

. . .

**Section 3. Applicability**

A. This regulation shall apply to any life insurance or annuity advertisement intended for dissemination in this state. In variable contracts where disclosure requirements are established pursuant to federal regulation, this regulation shall be interpreted so as to eliminate conflict with federal regulation.

**Model 613 - LIFE INSURANCE AND ANNUITIES REPLACEMENT MODEL REGULATION**

. . .

**Section 2. Definitions**

. . .

I. “Registered contract” means a variable annuity contract or variable life insurance policy subject to the prospectus delivery requirements of the Securities Act of 1933.
September 12, 2014

Ted Nickel
Chair, Contingent Deferred Annuity (A) Working Group
National Association of Insurance Commissioners

Dear Commissioner Nickel:

The American Academy of Actuaries\(^1\) Contingent Annuity Work Group (CAWG) understands that the Contingent Deferred Annuity (A) Working Group has exposed for comment the Guidelines for The Financial Solvency and Market Conduct Regulation of Insurers Who Offer Contingent Deferred Annuities. In response, the CAWG has prepared comments and suggested edits, as shown on the following pages.

We thank the Working Group for considering our comments. If you have questions, please contact Brian Widuch, Life Analyst at the American Academy of Actuaries (widuch@actuary.org; 202-223-8196).

Sincerely,

Andy Ferris, MAAA, FSA
Chairperson
Contingent Annuity Work Group
American Academy of Actuaries

Cande Olsen, MAAA, FSA
Vice Chairperson
Contingent Annuity Work Group
American Academy of Actuaries

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\(^1\) The American Academy of Actuaries is an 18,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.
GUIDELINES FOR THE FINANCIAL SOLVENCY AND MARKET CONDUCT REGULATION OF INSURERS WHO OFFER CONTINGENT DEFERRED ANNUITIES

Executive Summary

In late-2012, the Life Insurance and Annuities (A) Committee (the “A Committee”) charged the Contingent Deferred Annuity (“CDA”) Working Group with evaluating the adequacy of existing laws and regulations with regard to CDAs and whether additional solvency and consumer protection standards were required. The working group determined that CDAs do not easily fit into the categories of fixed or variable annuities and, therefore, do not always easily fit in existing laws and regulations governing annuities.

The CDA working group developed these guidelines to serve as a reference for states interested in modifying their annuity laws to clarify their applicability to CDAs. These guidelines set forth what consumer protection and financial solvency model laws and regulations should be applied to CDAs and what model laws and regulations that would not apply to CDAs. The guidelines outline what revisions, additions, and regulatory interpretations may be necessary for a state to clarify how existing state laws governing annuities apply to these products. These guidelines also includes a checklist and regulatory guidance developed by the Life Risk-Based Capital (E) Working Group for states to use in evaluating the capital requirements and risk management capabilities of insurers seeking to offer CDAs in their state. These guidelines are intended to provide a general framework for the regulation of CDAs while work on specific issues involving CDAs continues at the NAIC.

In the course of completing its charges, the CDA working group met with and heard testimony from the life industry, interested trade groups, consumer representatives, the U.S. Securities and Exchange Commission (“SEC”), the Financial Industry Regulatory Authority (“FINRA”), the U.S. Department of Labor, the American Academy of Actuaries (“AAA”), U.S. Government Accountability Office and the National Organization of Life & Health Guaranty Associations (“NOLHGA”) among other interested parties. These guidelines are based on the information provided by these parties and the working group’s review of existing NAIC model laws and regulations.

I. Background

A. Classification of CDAs

CDAs are hybrid products which on their face appear to have elements of both annuities and financial guarantee products. The CDA subgroup reviewed CDAs to determine how the product should be classified. In March 2012, the A Committee adopted the recommendations of the CDA subgroup that CDAs were a hybrid life product best written by life insurers.

B. Definition of CDAs

During the course of its review, the working group determined that CDAs did not neatly fit into the categories of fixed or variable annuities. In this regard, while a CDA in its accumulation phase resembles a variable annuity, a CDA more resembles a fixed annuity in its payout phase. The working group determined that a distinct definition of CDAs was needed for regulators, the industry, and consumers. The
NAIC has adopted a definition of CDA’s as “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.” Regulators may wish to include this definition in their statutes and regulations and use it in determining whether an annuity product would be considered a CDA.

C. Features of a CDA

CDAs are hybrid products which transfer both investment risk and longevity risk to the insurers who issue them. A CDA can be generally thought of as a living benefit added to an underlying retirement account. The underlying account is not held or managed by the insurer but is instead held by a related or unrelated third party entity. While the insurer may contractually restrict the type of investment assets and products related to a CDA, it does not control the investments in the underlying account. An example of this would be a CDA attached to a mutual fund held in an individual or employer-sponsored retirement account. The CDA issuer can contractually limit the CDA’s attachment to certain types of mutual funds, but would have no control over the assets that make up that mutual fund.

A CDA has three distinct phases during its lifespan. First, the CDA goes through an accumulation phase. This phase occurs from the time the CDA is purchased until the time the participant decides to take withdrawals from the separately managed account. The amount of the CDA benefit base may be determined in various ways, such as:

a) maximum value of accumulated deposits
b) deposits “rolled up” at a specified percentage, including possibility of accumulation at 0%
c) the greater of (a) and (b)
d) the value of the assets in the underlying account if greater than the calculated benefit base

As those assets increase in value (for example through investment gains or additional deposits), the CDA benefit base amount increases. Depending on the product design, the benefit base is calculated on a daily, monthly or annual basis. The more frequently the benefit base calculation is made, the more likely a consumer will realize investment gains in the benefit base.

Once a benefit base amount has been set, the CDA guarantees that the benefit amount can never decrease due to investment losses. In other words, should the underlying assets decrease in value due to poor market performance, the CDA’s benefit amount does not decline. This allows the insured to mitigate the risk that retirement payouts will decrease due to market conditions. The insurer assumes some of the market risk of the underlying asset by guaranteeing payments based on the underlying assets’ peak level or a “rolled up” amount, which may be greater than the actual amount of funds value of the covered assets held at withdrawal, the second phase of a CDA.

The withdrawal phase occurs when the participant begins to draw funds from the separately managed account, most typically upon retirement. During the withdrawal phase no benefit payments are made under the CDA and the insured is receiving income solely from the funds in their underlying account. The CDA contract sets a maximum periodic withdrawal amount that a participant may take. The withdrawal amount under current product designs is often a set percentage of the benefit base; for example five percent of the benefit base per year. Withdrawals at or below those permitted by the contract do not affect the benefit base level established during the accumulation phase. However, should a participant withdraw funds above the contractually permitted amount, the amount of benefits available under the CDA decreases, potentially all the way to zero. During the withdrawal phase, an insured still maintains
the investments in an underlying set of fund-covered assets. Thus, the amount of funds available to the insured may also decrease during the withdrawal phase due to market conditions. However, like in the accumulation phase, decreases in fund-covered assets due to market changes do not reduce benefits. It is likely that most insurers will address this issue by limiting the type of assets an insured may hold in the underlying account during the accumulation and withdrawal phases to those with low volatility.

The third and final phase is the payout or settlement phase. Upon exhaustion of the underlying account, the CDA begins making periodic benefit payments under a payout structure which often lasts until the insured's death, but could alternatively be based upon a 'life with period certain' structure. The amount of those payments is a percentage of the benefit base amount set during the accumulation phase less any penalties or reductions for withdrawals above the contractual limits during the withdrawal phase. If there are no penalties or reductions imposed, the periodic benefit payment is equal to the contractually permitted withdrawal amount during-at-the-end of the withdrawal phase. In this way, the CDA offers guaranteed level lifetime income payments during retirement. Those payments may be level or increasing, based on product design. It is the working group's understanding that CDA products sold to date do not include a death benefit; however, guaranteed lifetime withdrawal benefits, which are similar to CDAs, on some variable annuity and indexed annuity products do have such benefits. Since an insured is limited in the amount of periodic withdrawals he or she may take during the withdrawal phase, whether or not a CDA will reach the payout or settlement phase is a function of the performance of the underlying investment assets and the insured's longevity.

For the CDA products that the working group reviewed, the fee for the CDA policy was calculated as a percentage of the underlying assets or benefit base. Generally, the fee is not paid directly from the insured but instead deducted and paid by the administrator of the underlying fund-covered asset.

D. Federal Regulation of CDAs

There is a question as to whether CDAs are required to be registered as securities with the Securities and Exchange Commission ("SEC"). The SEC has not taken a position regarding whether CDAs are required to be registered as securities. However, based on information the SEC shared with the working group, it is the working group's understanding that a product that is a derivative of a registered security is also considered a security requiring registration. Since a CDA's value derives from the value of an underlying registered security, it would appear that CDAs need to be registered with the SEC. It is the working group’s understanding, based on its discussions with the life industry, that insurers have been registering CDA products with the SEC to date. Companies should continue to discuss registration requirements for CDA products with the SEC.

Products registered with the SEC may only be sold through a FINRA licensed broker dealer or a registered investment advisor. Sales of CDAs by broker dealers are subject to FINRA’s general suitability requirements. Investment advisors owe a fiduciary duty to their clients in recommending any investment product and a CDA purchase would be required to be made through a broker dealer. Registered CDAs are subject to SEC disclosure requirements, including a prospectus, and FINRA’s advertising and marketing rules.

1 For some CDA products an insured may elect to purchase spousal benefits so in these instances the CDA would be subject to the longevity of both spouses.

2 Investment advisors who manage less than $100 million in assets must register in the state of their principal place of business and investment advisors managing assets of $100 million or greater must register with the SEC.

3 Investment advisors who manage less than $100 million in assets must register in the state of their principal place of business and investment advisors managing assets of $100 million or greater must register with the SEC.
II. Financial Regulation of CDAs
   A. Risk Management

The design of CDAs and their attachment to funds-covered assets outside of the insurer’s control create unique risks that necessitate strong and comprehensive risk management practices by insurers. These risks included longevity risk, market risk, policyholder behavior risk, and third party risk.

Longevity risk is one of the main risks that CDAs transfer from the insured to the insurer. This is the risk that policyholders will live longer than expected and trigger the CDA lifetime income benefit by depleting the funds-covered assets in their retirement account. This risk can be managed by the insurer through product design, risk pooling, and risk management techniques that are similar to those used in other life products with longevity risk. Regulators reviewing an insurer’s handling of longevity risk should look to the company’s actuarial opinions to ensure that insurers are properly reserving for longevity risk.

Another risk that is transferred to the insurer from the insured is market risk. The market risk associated with a CDA is that the amount of benefit to the insured varies inversely to the market performance of the underlying assets. For example, a large downturn in the stock market would lower the value of the funds-covered assets underlying the CDA while the benefit remains locked in at a higher value, thus increasing the likelihood that a CDA will reach the payout phase. Insurers can manage the market risk by developing comprehensive hedging strategies; that is, investing in an offsetting position in related assets to those in which the insurer incurs the market risk, i.e., derivatives etc. Of course, hedging cannot offset all market risks and is only a method for mitigating losses and will vary depending upon hedge effectiveness. Regulators may wish to review an insurer’s hedging strategy to verify that it is comprehensive, it appropriately addresses the insurer’s market risks, and that an insurer is making reasonable assumptions regarding the effectiveness of the hedging strategy. An insurer must have a “Clearly Defined Hedging Strategy” to take credit for hedging in reserving (pursuant to Actuarial Guideline 43 (“AG 43”)) and risk based capital calculations (pursuant to C-3Phase 2 (“C3P2”)).

CDA issuers also incur risks based on policyholder behavior, including lapse rates, withdrawal timing and amounts, and investment decisions. In this regard, the value of the CDA to an insured and, correspondingly, the level of risk to the insurer are in many ways governed by policyholder behavior. For example, because CDAs take away some of the downside market risks of the insured’s investments, a CDA may encourage an insured to invest in riskier investments. An insured may wish to place his or her assets in more volatile investments because if the investments increase in value, the increase is added to the CDA’s benefit base, if the investments decrease in value, the benefit base is locked in at the portfolio’s peak. Thus, from the insured’s risk perspective, investment increases mean a higher benefit base and investment losses mean the CDA reaches the payout phase sooner.

Similarly, whether the payout phase will be reached also will depend in part on policyholder behavior. To maximize benefits under the CDA, a reasonable insured should take the maximum allowable withdrawal amount every period of the withdrawal phase in order to draw down the underlying funds-covered assets and trigger the settlement payout phase of the CDA. To maximize benefits, the insured would take the allowable withdrawal limit absent a liquidity need.

Insurers can manage policyholder behavioral risk through product design including limiting the investment assets that an insured may hold in the underlying portfolio, limiting withdrawals amounts during the withdrawal/reducing benefits for withdrawals during the accumulation phase, varying fees in accordance

\[ \text{Please note that the Life Actuarial (A) Task Force is reviewing AG 43 and the Life Risk-Based Capital (E) Working Group is reviewing C3P2 as to how they would apply to CDAs.} \]
with the risk level of the underlying investments, and decreasing benefits for withdrawals above those allowed under the policy. Regulators should review CDA products with a balanced view, ensuring that CDAs are designed to manage policyholder behavior risks while not being overly restrictive in how insured's may use and gain value from a CDA.

Insurers who offer CDAs must also manage third party risks. Insurers rely on third party non-insurers who manage the underlying assets. These third parties may collect the insurer’s fee, provide information regarding the assets performance (for determining the benefit base), and notifies the insurer if the insured changes the assets contained in the underlying account (to determine if the insured is invested in assets allowed under the CDA contract). If an insurer does not receive timely information from the third party asset manager, it will be difficult for the insurer to administer the CDA. Insurers will need to contract with these third-parties to clarify each party’s roles and responsibilities. Similarly, insurers face counterparty risks from the parties from whom they buy hedge instruments to back the guarantees they offer for other products.

The Financial Condition (E) Committee is developing a checklist for state regulators to use in reviewing the risk management program of insurer's wishing to offer CDAs. Regulators may also wish to consider reviewing the insurer’s risk management program within the framework of The Own Risk and Solvency Assessment (“ORSA”) Model Act as well.

B. Financial Checklist
   [In Development]
C. Reserve Requirements
   [In Development]
D. Capital Requirements
   [In Development]

III. Non-Financial Regulation of CDAs

The working group examined existing consumer protection laws and regulations to determine how CDAs best fit within the current regulations that apply to fixed and variable annuities. In conducting this review, the working group determined that CDAs do not fit neatly into either one of these categories. For example, the value of a CDA is determined, in part, by the market performance of the underlying assets, similar to how the value of a variable annuity is determined by the performance of a separate portfolio. Further, CDAs, if registered with the SEC, are subject to federal securities regulation. On the other hand, a CDA resembles a fixed annuity in that a CDA benefit consists of fixed, periodic payments upon annuitization. Additional confusion has been caused by CDA products being filed with states as both fixed and variable annuities. Because a CDA shares qualities of both a fixed and variable annuity, the working group concluded that a CDA should not be classified in either category but instead belongs in its own category.

A. Filing Requirements

Because CDAs do not fall easily into existing annuity categories, the working group recommends that CDAs be filed with states as “Contingent Deferred Annuities” and not as fixed or variable annuities. Based on this recommendation, “Contingent Deferred Annuities” has been added as a filing category in the System for Electronic Rate and Form Filing (“SERFF”). In this regard, a group and individual category has been established for CDAs under type of insurance. (A07G Group Annuities – Special / A07G.003 Contingent Deferred and A07I Individual Annuities – Special / A.07I.003 Contingent Deferred.)
B. Application of NAIC Model Laws and Regulations

Because CDAs do not fit neatly within existing categories, the working group reviewed which non-financial model acts and regulations should apply, or not apply, to CDAs. The working group’s findings and how states may wish to amend their laws to apply to CDAs are outlined below.

Producer Licensing Model Act (#218)

The Producer Licensing Model Act governs the qualification requirements and procedures for licensing insurance producers. Because some current CDAs are registered as securities, the working group reached a preliminary conclusion that the requirements for selling variable annuities should be applied to CDAs but determined that further review was warranted. As such, the working group recommended that this model be reviewed to determine if the license required to sell variable annuities would be appropriate for the sale of CDAs or whether revisions were necessary to apply the model act for the sale of CDAs. The committee has tasked the Producer Licensing (EX) Task Force with reviewing this model with regard to CDAs. Because For CDAs that are registered as securities, regulators should verify that producers have the requisite licenses and registration required to sell securities.

Annuity Disclosure Model Regulation (#245)

The Annuity Disclosure Model Regulations requires insurers who sell annuities to provide a disclosure document and a buyer’s guide in connection with the sale of an annuity. The model applies broadly to all annuity contracts but exempts specific types of annuities including those registered with the SEC and those covered by ERISA. See Sections 2B.(1)(a),(b), 3D.(1). Since When CDAs are being registered with the SEC, the federal prospectus and other disclosure requirements may preempt state disclosure requirements. The working group recommended that CDAs continue to be registered as securities and, as such, the working group found that the exemption in the annuity disclosure model regulation for registered products would apply to CDAs.

The Model Regulation does provide that the NAIC buyer’s guide is required to be provided in the sales of variable annuities “and when appropriate, in sales of other registered products.” Currently, the NAIC does not have a buyer’s guide which addresses CDAs and providing the current buyer’s guide for fixed and variable annuities, which is inapplicable, for CDAs may confuse consumers. Therefore, the working group concluded that the requirement to provide a buyer’s guide would not be appropriate for CDAs.

States should review their annuity disclosure regulations to determine if they need to revise the regulation to make clear the disclosure requirements do not apply to CDAs. The NAIC is currently considering changes to the model regulation that would clarify that the exemption for registered products would include CDAs. Alternatively, the model’s exemptions for registered products and products covered by ERISA plans may be broad enough for states to interpret existing law to exclude CDAs without revision to existing regulations. States may wish to consider issuing guidance to insurers that the regulation does not apply if revisions to the regulations regarding CDAs are not contemplated.

Suitability in Annuity Transactions Model Regulations (Model # 275)

The working group determined that the Suitability in Annuity Transactions Model Regulations should apply to CDAs and that suitability review for the sale of CDAs is an important consumer protection for these products. The working group concluded that the existing list of “suitability information” included in Section 1 of the Act contains all the information that is needed to examine the suitability of a CDA sale and that additional factors do not need to be added to specifically address CDAs. It should be noted that among the suitability information to be considered is the existing assets of the consumer “including

Comment [A1]: We suggest brief discussion of applicability of state disclosure requirements for CDAs that are not registered and therefore do not qualify for such exemption.
investment and life insurance holdings.” The working group determined that, as a part of suitability review, it was important that the insured’s underlying assets be suitable for the addition of a CDA. For example, the addition of a CDA to a certificate of deposit may be unsuitable because the fees for the CDA might absorb an unreasonable amount of the certificate of deposit’s rate of return undermining the insured’s investment goals. The working group concluded that the category for existing investment assets would encompass suitability review of the investment fund’s covered assets underlying the CDA.

It should also be noted that section H.1 of the suitability model act has a “safe harbor” provision that provides that sales made in compliance with FINRA requirements “pertaining to suitability and supervision of annuity transactions” satisfy the requirements of the model act. The working group has recommended that this section of the model be revised to include CDAs in the safe harbor provision because if FINRA’s variable annuity suitability rules are applied to CDAs or CDA specific suitability rules are developed by FINRA in the future, that suitability review would be considered to be in compliance with the model act.

That being said, FINRA indicated to the working group that it will not apply the suitability rule for variable annuities to CDAs. Because FINRA is not currently applying specific annuity suitability rules to the sale of CDAs, the working group believes CDAs fall outside the “safe harbor” provision and sales of CDAs would be governed by the suitability requirements of the model act. This interpretation will avoid any regulatory gaps between state and federal law. The safe harbor provision may be applicable in the future if FINRA applies specific annuity suitability rules to CDAs.

Life and Health Insurance Guaranty Association Model Act (#520)

The working group reviewed the issue of guaranty fund coverage but did not determine whether CDAs are covered under state guaranty funds. The National Organization of Life & Health Guaranty Associations (“NOLHGA”) testified before the working group that their review of CDAs was not complete but stated that it appeared that CDAs were eligible for coverage under the Model Act subject to a number of caveats and possible limitations. The working group also notes NOLHGA’s statement that individual guaranty fund coverage is ultimately a state by state determination.

The working group found that the issue of guaranty association coverage would likely vary from state to state. On one hand, a CDA is sold by life companies and would seem to be covered under guaranty funds like other life products. On the other hand, some guaranty funds exclude coverage for products that involve the transfer of investment risks or guarantees of employer retirement plans. CDAs would arguably fit into these categories. Each state should review its guaranty fund coverage laws to determine whether CDAs are covered by those funds.

The A committee has tasked the Receivership and Insolvency (E) Task Force with determining whether revisions to the model act are needed and warranted to address CDAs.

Advertisements of Life Insurance and Annuities Model Regulation (#570)

The Advertisements of Life Insurance and Annuities Model Regulations set forth standards for the advertisement of life products. The working group determined that this regulation should also be applied to CDAs. This regulation currently applies to “annuities” which may be broad enough to include application to CDAs. The working group has recommended that the regulation be amended to specifically include CDAs to make clear the regulation would apply to these products. Section 3 A. of the model regulation states that for “variable contracts” where federal regulations establish disclosure requirements, this regulation is interpreted to avoid conflicts with federal regulation. The working group believes this section should also apply to CDAs which, when they are registered and subject to federal disclosure requirements. States should review their existing regulations and consider clarifying their
regulations or issuing guidance that this regulation would apply to CDAs. States may also wish to clarify that application of these regulations to registered CDAs is not intended to conflict with federal disclosure requirements to avoid issues of preemption.

**Life Insurance and Annuities Replacement Model Regulation (#613)**

The Life Insurance and Annuities Replacement Model Regulation regulates insurers and producers with respect to the replacement of existing life insurance plans and annuity contracts. The working group concluded that the model regulation should be amended to make clear it applies to CDAs. The model regulation exempts “registered contracts” with respect to the provision of illustrations and policy summaries because those products are subject to federal prospectus and disclosure requirements. “Registered contracts” is defined in the regulation as a variable annuity contract or variable life insurance policy “subject to the prospectus delivery requirements of the Securities Act of 1933.” Because registered contracts are defined narrowly as variable products, the working group concluded that the term “registered contracts” should be amended to include registered CDAs that are subject to federal prospectus requirements.

**Synthetic Guaranteed Investment Contracts Model Regulation (#695)**

The Synthetic Guaranteed Investment Contracts Model Regulation prescribes terms and conditions under which life insurance companies can issue contracts that “establish the insurer’s obligation by reference to a segregated portfolio of assets that is not owned by the insurer.” The working group made no findings regarding whether this model regulation would apply to CDAs but did note that CDAs share certain characteristics with Synthetic Guaranteed Investment Contracts. For example, the obligations under the CDA are tied to a separately managed investment account. The working group recommended that this model regulation be subject to further review to clarify its relationship to CDAs. The A committee has tasked the Life Actuarial Task Force with reviewing this model and its relations to CDAs and further guidance will be forthcoming from this group.

**Standard Nonforfeiture Law for Individual Deferred Annuities (#805)**

The Standard Nonforfeiture Law for Individual Deferred Annuities sets requirements and minimum values for surrender benefits due to a contract holder upon non-payment or cancellation of an annuity contract. The law applies broadly to individual annuities unless specifically exempted. Because the law broadly applies to annuities and CDAs are not specifically exempted, this law would arguably apply to CDAs. However, the working group determined that it was unclear how nonforfeiture benefits would be calculated for CDAs under the current law as CDAs do not contain paid-up annuity, cash surrender, or death benefits, for example. Therefore, the working group recommended that the current model be amended to specifically exclude CDAs as there is no method in the law for calculating nonforfeiture benefits as they would apply to CDAs. Thus, inclusion of CDAs in this model would cause confusion. The working group made no recommendations as to whether nonforfeiture benefits should be required for CDAs. The A Committee is considering whether a referral is appropriate for further review of the application of nonforfeiture benefits to CDAs.
September 30, 2014

National Association of Insurance Commissioners
Commissioner Ted Nickel, Chair
NAIC Contingent Deferred Annuities (A) Working Group
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Attn: Jennifer Cook
Health and Life Policy Counsel
Via e-mail: jcook@naic.org

Re: Nonforfeiture Benefits for Contingent Deferred Annuities (CDAs)

Dear Commissioner Nickel:

The American Council of Life Insurers (ACLI)\(^1\) appreciates the opportunity to comment on the questions raised at the August meeting about whether there should be required nonforfeiture values for CDA contracts.

**Public Policy Question: should CDA’s have required minimum nonforfeiture benefits?**

The suggested requirement of minimum nonforfeiture requirements on CDAs raises several important public policy issues and concerns, including:

1. **Compromise of risk pooling.** CDAs provide longevity risk protection. The pooling of longevity risk provides clear public benefit, as individuals with shorter lifespans effectively fund the incomes of those with longer lifespans. Minimum nonforfeiture requirements, however, would encourage anti-selection: a customer who receives a health diagnosis with negative mortality implications would have a much greater incentive to surrender in order to minimize the funding of those with longer lifespans. This would fundamentally compromise the pooling mechanism that is fundamental to insurance.

2. **Increase in cost to consumers.** The decline of defined benefit pension plans and increased longevity have created a clear public policy need for affordable vehicles that allow a pool of assets to be

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\(^1\)The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. ACLI advocates in federal, state and international forums. Its members represent more than 90 percent of the assets and premiums of the U.S. life insurance and annuity industry. In addition to life insurance, annuities and other workplace and individual retirement plans, ACLI members offer long-term care and disability income insurance, and reinsurance. Its public website can be accessed at www.acli.com.
converted into reliable lifetime income. Every benefit, however, has a cost. The existence of a nonforfeiture benefit on CDAs would increase the cost of longevity risk protection which would, in turn, provide a disincentive for consumers to purchase the product.

3. **Potential arbitrage opportunities against the insurer.** Traditional nonforfeiture requirements are based on providing a minimum book value. If a minimum book value concept were applied to nonforfeiture requirements on CDAs, however, insurer solvency could be compromised. In particular, in situations when guarantees are not deeply “in the money” (i.e. the benefit base is near the value of the covered investments), a “book value” nonforfeiture benefit could create situations where a consumer could achieve economic arbitrage—at the expense of the insurer—by surrendering the CDA and using the proceeds to fund an alternative investment. This would be counter to the interests of both insurers and insurance regulators.

4. **Potential “run on the bank” scenarios.** While the use of market-based nonforfeiture benefits could address some of the challenges with book value-based requirements, they would create other concerns. In particular, they could lead to a “run on the bank” scenario when markets are down. Consider if variable annuity customers with guaranteed income benefits had market based cash values available during the market crash of 2008 – there could have been large surrender activity and a resulting increase in solvency concerns for insurers and potentially systemic risk implications for the broader economy. The 2008 crisis demonstrated that the absence of nonforfeiture benefits on guaranteed income benefits provides a stabilizing influence on insurers and the broader economy.

5. **Applicability.** The Model law exempts other annuities which emphasize payout streams over lifetime similar to those offered through CDAs, such as variable annuities (including those offering GLWBs), immediate annuities and deferred annuities after annuity payments have commenced. It would seem inappropriate to inconsistently apply nonforfeiture requirements across products that are providing similar longevity risk protection to consumers.

Based on the aforementioned concerns, we suggest that it would be counter to sound public policy and to the interests of consumers, regulators, and insurers to require minimum nonforfeiture benefits on CDAs. Nor is it clear that such benefits are actually desired by consumers, based on the industry’s experience with variable annuities that have lifetime withdrawal benefit riders. If market preferences shift to demand such benefits, competitive and creative forces will create an incentive for companies to provide them within their risk tolerances, even in the absence of a required regulatory minimum.

In February 2014, pursuant to its charges from the NAIC Life and Annuities Committee to specifically exclude CDAs from the scope of the Standard Nonforfeiture Law, the Life Actuarial Task Force exposed revisions to the Model to clarify the exemption of CDAs from the minimum requirements of the current law. We encourage the Working Group to support this revision and its formal adoption by the NAIC.

Sincerely,

John Bruins
Vice President & Senior Actuary

Kelly Ireland
Senior Counsel, Insurance Regulation

Cc: Richard Wicka, Deputy Chief Legal Counsel, Wisconsin Office of the Commissioner of Insurance
   Tomasz Serbinowski, Actuary, Utah Insurance Department
   Jennifer Cook, Health & Life Policy Counsel, NAIC