CONTINGENT DEFERRED ANNUITY (A) WORKING GROUP
Thursday, November 29, 2012
8:00 – 10:00 a.m.
Gaylord Convention Center—National Harbor 11—Level 3

ROLL CALL

Ted Nickel, Chair
Wisconsin

Bruce R. Ramge/Holly Blanchard
Nebraska

Suzetta Furlong
Florida

Michael Humphreys
Tennessee

Jim Mumford
Iowa

Tomasz Serbinowski
Utah

Jason Lapham
Kansas

AGENDA

1. Discuss Draft Recommendations to A Committee —Ted Nickel (WI)

2. Discuss Comments from Regulators and Interested Parties on Draft Recommendations —Ted Nickel (WI)


4. Hear Presentations—Ted Nickel (WI)
   a. Investment Parameters for CDAs—Insurance Industry pending confirmation
   b. Guaranty Fund Coverage of CDAs—Bill O’Sullivan (National Organization of Life and Health Guaranty Associations (NOLHGA)
   c. Financial Industry Regulatory Authority (FINRA) Presentation on Review of Advertising—, Amy Sochard (Director in FINRA Advertising Regulation)

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

6. Adjournment
Comments on these three proposals should be emailed to jcook@naic.org by November 21, 2013.

#1: Recommend to A Committee that CDAs be regulated as Variable Annuities for the Purpose of Market Regulation and Consumer Protection. Existing laws that apply to variable annuities may need to be revised to clarify that they also apply to CDAs.

    *Examples of applicable model acts include (but are not limited to): Producer Licensing Model Act (Model #218); Annuity Disclosure Model Regulation (Model #245); Suitability in Annuity Transactions Model Regulation (Model #275); Advertisements of Life Insurance and Annuities Model Regulation (Model #570); and Life Insurance and Annuities Replacement Model Regulation (model #613).

#2: The adequacy of existing laws and regulations applicable to the solvency of annuities, as such laws are applied to CDAs, should be referred by the A Committee to the NAIC Committees, Task forces or Working Groups with appropriate subject matter expertise.

#3 DRAFT DEFINITION:
"Contingent Deferred Annuity" means an annuity contract that establishes an 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 expenses.
Comments of the Center for Economic Justice on

Contingent Deferred Annuity Working Proposed Recommendations

November 13, 2012

By e-mail on November 8, 2012, the CDA Working Group solicited comments on the following proposed recommendations:

#1: Recommend to A Committee that CDAs be regulated as Variable Annuities for the Purpose of Market Regulation and Consumer Protection. Existing laws that apply to variable annuities may need to be revised to clarify that they also apply to CDAs.

*Examples of applicable model acts include (but are not limited to): Producer Licensing Model Act (Model #218); Annuity Disclosure Model Regulation (Model #245); Suitability in Annuity Transactions Model Regulation (Model #275); Advertisements of Life Insurance and Annuities Model Regulation (Model #570); and Life Insurance and Annuities Replacement Model Regulation (model #613).

#2: The adequacy of existing laws and regulations applicable to the solvency of annuities, as such laws are applied to CDAs, should be referred by the A Committee to the NAIC Committees, Task forces or Working Groups with appropriate subject matter expertise.

The proposed recommendations are unsupported by any findings or analysis from the working group. The recommendations are not responsive to and do not fulfill the charge of the working group. Consequently, the recommendations are, at best, premature. More importantly, the recommendations represent regression instead of progress, on issues of concern to regulators and consumers. With these recommendations, effective oversight and consumer protection of CDAs is further from fruition than back in March when the Life (A) Committee adopted the CDA Subgroup’s report.

The Center for Economic Justice (CEJ) opposes the proposed recommendations and urges the working group to produce a report that provides substantive analysis of key issues and support for any working group recommendation. We refer the working group to our October 8 letter for a list of issues to be more thoroughly researched and addressed.

The working group’s charge is stated as “Evaluate the adequacy of existing laws and regulations applicable to the solvency and consumer protections of annuities as such laws are applied to CDAs.”
The project timeline published earlier in the year included:

   Early the week of August 27th: Regulator to regulator call to debrief from the August NAIC meeting. Discuss information gathered and continue to identify issues the group would like to include in its recommendation (includes identifying where annuity regulation is sufficient, where it is not and recommended action to address gaps).

The proposed recommendations fail to include any analysis and evaluation of whether and how existing annuity regulation is or is not sufficient for CDAs and fail to include any recommended actions to address any regulatory or consumer protection gaps. None of the issues identified in our October 8, 2012 comments are explored, analyzed or addressed, including systemic risk, suitability specific to CDAs, reserving issues, consumer disclosures, limitations on product design features / sales and other consumer protection issues.

The working group has produced no analysis or support for the first recommendation – that CDAs be regulated as variable annuities. The working group has provided no analysis to indicate that the current regulatory structure for variable annuities is adequate or appropriate for CDAs. Further, the recommendation ignores the finding from the CDA subgroup that the concern over regulatory oversight of CDAs raised questions about the adequacy of regulatory oversight of GLWB riders for variable annuities. The working group has failed to build on, the work of the CDA Subgroup.

The second recommendation is simply passing the buck. Instead of carrying out its charge to “evaluate the adequacy of existing laws and regulations applicable to the solvency and consumer protections of annuities as such laws are applied to CDAs,” the proposed recommendation asks the parent committee to assign this task to someone else.

The working group’s second recommendation is a glaring contradiction to the first recommendation. If the working group has not evaluated the adequacy of existing laws and regulation of solvency of annuities – as well as the adequacy of disclosure, suitability and other consumer protection regulation of annuities – for CDAs, there is simply no basis for the first recommendation.

CEJ respectfully urges the working group to put any recommendations on hold and focus on producing an independent report that documents and analyzes the regulatory and consumer protection situation for CDAs. We urge the working group to dig beyond the generic assertions made by various industry proponents of CDAs.
October 8, 2012

Commissioner Ted Nickel  
Chair, NAIC Contingent Deferred Annuity Working Group

Re: Report of the CDA Working Group

By Electronic Mail

Dear Commissioner Nickel,

The Center for Economic Justice (CEJ) writes to reiterate our request that the working group’s report on contingent deferred annuities (CDAs) examine a number of specific issues, provide substantive information and analysis, and not simply state recommendations. CEJ has great concern about the sale and regulatory oversight of CDAs and we ask state insurance regulators to carefully review all aspects of this product in terms of consumer protection, insurer solvency and systemic risk.

We agree there is a need for retirement income products in the marketplace. However, that does not mean that CDAs are needed, beneficial or safe products for consumers seeking retirement income.

Issues of Concern

CDAs are effectively speculative financial derivatives on the value of investment portfolios. An annuity provides a guarantee of a minimum lifetime benefit. The CDA provides a benefit only if the portfolio has been depleted by prior withdrawals. Consequently, the CDA provides benefits if the portfolio performs poorly, the beneficiary lives a long time or both.

The studies of CDAs performed by the American Academy of Actuaries and the NAIC actuarial working group attempted to estimate the portion of CDA benefits attributable to market risk versus mortality risk. The results, of course, are a function of the estimates of market performance, mortality and lapse behavior. In any scenario, however, the value of the CDA to consumers and the risk to insurers is most related to market performance.

It seems clear that if markets perform well, insurers will realize massive profits on CDAs. If markets perform very poorly in timeframes unfavorable to insurers, insurers will realize catastrophic losses as many consumers will be making CDA claims in the same time period. This sounds like another financial derivative – credit default swaps – that nearly destroyed the financial system.
CEJ has concerns about how premium from CDAs will be recognized, how net income will be booked and how reserves will be established and maintained. We also have great concern about products for which payouts are not only long in the future, but also tied to events insurers are not able to predict. It is one thing to establish reserves based on expected mortality, it is quite another to establish reserves based on market volatility. We have seen how much difficulty insurers have had with pricing and reserves for long term care – a product for which we would expect insurers to have far greater capability to estimate future claims than a product based on market volatility.

We also see the difficulty insurers selling variable annuities indexed to market performance had in 2008 and 2009 – difficulty that had insurers going to state insurance regulators for a variety capital relief changes to reserving and accounting practices. We also see the collapse of insurers whose business was tied directly to financial market performance – mortgage guaranty and bond insurers.

Consider the financial difficulty encountered by insurers selling variable annuities in 2008 and 2009 and then consider what might have happened if three or four times as many assets were covered, insurer revenue did not include any underlying annuity fees but only the CDA fee and twice as many policyholders were in retirement. Given the interest of investment advisers in wrapping a lifetime income guarantee around assets the advisers continue to manage and the growth in retirees as baby-boomers age, this scenario is not far-fetched.

We have concerns about a product that seems certain to produce either massive profits or catastrophic losses for insurers. Such products can create moral hazard for the insurers. Further, what happens if, because of very poor market performance, insurers have inadequate reserves and surplus to pay promised benefits? Will guaranty funds be deluged with insolvent insurers leading to burdens on insurers not selling CDAs? Will promised benefits be slashed or fees increased dramatically, as we have seen with long-term care insurance?

We have great concern that CDAs will create systemic risk. The sale of CDAs could easily grow to massive amounts because CDAs promise consumers, investors and financial advisers the opportunity to increase the upside potential of the investment portfolio – by investing in a more risky portfolio than an investor looking to secure retirement income would otherwise do – while removing the downside risk of the riskier investment. As trillions of dollars of retirement investment are shifted from less risky to more risky investments – typically portfolios with a greater share of stocks – there must be impacts on the returns of those riskier investments resulting from greater supply of funds to the riskier investments. Historical returns on stocks would likely not be an indication of future returns in such a scenario.
We recognize that insurers can engage in sophisticated hedging techniques, but hedging involves one party paying if certain events occur. The question arises, if hundreds of thousands or millions of retirees suddenly are eligible for CDA benefits because of precipitous declines in the stock market and other investments, what position will the counter parties be in to pay the losing end of the hedge? Again, we can look to credit default swaps for an illustration of the problem.

Insurance is a system for the transfer of risk from individuals to insurers and, through this transfer to a risk pool, the individuals realize the benefit of diversification of risk. It is unclear how CDAs produce any risk diversification for large numbers of individuals; rather, the market risk becomes concentrated within insurers.

**Working Group Analysis and Report**

Based on these concerns, we ask that the working group’s report to the parent committee analyze in detail the following issues.

1. Overview of CDA Sales to Date
2. Solvency Oversight of CDAs, including Reserving and Hedging Practices
3. The Systemic Risk Posed by CDAs
4. Accounting for CDAs, including Recognition of Income
5. Suitability and Policyholder Behavior
6. Consumer Disclosures

**Overview of CDA Sales to Date**

The working group’s report should include a description of:

- Total sales of CDA to date, including fees collected and amount of covered assets
- Distribution fees collected to date to reserves, hedging, expenses, net income
- Type of Hedging Used to date
- Major sellers of CDAs
- Sales of CDAs by State
- Share of covered investments by type of investments and risk
- Types of purchases – individuals, employers, others
- Examples of current disclosures and suitability procedures

**Solvency Oversight**

With a Variable Annuity with a GLWB rider, fees, profits and revenue from the base annuity are available to cover the insurer’s costs of the rider. In contrast, a CDA is a derivative and the only revenues available to pay the costs of the CDA are the fees from the CDA. This fact seems to massively magnify the solvency risk of CDAs relative to VA/GLWB or traditional fixed deferred annuities.
We ask that the working group’s paper describe in detail how this risk will be managed – not simple references to actuarial guidelines, but examples of the reserves established and hedging programs employed to ensure that funds will be available in the future to pay the promised claims even in the event of a severe market downturn. We also ask the working group to examine if limits on the amount of CDA exposure in an insurer’s overall portfolio of products should be established.

Systemic Risk

We ask that the working group’s paper include an analysis of systemic risk posed by CDAs and the implications of any systemic risk on solvency oversight and the capacity of the state-based guaranty fund system to handle insolvencies associated with CDAs.

Accounting / Flow of Funds

We ask that the working group’s report provide examples of the flow of funds and accounting for CDAs, including the recognition of income and share of fees going to the cost of the guarantee, the cost of hedging, the cost of expenses for selling and administering the product by type of expense, contribution to reserves and profit provision. For example, if the fee for a CDA is 1.5% of covered assets, how are those funds accounted for and how much net income is recognized by the insurer in year 1, year 5, year 10, year 15, year 20 and so on. Again, we ask that the working group’s report provide specific examples and not simply references to accounting practices.

Suitability

We ask that the working group’s report analyze the suitability of the product for consumers. Specifically, under what scenarios is a CDA a rational choice over traditional guaranteed lifetime benefit products? For example, if an investor’s goal is guaranteed lifetime benefits, under what scenarios would the consumer benefit from a CDA over other lifetime benefit annuities?

We have seen that the realization of benefits from a CDA is tied to policyholder behavior. The likelihood of a consumer realizing a net benefit from a CDA is very small if the covered assets are more conservatively invested. The likelihood of realizing a net benefit from the CDA increases with riskier investments of the covered assets. Any suitability requirements imposed on insurers and producers selling CDAs must incorporate this important characteristic of CDAs.
Based on the analysis by the CDA subgroup last year, it is clear that a rational investor purchasing a CDA would invest in the riskiest portfolio permitted. Insurers selling CDAs offer a sliding scale of fees tied to the investment risk of the covered assets, creating the potential for inefficient policyholder behavior. CDA suitability requirements should ensure that consumers are not steered into a CDA with a suboptimal investment selection. CDA suitability protection should also prohibit producer compensation schemes that favor sales of CDAs associated with suboptimal investments.

Disclosure

We ask that the working group identify the key information for disclosures to consumers considering a CDA purchase through consumer testing of the disclosures. We suggest that, in addition to the massive disclosures currently employed, the working group develop and test a one-page disclosure that provides the most important information to consumers. Such a disclosure might include:

- When you receive a benefit from this product.
- If at any point in the future, you fail to pay the premium/fee, you will receive no benefit and will not recover any fees you have already paid.
- The likelihood of receiving a net benefit from this product for investments of different risk for the permissible investment options – X out of 100 for investment option 1, Y out of 100 for investment option 2, etc..
- Alternative lifetime income products and the pros/cons of each relative to CDAs

Thank you for your consideration.

Sincerely,

Birny Birnbaum
Executive Director
e-mail: birny@sbcglobal.net
The National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) is pleased to submit this written statement of its testimony to the NAIC Contingent Deferred Annuity (A) Working Group (“CDA Working Group”). NOLHGA’s 52 members are the guaranty associations (“GAs”) formed by the 50 states, Puerto Rico, and the District of Columbia to provide protection for consumers from the failure of a life or health insurance company.

The purpose of this statement is to provide the CDA Working Group with an overview of (i) the life and health insurance guaranty system; (ii) NOLHGA’s Coverage Claims Committee (“Committee”), which is the principal mechanism by which the guaranty system coordinates on GA coverage issues; and (iii) the Committee’s ongoing review of “contingent deferred annuities” (CDAs), which is focused on the technical question of whether CDAs are eligible for coverage under the existing NAIC Life and Health Insurance Guaranty Association Model Act (the “GA Model Act”), on which most state guaranty association laws are based.¹

**The Life and Health Insurance Guaranty System**

*Introduction* -- The life and health insurance guaranty system consists of the nation’s 52 guaranty associations -- representing each of the states, the District of Columbia and Puerto Rico -- working collaboratively through NOLHGA. NOLHGA serves as the national coordinating body and negotiating representative

¹ We understand the CDA Working Group is currently discussing a possible definition for “contingent deferred annuity.” In the absence of having an established definition of that term, this Statement will ascribe to contingent deferred annuities the meaning that has generally developed during the NAIC’s review of these products, provided that NOLHGA’s analysis of coverage is based upon and limited to the CDA contract forms that were the subject of NOLHGA’s review.
for its member guaranty associations in multi-state insolvencies. Through a
NOLHGA-appointed Task Force of its members, the guaranty system develops
plans to provide coordinated protection for policyholders of insolvent insurers.
During NOLHGA’s almost 30-year history, the guaranty system has been involved
in over 100 multi-state insolvencies and has provided in excess of $27 billion of
guarantees for over 2.8 million insurance consumers.

The multi-state guaranty system’s origins date back to the early 1970s. At that
time, a consensus developed that there was a need for a safety net to protect
policyholders from the financial failure of insurance companies. As a result, in
1971 insurance regulators, legislators, and industry representatives, acting under
the auspices of the NAIC, developed the initial GA Model Act. Over the next two
decades, a version of the GA Model Act was adopted by each of the legislatures
for NOLHGA’s 52 member guaranty associations, thereby creating the foundation
for the current system.

In 1983, NOLHGA was formed by its members to provide a facility and staff to
coordinate and support the activities of the guaranty associations, particularly in
connection with the insolvencies of insurers writing business in multiple states.

*How the Guaranty System Works* -- When an insurer doing business in multiple
states becomes insolvent, NOLHGA appoints a Task Force of guaranty
associations representing the states affected by the insolvency. The Task Force is
assisted by NOLHGA staff and outside legal, actuarial, and financial experts. The
Task Force also works cooperatively with the state insurance commissioner of the
insolvent company’s state of domicile (the “Commissioner”). The Commissioner
acts as the statutory receiver for the insolvent insurer and is responsible for
winding up the affairs of the company and paying claimants their proportionate
share of the company’s remaining assets.

The Task Force’s principal function is to formulate a plan by which all affected
guaranty associations can provide their statutory protections to policyholders on a
timely, effective, and consistent basis. With the cooperation of the Commissioner,
the Task Force performs an investigation of the insolvent insurer to determine its
financial position, including its policyholder liabilities and available assets to
support policyholder benefits. The Task Force also examines the company’s
insurance products to determine their key features and the benefits they provide to
policyholders. Based on this review, the Task Force develops a plan for guaranty
associations to provide coverage to policyholders. Since guaranty associations are
not only obligated to pay mature insurance claims (e.g., death benefit claims) but
also must ensure that future insurance obligations under non-cancellable policies
are met, the plan must provide for continuing insurance coverage to policyholders.
Continuation of coverage can be critical to protecting insurance consumers because
some policyholders may have become uninsurable since they first acquired their
policies, or may be unable to obtain comparable coverage without paying
substantially higher premiums.

The Task Force’s principal consideration in formulating a plan is to provide
policyholders with guaranty association protection in a timely and effective
manner. Under their enabling acts, guaranty associations have a variety of
mechanisms that they can use to protect policyholders. These include the power to
guaranty, assume, or reinsure the policyholder obligations of an insolvent insurer.
In most cases, the guaranty associations utilize a plan that involves reinsuring the
policy obligations by making payment to a financially sound insurance company to
assume those obligations. The assumption transaction is usually accomplished
following a request for proposal process, which is utilized to optimize terms for the
assumption. However, in certain cases, the guaranty associations have used other
approaches to protect policyholders. One such approach involves guaranty
associations retaining their covered obligations and fulfilling them over time as
they mature, which can sometimes be decades into the future. In those cases, the
guaranty associations have retained third party administrators or have formed
special-purpose insurance companies as the vehicles for servicing and paying their
statutory obligations as they become due.

Once the Task Force has formulated a plan, it is recommended to all of the affected
guaranty associations for their participation. Because NOLHGA-sponsored plans
permit guaranty associations to meet their obligations on a coordinated and cost-
efficient basis, they have consistently obtained unanimous or near unanimous
participation by affected associations. Following approval by the affected guaranty
associations, the Task Force then coordinates implementation of the plan.
Guaranty System Coordination on Coverage Issues

NOLHGA’s Coverage Claims Committee (the “Committee”) serves as the principal means by which the guaranty system coordinates and develops consistent positions on coverage issues. Membership of the Committee, which was formed by NOLHGA’s Board of Directors in 2004, includes guaranty association administrators, outside counsel, and board members who are knowledgeable about both coverage issues and insurance products. The Committee is charged with providing analysis and recommendations to NOLHGA’s members on emerging coverage issues and promoting uniform and system-wide approaches to address those issues.

In carrying out its charge, the Committee focuses on the technical questions of whether particular products are eligible for coverage under existing law and if there is coverage, how the guaranty associations might implement that coverage. Neither the Committee nor NOLHGA has responsibility for evaluating, from a regulatory or public policy perspective, the merits of particular insurance products and whether products should or should not be eligible for coverage.

Upon the identification of an emerging coverage issue, the Committee undertakes a comprehensive review of the product giving rise to the coverage issue. This review typically involves meeting with industry experts and other knowledgeable persons to gain a thorough understanding of the product, reviewing sample product forms and filings, and analyzing the potential coverage of the product under the GA Model Act. Upon the completion of its review, the Committee reports to NOLHGA’s members on its finding and provides analysis and recommendations on the availability of coverage under the GA Model Act. In cases where there is coverage, the Committee also makes recommendations on how guaranty associations might implement coverage. While the Committee’s recommendations are subject to each guaranty association’s review and determination of coverage under its state’s law, they typically have provided the basis for a substantial consensus on coverage by the guaranty associations.
The Guaranty System’s Work on Contingent Deferred Annuities

NOLHGA began tracking developments on CDAs during 2011. In early 2012, NOLHGA’s Coverage Claims Committee commenced its review of coverage of CDAs. Among other activities, the Committee received an educational presentation on CDAs from industry representatives, reviewed product forms and other publicly-available information on CDAs, analyzed the availability of GA coverage for CDAs under the current GA Model Act, and discussed the results of its work with NOLHGA’s members. NOLHGA’s members are still in the process of considering the Committee’s analysis, and therefore many of them have not yet taken a position on coverage of CDAs.

The balance of this Statement will discuss the framework used by the Committee to analyze the possible coverage of CDAs. This discussion is subject to the following:

- The Committee’s work on CDAs is not yet complete. The Committee continues to review and track developments on CDAs, and the results of its analysis could be impacted by further developments.
- The Committee’s analysis of CDAs is based solely on the GA Model Act. While individual GA Acts are believed to be relevantly similar to the GA Model Act, the Committee has not reviewed the totality of each individual state’s statutory, regulatory, and case law relevant to the coverage of CDAs. Therefore, NOLHGA and the Committee do not express a view on the coverage of CDAs under any particular state’s law.
- The Committee’s review is based on certain CDA contract forms. The results of the Committee’s analysis could change based on variations in contract forms.
- Only individual guaranty associations have statutory responsibility for determining coverage, based on the terms of the relevant insurance policy and relevant state law in effect at the time the guaranty association is triggered to provide coverage.

Framework for Analyzing Coverage -- Generally, there are three questions that need to be addressed to determine whether an insurance product is potentially eligible for coverage. These questions are listed below, together with the
Committee’s analysis as to how the questions apply in the case of the CDA contracts reviewed by the Committee.

1. **Is the product issued by a “member insurer” of the guaranty association?**

   - If the answer to the question is yes, then the product may be eligible for coverage subject to further analysis. If the answer is no, the product, regardless of its terms, will not be eligible for coverage.
   - GA Model Act Section 5.L defines “member insurer” as “an insurer licensed or that holds a certificate of authority to transact in this state any kind of insurance for which coverage is provided under Section 3…” of the GA Model Act.
   - In the case of CDA product forms reviewed by the Committee, they were to be issued by widely licensed insurers that would qualify as “member insurers” under the GA Model Act.

2. **Is the product of a type eligible for GA coverage (i.e., a life, health or annuity policy/contract)?**

   - If the answer to the question is yes, then the product may be eligible for coverage subject to further analysis. If the answer is no, the product, regardless of its terms, will not be eligible for coverage.
   - The CDA product forms reviewed by the Committee were filed as group annuity contracts.
   - The CDAs reviewed provide for the issuance of annuity certificates to individuals. The certificates evidence the issuing insurer’s contractual obligations, subject to certain conditions, to make determinable, periodic payments to the individual holder based on the life of the holder (i.e., the products have a life contingency).
   - GA Model Act Section 3.B (1) recognizes that certificates issued under group annuity contracts are eligible for coverage as a type of allocated annuity.
• The NAIC has concluded that CDAs are a type of annuity contract.²
• Based on the above, the CDA contracts reviewed by the Committee appear to be eligible for treatment as allocated annuity contracts under the GA Model Act.

3. Are there exclusions or limitations on coverage that apply to the product?

• The GA Model Act (and all state guaranty association laws) contain exclusions and limitations on coverage. If a product is entirely excluded from coverage (e.g., contracts of reinsurance), there will be no coverage. If a product is partially excluded from coverage (e.g., limitations on applicable crediting rates), there will be coverage, subject to the partial exclusion.
• The Committee has reviewed the coverage exclusions and limitations in the GA Model Act. Based on that review, there do not appear to be any coverage exclusions of general application that would wholly exclude CDA products as a class from coverage. In particular, the Committee noted:
  i. The insurer issuing the CDA assumes the risk (e.g., mortality and investment risk) of making lifetime payments to the holder.
  ii. The CDA provides for the issuance of certificates to individuals, and those certificates evidence the insurer’s obligation to the certificate holders to make lifetime payments.
• As is the case with all products, there are exclusions that could partially limit coverage of CDAs (e.g., dollar coverage limits).

Summary -- Under the NAIC GA Model Act, and subject to the significant provisos stated above, the form of CDAs reviewed by the Committee appear to be eligible for coverage as annuity certificates issued under a group annuity contract.

² Each guaranty association will be subject to regulatory/legal determinations made in its state as to whether CDAs are annuities. If a particular state determines that CDAs are not annuities, then it is unlikely that CDAs will be viewed as a product eligible for GA coverage in that state.
Background

NOLHGA Coverage Claims Committee (CCC)

- **Established**: 2004
- **Committee Members**: GA Administrators, Lawyers and Industry Representatives Knowledgeable about both Products and GA Coverage
- **Role**: To Advise NOLHGA’s Members on Complex and Emerging GA Coverage Issues Involving Life, Annuity and Health Products
- **Goal**: Promote Consistency Under Similar GA Statutes
Background

NOLHGA’s 2012 CCC

John Colpean, Chair, Michigan
Chris Chandler, Prudential
William Falck, Florida
Kevin Griffith, FBD
Jim Lenaghan, New Jersey
Bill O'Sullivan, NOLHGA
Tim Ring, MetLife

Mark Backe, Northwestern Mutual
Art Dummer, Utah
Bill Fisher, Mass Mutual
Dick Horne, Arkansas
Dave McMahon, GenWorth
Noreen Parrett, Wisconsin
NOLHGA Work on CDAs

**CCC’s work on Contingent Deferred Annuities (CDAs)**

- NOLHGA Began Tracking Market and NAIC Developments on CDAs During 2011
- In Early 2012, CCC Undertook GA Coverage Analysis of CDAs
- CCC Actions:
  - Reviewed NAIC Deliberations and Determination that CDAs are Annuities
  - Received Educational Presentation from Industry Representatives
  - Reviewed Some Publicly Available CDA Product Forms
  - Performed Coverage Analysis (based on NAIC GA Model Act)
  - Presented Results to NOLHGA’s Member State Guaranty Associations
- NOLHGA’s Members still reviewing/considering issue
Specific Issue Addressed by CCC

- **Scope of Analysis:**
  - Would an Individual Certificate Holder Under a CDA be Covered, Based on
    - Specific Language in NAIC GA Model Act
    - Applied to Sample Publicly Available CDA Product Forms
  - Under the Assumptions that:
    - The Insurer Issuing the CDA was a “Member Insurer” and became Insolvent
    - The CDA was Classified Under State Law as an Annuity as Recommended by NAIC
  - **CCC Did NOT Evaluate the “Public Policy” for or against GA Coverage**
NOLHGA Work on CDAs, Cont’d

**CCC’s Coverage Analysis Approach For CDAs**

- Key Provisos
  - CCC Work Incomplete—CDAs Present an Evolving Area and Legal/Regulatory Action Could Impact CCC Analysis
  - CCC Analysis Based Solely on:
    - NAIC GA Model Act and
    - CDA Forms Reviewed
  - Each GA Ultimately Responsible for Legal Coverage Determinations at Time GA is Triggered to Provide Coverage
NOLHGA Work on CDAs, Cont’d

**CCC’s Coverage Analysis Approach For CDAs**

- Key Assumptions
  - CDAs Qualify as Annuities
  - Each Consumer Would Receive Certificate of Coverage from the Insurer Issuing the CDA
  - Certificate Establishes Contractual Obligation of Issuing Insurer to Make Determinable Periodic Payments to Certificate Holder at Some Point in Future Once Specified Conditions Satisfied
CCC’s Coverage Analysis Approach For CDAs

- Three Questions Under NAIC Model GA Act:
  - **First**: Are CDAs Issued by “Member Insurers”?
    - If **NO**—No GA Coverage
    - If **YES**—Further Analysis Necessary
  - “Member Insurer” Defined in NAIC GA Model Act § 5L: “[A]n insurer licensed or that holds a certificate of authority to transact in this state [annuity business]”
  - Forms Reviewed Were to be Issued by Widely Licensed Insurers that Would be “Member Insurers” under NAIC Model GA Act
CCC’s Coverage Analysis Approach For CDAs

- **Second** Question Under NAIC Model GA Act:
  - Are CDAs a Form of Covered Product (e.g., Annuities)?
    - If **NO**—No GA Coverage
    - If **YES**—Further Analysis Necessary
      - CDAs Reviewed Appear to be Group Annuities
      - CDA Certificates that Establish Determinable Periodic Payments are to be Issued to Consumers Guaranteeing Payments to Consumer
      - NAIC has concluded that CDAs are a type of annuity contract
      - NAIC GA Model Act § 3B(1) Recognizes Coverage for Individual Certificates Issued Under a Group Annuity
      - Based on Review, CDAs Appear to be Annuities, and Individual Certificates Issued Under a CDA Would be a Covered Product
CCC’s Coverage Analysis Approach For CDAs

Third Question Under NAIC Model GA Act:

- Are There Statutory Coverage Exclusions that Would Completely Exclude a CDA or Certificate Thereunder from GA Coverage?
- If CDAs and/or Certificates Issued Thereunder Would Fall into a Specifically Defined Exclusion, NO GA Coverage
- CCC Found NO EXCLUSION that Would Categorically Exclude CDAs or the Certificates Completely from Coverage
  - Risk for Making Lifetime Payments (e.g., mortality and investment risk) Assumed by Issuing Insurer in Exchange for Periodic Fees from Consumer
  - Certificates Issued to Consumers Establish Periodic Payments Are Guaranteed to Consumers
- As With All Covered Products, General Coverage Limitations and Partial Exclusions May Limit GA Coverage
CCC’s Coverage Summary

- Based on:
  - NAIC GA Model Act
  - CDA Forms Reviewed
  - Characterization of CDAs as Annuities Under State Law
  - Other Provisos Described Above

- CDA Certificates Issued to Individual Consumers Appear to be Eligible for GA Coverage, Subject to General GA Coverage Limitations and Partial Exclusions That May Limit GA Coverage
Questions
November 28, 2012

The Honorable Ted Nickel
Chair, NAIC Contingent Deferred Annuity Working Group
Commissioner, Wisconsin Insurance Department
125 South Webster Street
Madison, WI 53707-7873

Re: Contingent Deferred Annuity Working Group ("CDA Working Group") Draft Propositions

Dear Commissioner Nickel:

On behalf of our members, the Insured Retirement Institute\(^1\) ("IRI") appreciates the opportunity to comment on the draft definition of Contingent Deferred Annuities ("CDAs") and the draft propositions that the CDA Working Group will be discussing at the upcoming NAIC National Meeting.

**Draft Definition of CDAs**

The draft definition of CDAs appears to accurately reflect the current CDA designs available in or planned for market. Therefore, based on the information we currently have, we support the draft CDA definition.

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\(^1\) The Insured Retirement Institute has been called the "primary trade association for annuities" by U.S. News and World Report and is the only association that represents the entire supply chain of the insured retirement strategies industry. Our members include major insurers, asset managers, broker dealers, banks and financial advisors. We currently have over 500 member companies and provide member benefits to more than 150,000 financial advisors and 10,000 home office financial professionals. IRI is a not-for-profit organization that brings together the interests of industry, financial advisors and consumers. Our official mission is to: (1) encourage industry adherence to highest ethical principles; (2) promote better understanding of the insured retirement value proposition; (3) develop and promote best practice standards to improve value delivery; and (4) advocate before public policy makers on critical issues affecting insured retirement strategies.
Draft Proposition #1: Recommend to A Committee that CDAs be regulated as Variable Annuities for the Purpose of Market Regulation and Consumer Protection. Existing laws that apply to variable annuities may need to be revised to clarify that they also apply to CDAs.

For the reasons stated herein, we believe this proposition should be revised to state as follows:

"Recommend to A Committee that CDAs be subject to the same regulations as variable annuities, as appropriate, for the purpose of market regulation and consumer protection. If variable annuity regulation is not appropriate, fixed annuity regulations should be applied"

Based upon our review of the model acts identified within the framework of market regulation and consumer protections, our preliminary conclusion would support a recommendation and finding that CDAs should be and are currently subject to the identified regulations the same as variable annuities.

If, however, additional regulations were contemplated under the umbrella of market regulation and consumer protections, an analysis would be necessary to determine whether any requirements applicable to variable annuities would be appropriate for CDAs as well.

We will be prepared to discuss these items more fully at the working group meeting and to answer any questions from working group members.

Draft Proposition #2: The adequacy of existing laws and regulations applicable to the solvency of annuities, as such laws are applied to CDAs, should be referred by the A Committee to the NAIC Committees, Task Forces or Working Groups with appropriate subject matter expertise.

IRI requests a recommendation be made by the CDA Working Group to the Life Insurance and Annuities Committee (“A Committee”) to acknowledge that current capital and reserving requirements set forth in Risk Based Capital C-3 Phase II (“C3P2”) and Actuarial Guideline 43 (“AG 43”), are applicable to “guarantees similar in nature to . . . . Variable Annuity Guaranteed Living Benefits, even if the insurer does not offer the mutual funds or variable funds to which these guarantees relate”, and therefore, are applicable to and appropriate for CDAs.

The Committee may also choose to acknowledge that appropriate NAIC committees have the jurisdiction and responsibility to continually monitor the appropriateness of capital and reserving requirements for all products, including CDAs. Therefore, these committees will monitor CDA financial experience, and if necessary in the future, the appropriate committee of jurisdiction will review the capital and reserving requirements for these products.
After almost two years of NAIC evaluation, no specific or general potential deficiency with the current capital and reserving requirements for CDAs has been identified. Given the absence of a supporting reason, we believe a referral for continued evaluation of solvency, which would encompass a review of capital and reserving requirements for CDAs, is not necessary. Furthermore, the NAIC recently completed a full evaluation and adoption of revisions to C3P2 and AG43. Additionally, the American Academy of Actuaries and industry representatives have expressed the clear position that existing capital and reserving requirements for Guaranteed Lifetime Withdrawal Benefits ("GLWBs") are applicable to and appropriate for CDAs.

Expressly referring to C3P2 and AG43, the American Academy of Actuaries set forth its conclusions on capital and reserving requirements in its letter to the A Committee on October 28, 2011:

“Reserves – Statutory reserve guidelines for contingent annuities are the same as for GLWBs and are already address under AG43.”

“Capital – Statutory risk-based capital requirements for contingent annuities are also already address by the current requirements”

On June 27, 2012, the Academy restated its conclusions in testimony delivered to the CDA Working Group:

“The regulatory framework for GLWBs already in place is appropriate for CDAs: The NAIC model laws for reserves and risk-based capital, AG 43 & C3P2, explicitly cover GLWBs and CDAs. We believe that AG 43 and C3P2 provide appropriate methodologies for establishing CDA reserve and risk-based capital requirements.”

Industry representatives through IRI and ACLI expressed similar conclusions through testimony delivered to the Contingent Deferred Annuity Subgroup Group on February 16, 2012, and subsequently to the successor CDA Working Group on June 27, 2012.

Given the Academy and industry’s evaluations and supported conclusions, as well as the NAIC’s recent evaluation and adoption of AG43 and C3P2 specifically contemplating products such as CDAs, the A Committee should not make a general referral, without a basis to do so, to another committee to again review the adequacy of existing laws and regulations applicable to CDAs.

Based on the foregoing, we recommend that Draft Proposition #2 be revised to read as follows:

The current capital and reserving requirements set forth in C3-Phase II (“C3P2”) and Actuarial Guideline 43 (“AG 43”) specifically apply to other guarantees
similar in nature to guaranteed living withdrawal benefits and therefore currently apply to CDAs. Other NAIC committees have the jurisdiction and responsibility to continually monitor the appropriateness of capital and reserving requirements for all products, including CDAs. Therefore, these committees should monitor CDA financial experience and if necessary in the future, review the capital and reserving requirements for these products.

Again, IRI appreciates the opportunity to comment on the draft definition of CDAs and the draft propositions that the CDA Working Group will be discussing at the upcoming NAIC National Meeting. We will be present at the meeting and prepared to answer any questions from the working group.

Best regards,

[J. Lee Covington II]
Senior Vice President and General Counsel
Insured Retirement Institute (IRI)