The Contingent Deferred Annuity (A) Working Group of the Life Insurance and Annuities (A) Committee met via conference call Oct. 31, 2014, and Oct. 24, 2014. The following Working Group members participated: Ted Nickel, Chair, Richard Wicka and Dan Schwartz (WI); Robert Chester (CT); Jim Mumford (IA); Jason Lapham (KS); Bruce R. Ramge (NE); Keith Nyhan (NH); Michael Humphreys (TN); and Tomasz Serbinsowski (UT).


Commissioner Nickel reminded the Working Group of its charge to develop a guidance document for states interested in modifying their annuity laws or having a reference to help determine which models apply when regulating contingent deferred annuities (CDAs). He said that the guidance document was released for comment following the Summer National Meeting, and comments were requested by Sept. 5. A revised draft dated Oct. 15 was distributed prior to the call and incorporated the comments received.

Mr. Wicka reviewed the Oct. 15 draft and highlighted the areas where changes were made from the previous draft. Mr. Nyhan wondered whether there was a discussion about balancing the need for detailed information versus getting too far into the details. Mr. Mumford suggested that it is easier to remove information once revisions are accepted. Commissioner Nickel suggested and the Working Group agreed to review a clean version of the next draft and decide where it may be appropriate to streamline the document.

Birny Birnbaum (Center for Economic Justice—CEJ) suggested that an explanation of why CDAs do not fit neatly into variable or fixed annuity categories was needed in the document. Mr. Nyhan and Mr. Mumford preferred deleting the statement that CDAs do not fit neatly into either variable or fixed annuity categories rather than adding additional information to explain the statement.

Mr. Birnbaum said he was concerned that there is the opportunity for regulatory arbitrage with CDAs if insurers are able to avoid oversight by the U.S. Securities and Exchange Commission (SEC) by filing CDAs as an individual plan instead of a group plan in a state. Jason Berkowitz (Insured Retirement Institute—IRI) said that oversight by the SEC was not dependent on how a product is filed in a state, so he did not think there is an opportunity for insurers to game the system.

The Working Group discussed deleting the phrase from the guidance document that said that CDAs may encourage insureds to invest in riskier products. Mr. Mumford suggested that oversight by the U.S. Securities and Exchange Commission (SEC) by filing CDAs as an individual plan instead of a group plan in a state. Jason Berkowitz (Insured Retirement Institute—IRI) said that oversight by the SEC was not dependent on how a product is filed in a state, so he did not think there is an opportunity for insurers to game the system.

The Working Group discontinued deleting the phrase from the guidance document that said that CDAs may encourage insureds to invest in riskier products. Mr. Mumford said he would delete the phrase because it is unclear. Mr. Serbinowski said that CDAs are designed to allow people to feel more comfortable in a more volatile investment environment. Mr. Lapham suggested explaining that because the benefits of a CDA are only realized when an insured’s covered investment loses its value, a purchaser of a CDA who takes this information into account is likely to choose riskier investments than they would otherwise choose. Mr. Wicka agreed to rephrase in the next draft.

Mr. Berkowitz said that the IRI had suggested inserting draft language into the guidance document to better assist the states. After discussion, the Working Group concluded that the resources in the guidance document and model law revisions were sufficient to guide the states. The Working Group said any clarity that might be gained by including model language in the guidance document is overshadowed by how long the document would become.

The Working Group discussed and agreed to delete an example of a certificate of deposit as an example of an inappropriate vehicle for a CDA. The Working Group agreed that is was too specific and did not fit with the rest of the paper. The Working group discussed the section on suitability and the list of things that should be considered during a suitability review. Because these suggestions do not track the model and each state is going to have to interpret its own law to accommodate CDAs, the Working Group agreed to the suggestions.

The Working Group identified a few minor, technical changes and agreed to make those changes in the next draft of the paper. Commissioner Nickel said that a revised draft would be posted on the website, with comments requested by Nov. 7.
2. Discussed Oct. 15 Drafts of Model #245, Model #275, Model #570 and Model #613

The Working Group discussed model law review requests to make CDA-related revisions to the Annuity Disclosure Model Regulation (#245), the Suitability in Annuity Transactions Model Regulation (#275), the Advertisements of Life Insurance and Annuities Model Regulation (#570) and the Life Insurance and Annuities Replacement Model Regulation (#613) consistent with the Working Group’s charges.

Mr. Wicka explained that the Oct. 15 drafts of the models incorporated comments received following the Summer National Meeting. He reviewed revisions to Model #245. The Working Group discussed Section 3—Applicability and Scope, which had been revised to include CDAs. After discussion, the Working Group agreed to delete the reference to CDAs because it is encompassed within the term “other registered products.” The Working Group agreed to add a definition of “registered product.”

Mr. Berkowitz asked whether the language in a proposed drafting note explaining that a buyer’s guide on CDAs would not be required until the NAIC adopts one obligates the NAIC to develop a CDA buyer’s guide. The Working Group agreed that it was not the Working Group’s intention to require the development of a CDA buyer’s guide. The Working Group agreed to revise the drafting note to say “until such time as” the NAIC develops a buyer’s guide on CDAs. The Working Group agreed to delete the reference to CDAs, since the term is not used in the model, and to add a definition of “registered product.”

The Working Group discussed revisions to Model #275. The Working Group agreed to delete the reference to CDAs in the definition of annuity and to delete the definition of a CDA. Additionally, the Working Group agreed to reference the “sales of annuities” rather than reference “variable annuities, contingent deferred annuities and fixed annuities.” Mr. Birnbaum wondered whether this change made a substantive difference in the meaning of the language. The Working Group agreed that this was not a substantive change. The Working Group discussed Section 7—Insurance Producer Training and agreed to delete the reference to “how fixed, variable and indexed annuity provisions affect consumers” and instead include a broader reference to “how product specific annuity contract features affect consumers”.

The Working Group discussed Model #570. The Working Group agreed to add a reference to “other registered products” in Section 3—Applicability. The Working Group agreed to add a definition of “registered product.”

The Working Group discussed Model #613. The Working Group agreed to delete the definitions of annuity and CDA, as neither term is used in the model. The Working Group discussed the definition of “registered contract” and agreed to delete “variable” from the definition.

3. Discussed Issue of Nonforfeiture/Cancellation Benefits as They Relate to CDAs

The Working Group discussed the issue of nonforfeiture/cancellation benefits. Mr. Wicka explained that the concern with a nonforfeiture or cancellation benefit for CDAs arises from the third-party contractual issues inherent in the product that allow for the termination of the CDA through no fault or action of the policyholder. Mr. Chester said he felt strongly that there needs to be some kind of nonforfeiture benefit. He said that there is no other annuity where the insurer can terminate so unilaterally. Mr. Berkowitz said the industry recognizes the challenges where consumers are deprived of a benefit through no action of their own. He said that the industry would prefer exploring ways to protect the consumer that do not include applying the Standard Nonforfeiture Law for Individual Deferred Annuities (#805) to CDAs. Mr. Berkowitz suggested that the CDA contract could include mechanisms to protect consumers in the event their contract is terminated through no fault of their own, without being too prescriptive. Mr. Chester said that a value appropriate to be returned to consumers must be considered. Mr. Serbinowski said that there are significant fees collected with this product, and he had not decided whether some kind of benefit, or longevity payment, was appropriate, no matter why the product terminated. Mr. Mumford, Mr. Nyhan and Mr. Lapham said that they would like to see the industry come up with some solutions for the regulators to consider. Mr. Schwartz said that everyone agrees that the current model does not work for CDAs, but a retrospective value should be determined. He said all parties will benefit by the industry working with the regulators to solve the issue for consumers. Mr. Wicka asked Mr. Berkowitz to have some options for discussion at the Fall National Meeting.

4. Discussed Next Steps

Mr. Wicka reviewed the Working Group’s agenda for the Fall National Meeting. He said the Working Group will review comments received on a revised draft guidance document. He said the Working Group also hopes to adopt revised CDA-
related revisions to the annuity models. He said, additionally, there will be a discussion of nonforfeiture/cancellation benefits for CDA policyholders.

Having no further business, the Contingent Deferred Annuity (A) Working Group adjourned.
2014 Contingent Deferred Annuities (CDAs) – CDA-Related Activity - Progress Report
2014 NAIC Fall National Meeting

In late-2012, the Life Insurance and Annuities (A) Committee ("Committee") charged the Contingent Deferred Annuity ("CDA") Working Group with evaluating the adequacy of existing laws and regulations as applied to CDAs and whether additional solvency and consumer protection standards are required. The CDA Working Group submitted its report and findings and recommendations to the Committee at the NAIC 2013 Spring National Meeting. Among its findings, the CDA Working Group found that CDAs do not easily fit into the category of fixed or variable annuity, that review of solvency and consumer protection standards are necessary and that tools to assist states in review CDA product filings and solvency oversight of CDAs should be established. The CDA Working Group also identified issues that would be more appropriately addressed by other existing NAIC groups with the specific subject-matter expertise.

Below are proposed charges to the various NAIC groups identified in the CDA Working Group’s report as having the specific subject matter expertise to implement its findings and recommendations. These charges were delegated to the listed groups and adopted by Executive Committee at the 2013 Fall National Meeting.

**Producer Licensing (EX) Task Force**

- Charge to review the types of producer licenses, including appropriate provisions in the *Producer Licensing Model Act* (#218), required to sell contingent deferred annuities (CDAs) to determine if those licenses are consistent with the licenses required to sell variable annuities and recommend any necessary changes and/or revisions.

**Completed** – The Task Force finalized its recommendation on what license should be required to sell CDAs at the Summer National Meeting. The Task Force recommended that individuals selling CDAs should be required to obtain a variable line authority.

**Speed to Market (EX) Task Force, Operational Efficiencies (EX) Working Group**

- Create a separate type of insurance (TOI) category for contingent deferred annuities (CDAs) in SERFF and SBS systems, and any other relevant speed to market tools, as necessary.

**Completed** – As of November 11, 2014

- 40 jurisdictions have implemented.
- 12 states declined implementation, of which
  - 9 do not allow CDAs or do not regulate them
  - 1 has never received this type of product before and would require legal changes in their office before considering
  - 2 said they are waiting for NAIC guidance/models before moving forward
- 1 state has never responded to any of our multiple inquiries on this subject

**Contingent Deferred Annuity (A) Working Group**

- Charge to serve as the coordinating body with all of the NAIC technical groups with projects related to contingent deferred annuities (CDAs).

- Charge to develop NAIC guidelines and/or model bulletin that can serve as a reference for states interested in modifying their annuity laws to clarify their applicability to contingent deferred annuities (CDAs) and, as part of this work, review existing NAIC model laws and regulations applicable to consumer protection issues associated with CDAs.

November 2014 – CDA Working Group has released second draft “Guidance Document” for comments by November 7. Comments to be discussed at Fall National meeting.

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• Charge to develop a work plan that would allow Committee members, interested regulators and interested parties to easily track, monitor and coordinate the progress of the NAIC technical groups working on issues identified in the Contingent Deferred Annuity (A) Working Group report and recommendations concerning contingent deferred annuities (CDAs). The work plan should include timelines and dates for expected completion of the work done by each NAIC technical group.

• Charge to review and consider revisions to the Annuity Disclosure Model Regulation (#245) to exempt SEC registered contingent deferred annuities (CDAs) and CDAs offered through ERISA retirement plans.

• Charge to review and consider revisions to the Suitability in Annuity Transactions Model Regulation (#275) to specifically reference its applicability to the sale of contingent deferred annuities (CDAs), including the one-time, four hour training and the product-specific training requirements.

• Charge to review and consider revisions to the Advertisements of Life Insurance and Annuities Model Regulation (#570) to specifically reference its applicability to contingent deferred annuities (CDAs).

• Charge to review and consider revisions to the Life Insurance and Annuities Replacement Model Regulation (#613) to specifically reference its applicability to contingent deferred annuities (CDAs).

November 2014 – Draft revisions to Models #245, #275, #570 and #613 to be discussed, and possibly adopted, at Fall National Meeting.

**Life Actuarial (A) Task Force**

• Charge to evaluate Actuarial Guideline 43 to determine whether the reserve guidance as it applies for variable annuity guarantees would be deficient when applied to contingent deferred annuities (CDAs). Recommend changes, as appropriate, to address any deficiencies and determine whether clarifying guidance would be useful due to different nomenclature than variable annuities with guarantees.

November 2014 – At the Summer National Meeting, the CDA Subgroup reviewed an ACLI proposal to add a supplement to Actuarial Guideline XLIII, *CARYM for Variable Annuities* (AG 43) to provide guidance for contracts in which the insurer does not own the investments that form the basis for the guarantee. As a result of the review, the Subgroup asked the ACLI to consider using a term other than “separate account” to define the investments related to the guarantee and to demonstrate the equivalence of the two proposed methods of calculating the valuation of the guarantees.

• Charge to consider revisions to the Standard Nonforfeiture Law for Individual Deferred Annuities (#805) to specifically exclude contingent deferred annuities (CDAs) from the scope of the model.

November 2014 – Revisions to Model #805 were completed by the CDA Subgroup, but have not yet been adopted by the Task Force

*NOTE: LATF is working on the following additional CDA-related charges at the request of the E Committee.*

• Charge to review and consider changes, as necessary, to the appropriate Annual Statement Blank to address financial reporting requirements for contingent deferred annuities (CDAs).

November 2014 –

• Charge to review and determine whether revisions to the Synthetic Guaranteed Investment Contracts Model Regulation (#695) are needed to clarify its relationship with contingent deferred annuities (CDAs).
November 2014 –

- Charge to consider the development of a template/checklist of questions that state insurance departments could use to facilitate the review of an insurer’s risk management program at the time of a policy form filing related to a contingent deferred annuity (CDA) consistent with the recommendations from the Contingent Deferred Annuity (A) Working Group.

November 2014 – E-Committee has requested the coordinated assistance of the Life Actuarial (A) Task Force and the Examination Oversight (E) Task Force in addressing this charge. Consideration and Coordination is in progress.

**Financial Condition (E) Committee**

- Charge to consider the development of a template/checklist of questions that state insurance departments could use to facilitate the review of an insurer’s risk management program at the time of a policy form filing related to a contingent deferred annuity (CDA) consistent with the recommendations from the Contingent Deferred Annuity (A) Working Group.

November 2014 – E-Committee has requested the coordinated assistance of the Life Actuarial (A) Task Force and the Examination Oversight (E) Task Force in addressing this charge. Consideration and Coordination is in progress.

**NOTE:** the following charge stayed on E-Committee’s list for 2014, although E-Committee has requested assistance from the Life Actuarial (A) Task Force in addressing these charge:

- Charge to review and determine whether revisions to the Synthetic Guaranteed Investment Contracts Model Regulation (#695) are needed to clarify its relationship with contingent deferred annuities (CDAs).

November 2014 - E-Committee has requested assistance from the Life Actuarial (A) Task Force in addressing this charge.

- Charge to review and consider changes, as necessary, to the appropriate Annual Statement Blank to address financial reporting requirements for contingent deferred annuities (CDAs).

November 2014 - E-Committee has requested assistance from the Life Actuarial (A) Task Force in addressing this charge.

**Blanks (E) Working Group**

- Consider adjusting the appropriate Annual Statement Blank and Instructions to replace the contingent deferred annuity (CDA) definition currently used with the CDA definition developed by the Contingent Deferred (A) Working Group.

**Completed** - Form completed to revise annual statement blank and adopted by the Working group at the Spring National Meeting. Adopted in the reports to the Accounting Practices and Procedures (E) Task Force and the Financial Condition (E) Committee at the Summer National Meeting.

**Life Risk Based Capital (E) Working Group**

- Develop guidance, for inclusion in the proposed NAIC contingent deferred annuity (CDA) guidelines, for states as to how current regulations governing risk-based capital requirements, including C-3 Phase II, should be applied to contingent deferred annuities (CDAs). Recommend a process for reviewing capital adequacy for insurers issuing CDAs and prepare clarifying guidance, if necessary, due to different nomenclature then used with regard to CDAs. The development of this guidance does not preclude the Working Group from reviewing CDAs as part of any ongoing or future charges where applicable and is made with the understanding that this guidance could change as a result of such a review.
November 2014 – The Life Risk-Based Capital (E) Working Group is waiting for input on company modeling on CDAs from the American Council of Life Insurers. An update from the ACLI will be discussed at the Fall National Meeting.

**Receivership and Insolvency (E) Task Force**

- Review the definition of contingent deferred annuity (CDA), as proposed by the Contingent Deferred Annuity (A) Working Group, and determine whether amendments to the *Life and Health Insurance Guaranty Association Model Act* (#520) are needed and warranted in light of that proposed definition.

**Completed** – No amendments are needed or warranted. 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.
GUIDANCE 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 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 this guidance to serve as a reference for states that are either interested in modifying their annuity laws to clarify their applicability to CDAs or to help states determine how to apply their existing annuity laws and rules to CDAs. This guidance sets forth what consumer protection and financial solvency model laws and regulations should be applied to CDAs and what model laws and regulations that should not apply to CDAs. The guidance outlines what revisions, additions, and regulatory interpretations a state may wish to consider in determining how existing state laws governing annuities apply to these products. This guidance also includes regulatory guidance developed by the Financial Condition (E) Committee, Life Risk-Based Capital (E) Working Group, and the Life Actuarial Task Force for states to use in evaluating capital and reserving requirements and a checklist for reviewing the risk management capabilities of insurers seeking to offer CDAs in their state. This guidance is 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. This guidance is based on the information provided by these parties and the CDA Working Group’s review of existing NAIC model laws and regulations.

I. Background
   A. Classification of CDAs
In 2012, the CDA Subgroup reviewed CDAs to determine how the product should be classified. In March 2012, the A Committee and the Executive Committee and Plenary adopted the recommendations of the CDA subgroup that CDAs are annuities best written by life insurers.

B. Definition of CDAs

The CDA Working Group developed and the NAIC has adopted a definition of a CDA 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 should consider this definition when determining whether a product is properly classified as a CDA. If revisions to statutes or regulations are contemplated, states may wish to add this definition in their statutes or regulations.

C. Features of a CDA

CDAs are annuity 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 investment account (“Covered Investments”), such as a mutual funds or a managed account. The underlying account is not held or managed by the insurer but is instead held by a related or unrelated third party entity. The insurer contractually restricts the type of Covered Investments that can be covered by the CDA, but the insurer 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 allowable mutual funds, but would have no control over the assets that make up those mutual funds.

A CDA has three distinct phases during the life of the contract. First, the CDA goes through an accumulation phase. This phase occurs from the date the CDA is issued until the time the participant decides to take withdrawals from the Covered Investments, typically upon reaching a certain age such as retirement age. During this phase, 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. The CDA benefit base may also increase due to contractual features. The CDA benefit base is a notional amount used for calculating permitted withdrawals and the benefit amount. 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 increases in the benefit base.

Once a benefit base amount has been set, the CDA guarantees that the benefit base can never decrease due to declines in the value of Covered Investments as the result of investment losses. This allows the insured to mitigate the risk that future 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 benefit base, which may be greater than the actual value of the Covered Investments held at the time of withdrawal, the second phase of a CDA.

The withdrawal phase occurs when the participant begins to draw funds from the Covered Investments after reaching the age specified in the CDA contract, most typically retirement age. 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 up or down accordingly. The “guaranteed withdrawal amount” under the CDA is based, under current product designs, on a specified percentage of the value of the CDA benefit base at the time distributions begin. During the withdrawal phase no benefit payments are made under the CDA and the insured is making withdrawals solely from the Covered Investments. The CDA contract sets a maximum guaranteed withdrawal amount that a participant may take. Withdrawals at or below the guaranteed withdrawal amount do not affect the amount of future withdrawals. However, should a policyholder withdraw funds above the contractually permitted amount, a pro rata reduction of the CDA benefit base and/or guaranteed withdrawal amount may occur. Excessive withdrawals could also result in termination of the CDA. During the withdrawal phase, an insured still maintains his or her assets in the Covered Investment. Thus, the value of the Covered Investments may decrease during the withdrawal phase due to market conditions. However, the guaranteed withdrawal amount will not decrease due to loss of value of the Covered Investments though such losses could have the effect of triggering payments under the CDA. Consequently, insurers will typically offer CDAs in connection with Covered Investments that can be effectively hedged or limit the type of assets a policyholder may hold in the Covered Investments during the withdrawal phase to those with low volatility.

The third and final phase is the payout or settlement phase. Upon exhaustion of the Covered Investments, the insurer begins making periodic payments equal to the guaranteed withdrawal amount for the policyholder’s lifetime. In this way, the CDA guarantees 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 a policyholder 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 Covered Investments, increases to the CDA benefit base, policyholder behavior, 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 Covered Investments or benefit base. Generally, the fee is deducted from the Covered Investments.

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1 A payout structure could alternatively be based upon a “life with period certain” structure.
2 Payments may be level or increasing depending upon product design.
3 For some CDA products an insured may elect to purchase spousal benefits. In these instances the CDA would be subject to the longevity of both spouses.
D. Federal Regulation of CDAs

The Securities and Exchange Commission ("SEC") has not taken a position regarding whether CDAs are required to be registered as securities under the Securities Act of 1933. However, based on information received from the SEC, it is the CDA Working Group’s understanding that a product whose value derives from 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 specific registration exemption applies. Since a CDA’s value is derived 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 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 advisor. Sales of CDAs 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 relationship to investments outside of the insurer’s control create 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 to the insurer. This is the risk that policyholders will live beyond their anticipated life expectancy, deplete their Covered Investments, and trigger the CDA lifetime income benefit. 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 insurer’s actuarial opinions to ensure that it is properly reserving for longevity risk.

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4 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 is market risk. The market risk associated with a CDA is that the amount of benefit to the policyholder varies inversely to the market performance of the Covered Investments. The value of the Covered Investments may decrease while the benefit base and guaranteed withdrawal amount are set at a higher level. Thus, when the policyholder takes the guaranteed withdrawal amount it will deplete the Covered Investments sooner than anticipated triggering the CDA benefit. For example, a large downturn in the stock market could reduce the value of the Covered Investments underlying the CDA but the CDA benefit base would remain locked in at a higher value, thus increasing the likelihood that the 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. Of course, hedging cannot offset all market risks and is only a method for mitigating losses and results will vary depending upon hedge effectiveness. Further, in the event there is a significant, broad-based market downturn, such as the 2008 financial crisis, CDA issuers may see a greater than anticipated increase in the number of CDAs in the payout phase because of a high number of policyholders suffering losses in the underlying Covered Investments. Regulators may wish to review an insurer’s hedging strategy to verify that it is comprehensive, it appropriately addresses the insurer’s market risks under adverse scenarios, 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”))\(^5\).

CDA issuers also incur risks based on policyholder behavior, including lapse rates, investment decisions, and the amount and timing of withdrawals. In this regard, the value of the CDA to a policyholder and, correspondingly, the level of risk to the insurer are in many ways governed by policyholder behavior. A policyholder 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. From the policyholders’ 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. A policyholder would achieve the maximum benefit under a typical CDA by taking the maximum allowable withdrawal amount each year in order to draw down the Covered Investments and trigger the payout phase of the CDA. Insurers can manage policyholder behavioral risk through product design including restrictions on the type of investment assets that an insured may use with a CDA, limiting

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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 apply to CDAs.
withdrawals amounts during the withdrawal phase, varying fees in accordance with the risk level of the Covered Investments, and decreasing benefits in the payout phase for withdrawals above the guaranteed withdrawal amount during the withdrawal phase or for withdrawals made during the accumulation phase. 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 policyholders may use and gain value from a CDA.

Insurers who offer CDAs must also manage third party relationships and risks. Insurers establish the terms and conditions of the CDA but work with third party non-insurers who manage the Covered Investments. These third parties may collect the CDA fee, provide information regarding Covered Investments’ performance (for determining the CDA benefit base), and notify the insurer if the policyholder changes the assets contained in the underlying account (to determine if the 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. Similarly, insurers face counterparty risks from the parties from whom they buy hedge instruments, specifically, whether the counterparty will back the guarantees they offer.

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.

B. Risk Management Checklist

[C. Reserve Requirements

[D. Capital Requirements

III. Non-Financial Regulation of CDAs

The CDA 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 or
depletion of the underlying assets. 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

The CDA 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 Working Group reviewed which non-financial model acts and regulations should apply, or
not apply, to CDAs. The Working Group’s findings are outlined below along with
recommendations about how states could interpret and/or amend their existing annuity laws and
rules.

Producer Licensing Model Act (#218)

The Producer Licensing Model Act governs the qualification requirements and procedures for
licensing insurance producers. 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.

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 or issued to employer-sponsored retirement plans which may have their
own disclosure requirements that preempt state law. See Section 3. Since CDAs generally fall
within one of these two categories, the Working Group found that the exemption in the annuity
disclosure model regulation for registered products and employer-sponsored plans would apply to CDAs. To the extent there are any CDAs products that do not fall within one of these two exceptions, the disclosure requirements outlined in Section 5.B. of the Model Regulation would apply.

Under the Model Regulation, 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. 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 laws and regulations to determine if they need to be revised to clarify 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. However, the model’s exemptions for registered products and products issued to employer-sponsored plans may be broad enough for states to interpret existing law to exclude CDAs without revision to existing regulations.

Suitability in Annuity Transactions Model Regulations (#275)

The CDA Working Group determined that the Suitability in Annuity Transactions Model Regulation should apply to CDAs and that suitability review for the sale of CDAs is an important consumer protection for these products. Section 6. H.1 of the 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 so that if FINRA’s variable annuity suitability rules are applied to registered 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 require that broker dealers apply the suitability standards for variable annuities to CDA sales, though FINRA general suitability requirements would apply. If a broker-dealer does not apply FINRA’s annuity suitability standards to the sale of a CDA than the safe harbor provision would not be applicable and the suitability requirements of the Model Act would apply. However, individual broker-dealers may apply FINRA annuity suitability standards to CDAs, despite FINRA not requiring it, and that would be sufficient for the safe harbor provision to apply. State regulators should ensure that sales of CDAs are subjected to suitability review either under FINRA standards or state standards. If suitability review is not conducted under FINRA’s suitability standards than the suitability requirements of the Model Act apply.
For sales governed by the Model Act, the Working Group concluded that the existing list of “suitability information” included in section 5.1 of the Act contains all the information that is needed to examine the suitability of a CDA sale and additional factors do not need to be added to the Model Act to specifically address CDAs.

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

The Receivership and Insolvency (E) Task Force (“RITF”) reviewed whether revisions to the model act were needed and warranted to address CDAs. After presentations from the National Organization of Life & Health Guaranty Associations (“NOLGHA”), discussions with taskforce members, and comments from interested parties, the RITF found 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 finding was 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 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 Regulation sets forth standards for the advertisement of life products. The CDA Working Group determined that this regulation is applicable 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 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 CDA Working Group concluded that the Model Regulation should be amended to make clear it applies to CDAs. Section 1.C. of 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 CDA 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 CDA 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 CDA 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 CDA 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 CDA 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.
GUIDELINES GUIDANCE 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 that are either interested in modifying their annuity laws to clarify their applicability to CDAs or to help states determine how to apply their existing annuity laws and rules to CDAs. These guidelines sets 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 outlines 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 Financial Condition (E) Committee, Life Risk-Based Capital (E) Working Group, and the Life Actuarial Task Force for states to use in evaluating the capital and reserving requirements and a checklist for reviewing the 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 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. In 2012, the CDA Subgroup reviewed CDAs to determine how the product should be classified. In March 2012, the A Committee and the Executive Committee and Plenary adopted the recommendations of the CDA subgroup that CDAs were a hybrid life product best written by life insurers.

B. Definition of CDAs

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 CDA Working Group developed and the NAIC has adopted a definition of a CDA 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 should consider this definition when determining whether a product is properly classified as a CDA. If revisions to statutes or regulations are contemplated, states may wish to add this definition in their statutes and/or regulations and use it in determining whether an annuity product would be considered a CDA.

C. Features of a CDA

CDAs are hybrid annuity 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 investment account (“Covered Investments”), such as a mutual funds or a managed 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 Covered Investments that can be covered related to the CDA, but the insurer 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 allowable mutual funds, but would have no control over the assets that make up those mutual funds.

A CDA has three distinct phases during its life of the contract. First, the CDA goes through an accumulation phase. This phase occurs from the time the CDA is purchased issued until the time the participant decides to take withdrawals from the separately-managed account Covered Investments, typically upon reaching a certain age such as retirement age. During this phase, 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. The CDA benefit base may also increase due to contractual features. The CDA benefit base is a notional amount used
for calculating permitted withdrawals and the benefit amount. 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 base can never decrease due to declines in the value of Covered Investments as the result of 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 future withdrawal amounts will decrease due to market conditions. The insurer assumes some of the market risk of the underlying asset Covered Investments by guaranteeing periodic withdrawal amounts based on the underlying assets peak level benefit base, which may be greater than the actual amount of funds held value of the Covered Investments held at the time of withdrawal, the second phase of a CDA.

The withdrawal phase occurs when the participant begins to draw funds from the separately managed account the Covered Investments after reaching the age specified in the CDA contract, most typically upon retirement age. 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 up or down accordingly. The “guaranteed withdrawal amount” under the CDA is based, under current product designs, on a specified percentage of the value of the CDA benefit base at the time distributions begin. During the withdrawal phase no benefit payments are made under the CDA and the insured is receiving income making withdrawals solely from the funds in their underlying account Covered Investments. The CDA contract sets a maximum periodic guaranteed 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 the guaranteed withdrawal amount do not affect the benefit base level established during the accumulation phase amount of future withdrawals. However, should a participant policyholder withdraw funds above the contractually permitted amount, the amount of benefits available under the CDA decreases, potentially all the way to zero, a pro rata reduction of the CDA benefit base and/or guaranteed withdrawal amount may occur. Excessive withdrawals could also result in termination of the CDA. During the withdrawal phase, an insured still maintains the investments in an underlying fund his or her assets in the Covered Investment. Thus, the amount of fund value of the Covered Investments 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 the guaranteed withdrawal amount will not decrease due to loss of value of the Covered Investments though such losses could have the effect of triggering payments under the CDA. Consequently, insurers will typically offer CDAs in connection with Covered Investments that can be effectively hedged or limit the type of assets a policyholder may hold in the Covered Investments during the withdrawal phase to those with low volatility. 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 insurer begins making periodic benefit payments equal to the guaranteed withdrawal amount for the policyholder’s lifetime 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’s policyholder 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, increases to the CDA benefit base, policyholder behavior, 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 is deducted and paid by the administrator of the underlying fund.

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 under the Securities Act of 1933. However, based on information received from the SEC shared with the working group, it is the CDA Working Group’s understanding that a product that is whose value derivatives of 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 specific registration exemption applies. Since a CDA’s value is derived 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 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.

1 A payout structure could alternatively be based upon a “life with period certain” structure.
2 Payments may be level or increasing depending upon product design.
3 For some CDA products an insured may elect to purchase spousal benefits. In these instances the CDA would be subject to the longevity of both spouses.
structured as group annuities offered to 401(k) plans and similar plans typically rely on this exemption. Companies 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 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 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 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 insured to the insurer. This is the risk that policyholders will live longer than expected and trigger the CDA lifetime income benefit. This risk can be managed by insurers 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 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 policyholder varies inversely to the market performance of the Covered Investments. The value of the Covered Investments may decrease while the benefit base and guaranteed withdrawal amount are set at a higher level. Thus, when the policyholder takes the guaranteed withdrawal amount it will deplete the Covered Investments sooner than anticipated triggering the CDA benefit. Insurers can manage the market risk by developing comprehensive hedging strategies similar to those used to manage the market risk.

4 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.
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 results will vary depending upon hedge effectiveness. Further, in the event there is a significant, broad-based market downturn, such as the 2008 financial crisis, CDA issuers may see a greater than anticipated increase in the number of CDAs in the payout phase because of a high number of policyholders suffering losses in the underlying Covered Investments. Regulators may wish to review an insurer’s hedging strategy to verify that it is comprehensive, it appropriately addresses the insurer’s market risks under adverse scenarios, 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, investment decisions, and the amount and timing of withdrawals. Timing and amounts, and investment decisions. In this regard, the value of the CDA to an insured policyholder 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 down-side market risks of the insured’s investments, a CDA may encourage an insured to invest in riskier investments. An insured policyholder can 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 policyholders’ 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. To maximize benefits under the CDA, a reasonable insured policyholder should achieve the maximum benefit under a typical CDA by taking the maximum allowable withdrawal amount each year every period of the withdrawal phase in order to draw down the underlying funds Covered Investments 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 restrictions on the type of investment assets that an insured may hold in the underlying portfolio with a CDA, limiting withdrawals amounts during the withdrawal phase, varying fees in accordance with the risk level of the underlying investments Covered Investments, and decreasing benefits in the payout phase for withdrawals above the guaranteed withdrawal amount.

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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.
during the withdrawal phase those allowed under the policy or for withdrawals made during the accumulation phase. 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 rely on third party non-insurers who manage the underlying assets Covered Investments. These third parties may collect the insurer’s fee CDA fee, provide information regarding the assets Covered Investments’ 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. Similarly, insurers face counterparty risks from the parties from whom they buy hedge instruments, specifically, whether the counterparty will back the guarantees they offer.

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 Risk Management Checklist

C. Reserve Requirements

D. Capital Requirements

III. Non-Financial Regulation of CDAs

The CDA 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 or depletion of the underlying assets. 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

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 A committee has tasked the Producer Licensing (EX) Task Force with reviewing this model with regard to 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. 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 or issued to employer-sponsored retirement plans which may have their own disclosure requirements that preempt state law, those covered by ERISA. See Sections 3B.1(a),(b), 3D.1. Since CDAs are being registered with the SEC, the federal prospectus and other disclosure requirements may preempt state disclosure requirements. Since CDAs generally fall within one of these two categories, 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 and employer-sponsored plans would apply to CDAs. To the extent there are any CDAs products that do not fall within one of these two exceptions, the disclosure requirements outlined in Section 5.B. of the Model Regulation would apply.

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, 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 laws and regulations to determine if they need to be revised 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, however, the model’s exemptions for registered products and products covered by ERISA employer-sponsored 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 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. Section 6. H.1 of the 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 so that if FINRA’s variable annuity suitability rules are applied to registered 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 require that broker dealers apply the suitability standards for variable annuities to CDA sales, though FINRA general suitability requirements would apply. If a broker-dealer does not apply FINRA’s annuity suitability standards to the sale of a CDA than the safe harbor provision would not be applicable and the suitability requirements of the Model Act would apply. However, individual broker-dealers may apply FINRA annuity suitability standards to CDAs, despite FINRA not requiring it, and that would be sufficient for the safe harbor provision to apply. State regulators should ensure that sales of CDAs are subjected to suitability review either under FINRA standards or state standards. If suitability review is not conducted under FINRA’s suitability standards than the suitability requirements of the Model Act apply.

For sales governed by the Model Act, the Working Group concluded that the existing list of “suitability information” included in Section 5.1 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 the Model Act to specifically address CDAs. It should be noted that among the suitability information to be considered is the existing assets of the consumer “including 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 deposits 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 funds 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 committee has tasked The Receivership and Insolvency (E) Task Force (“RITF”) with determining whether revisions to the model act were needed and warranted to address CDAs. After presentations from the National Organization of Life & Health Guaranty Associations (“NOLHGA”), discussions with taskforce members, and comments from interested parties, the RITF found 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 finding was 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 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 sets forth standards for the advertisement of life products. The CDA working group determined that this regulation should also be applicable 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 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 CDA Working Group concluded that the Model Regulation should be amended to make clear it applies to CDAs. Section 1.C. of 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 CDA 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 CDA Working Group recommended that this model regulation be subject to further review to clarify its relationship to CDAs. The 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 CDA 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 CDA 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 CDA 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.
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 DISCLOSURE 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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Appendix A. Annuity Illustration Example

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. Annuities used to fund:

   (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 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 unless, or until such time as, 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. “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. “Registered product” means an annuity contract or life insurance policy subject to the prospectus delivery requirements of the Securities Act of 1933.

Drafting Note: Registered products include, but are not limited to, contingent deferred annuities.

KL. “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 be given both the disclosure document described in Subsection B and the Buyer’s Guide, if any.
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.
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);

(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, that is an insurance product under State law that is individually solicited, whether the product is classified as an individual or group annuity.

B. “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].

C. “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].

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

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

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

G. “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.

H. “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.

I. “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.

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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 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:

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

(b) Identification of the parties to an annuity;

(c) How product fixed, variable and indexed specific annuity contract provisions features 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 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.

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SECTION 1. PURPOSE

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:

   (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.

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

(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;
(b) Communications with policyholders other than material urging policyholders to purchase, increase, modify, reinstate or retain a policy; and

(c) 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. “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.

C. “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.

D. “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.

E. “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.

F. “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.

G. “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.

H. “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.

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

Drafting Note: Registered product includes, but is not limited to, contingent deferred annuities.
Section 3.  **Applicability**

A. This regulation shall apply to any life insurance or annuity advertisement intended for dissemination in this state. In variable contracts and other 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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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.

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. “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.

B. “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.”

C. “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.

D. “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.

E. “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].

F. “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.

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

H. “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.

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.  

Drafting Note: Registered contracts include, but are not limited to, contingent deferred annuities.
J. “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.

K. “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.

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