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 Nov. 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).

**Ongoing**

- 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.
March 2015 – CDA Working Group has an updated draft “Guidance Document” posted on the CDA Working group website based on discussions at the Fall National meeting. Additional revisions will be made once other groups complete their CDA-related work

- 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.

**Ongoing**

- 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.

**Completed** – Up for adoption by Executive/Plenary at Spring National Meeting.

- 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.

**Completed** – Up for adoption by Executive/Plenary at Spring National Meeting.

- 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).

**Completed** – Up for adoption by Executive/Plenary at Spring National Meeting.

- 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).

**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.

March 2015 – The CDA Subgroup reviewed the issue and recommended making no changes to AG 43 to accommodate CDAs. This recommendation will go before the Task Force for adoption at the Spring National Meeting

- 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.

March 2015 – Revisions to Model #805 were completed by the CDA Subgroup, and will go before the Task Force for adoption at the Spring National Meeting

*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).

March 2015 –
• 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).

March 2015 – The Subgroup adopted revisions to #695. The revisions will go before the Task Force for adoption at the Spring National Meeting.

• 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.

March 2015 – 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.

March 2015 – 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. (See above).

• 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).

March 2015 – E Committee has requested assistance from the Life Actuarial (A) Task Force in addressing this charge (See above).

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

March 2015 – E Committee has requested assistance from the Life Actuarial (A) Task Force in addressing this charge (See above).

**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.

**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 the consumer protection and financial solvency model laws and regulations that 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

A CDA is an insurance product that provides protection against underperforming and downward performing markets in the form of an income guarantee on outside investment accounts owned by an insured. The insurer provides this income guarantee through the collection of on-going charges or fees from within these outside investment accounts. The insured must agree to certain portfolio restrictions and must first deplete their outside investment account assets at the CDA guaranteed income amount and rate according to the contract and prior to the insurer’s assumption of this amount.

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 (“Covered Investments”). 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 Covered 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: accumulation, withdrawal, and payout. First, the CDA goes through an accumulation phase. This phase occurs from the date the CDA is issued until the time the participant insured 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, a notional amount used for calculating permitted withdrawals and the benefit amount, is typically determined by the value of the assets in the...
underlying account of Covered Investments. 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 an insured 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 second phase of the CDA is the withdrawal phase. The withdrawal phase occurs when the participant-insured elects to begin 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-insureds to elect to begin withdrawals at an earlier or later age, in which case, the withdrawal percentage of the benefit base permitted for withdrawals may be adjusted up or down accordingly. During the withdrawal phase no benefit payments are made under the CDA and the insured is making withdrawals solely from the Covered Investments.

The “guaranteed withdrawal amount” under the CDA is the maximum withdrawal that an insured may take without penalty. It 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-insured withdraw funds above the contractually permitted amount, a pro rata reduction of the CDA benefit base and/or the guaranteed withdrawal amount may occur. Excessive withdrawals could also result in termination of the CDA. Under current product designs, the guaranteed withdrawal amount is based on a specified percentage of the value of the CDA benefit base at the time distributions begin.

During the withdrawal phase, an insured still maintains his or her assets in the Covered Investments. 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

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1 A benefit base could also be calculated as premium “rolled up” at a specified rate.
due to loss of value of the Covered Investments though such losses could have the effect of triggering payments earlier under the CDA. Consequently, insurers will typically offer CDAs in connection with Covered Investments that can be effectively hedged and may also 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 insured’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.

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 in cases where 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.

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2 A payout structure could alternatively be based upon a joint life or “life with period certain” structure.
3 Payments may be level or increasing depending upon product design.
4 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.
Products registered with the SEC may only be sold by a registered financial professional through a FINRA licensed broker dealer or recommended by a Registered Investment Advisor. Sales of CDAs through broker dealers are subject to FINRA’s general suitability requirements. Registered 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.

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 insured varies inversely to the 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, under this scenario, when the policyholder insured takes the guaranteed withdrawal amount it will deplete the Covered Investments sooner than anticipated and triggering the CDA benefit earlier than compared to an up market scenario. 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

1 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.
policyholders insureds 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 insured behavior, including lapse rates, investment decisions, and the amount and timing of withdrawals. In this regard, the value of the CDA to an policyholder insured and, correspondingly, the level of risk to the insurer are in many ways governed by policyholder insured behavior. An policyholder insured may wish to place his or her assets in more volatile investments because if the investments increase in value, the increase is added to the CDA’s benefit base, if the investments decrease in value, the benefit base is locked in at the portfolio’s peak. From the policyholder insured’s risk perspective, investment increases mean a higher benefit base and investment losses mean the CDA reaches the payout phase sooner.

Similarly, whether the payout phase will be reached also will depend in part on policyholder insured behavior, and in particular, when the policyholder insured commences withdrawals and whether the policyholder insured takes the maximum allowable withdrawal amount. An policyholder insured 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 insured behavioral risk through product design including restrictions on the type of investment assets that an insured may use with a CDA, limiting 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 insured behavior risks while not being overly restrictive in how policyholders insureds 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 insured changes the assets contained in the underlying account (to determine if the policyholder insured is invested in assets allowed under the CDA contract). If

\footnote{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.}
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

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

C. Reserve Requirements

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

D. Capital Requirements

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

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

Covered Investments, 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 ContingentDeferred 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 when 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 then 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 then 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. I. 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 insurance departments and 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.
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 the consumer protection and financial solvency model laws and regulations that should be applied to CDAs and those which 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 discussion 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 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

A CDA is an insurance product that provides protection against underperforming and downward performing markets in the form of an income guarantee on outside investment accounts owned by an insured. The insurer provides this income guarantee through the collection of on-going charges or fees from within these outside investment accounts. The insured must agree to certain portfolio restrictions and must first deplete their outside investment account assets at the CDA guaranteed income amount and rate according to the contract and prior to the insurer’s assumption of this amount.

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, such as a mutual funds or a managed account (“Covered Investments”). The underlying account is not held or managed by the insurer but is instead held by a related or unrelated third party. The insurer contractually restricts the type of Covered Investments that can be covered by the CDA, but the insurer does not control the Covered Investments. 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: accumulation, withdrawal, and payout. First, the CDA goes through an accumulation phase. This phase occurs from the date the CDA is issued until the time the insured decides to take withdrawals from the Covered Investments, typically upon reaching a certain age such as retirement age. During this phase, the CDA benefit base, a notional amount used for calculating permitted withdrawals and the benefit amount, is typically determined by the value of the Covered Investments\(^1\). As those assets

\(^1\) A benefit base could also be calculated as premium “rolled up” at a specified rate.
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. 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 an insured 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 the CDA is the withdrawal phase. The withdrawal phase occurs when the insured elects to begin 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 insureds to elect to begin withdrawals at an earlier or later age, in which case, the percentage of the benefit base permitted for withdrawals may be adjusted up or down accordingly. During the withdrawal phase no benefit payments are made under the CDA and the insured is making withdrawals solely from the Covered Investments.

The “guaranteed withdrawal amount” under the CDA is the maximum withdrawal that an insured may take without penalty. Withdrawals at or below the guaranteed withdrawal amount do not affect the amount of future withdrawals. However, should an insured withdraw funds above the contractually permitted amount, a pro rata reduction of the CDA benefit base and/or the guaranteed withdrawal amount may occur. Excessive withdrawals could also result in termination of the CDA. Under current product designs, the guaranteed withdrawal amount is based on a specified percentage of the value of the CDA benefit base at the time distributions begin.

During the withdrawal phase, an insured still maintains his or her assets in the Covered Investments. 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 earlier under the CDA. Consequently, insurers will typically offer CDAs in connection with Covered Investments that can be effectively hedged and may also 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 insured’s lifetime.\footnote{A payout structure could alternatively be based upon a joint life or “life with period certain” structure.} In this way, the CDA guarantees lifetime income payments during retirement\footnote{Payments may be level or increasing depending upon product design.}. It is the Working Group’s understanding that CDA products sold to date do not include a death benefit. Since an insured is limited in the amount of periodic withdrawals he or she may take during the withdrawal phase, whether or not a CDA will reach the payout or settlement phase is a function of the performance of the Covered Investments, increases to the CDA benefit base, insured behavior, and the insured’s longevity\footnote{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.}.

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.

\section*{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. In cases where 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 through a FINRA licensed broker dealer or recommended by a Registered Investment Advisor\footnote{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.}. Sales of CDAs through broker dealers are subject to FINRA’s general suitability requirements. Registered 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 include 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.

Another risk that is transferred to the insurer from the insured is market risk. The market risk associated with a CDA is that the amount of benefit to the insured varies inversely to the market performance of the Covered Investments. The value of the Covered Investments may decrease while the benefit base and guaranteed withdrawal amount remain at a higher level. Under this scenario, when the insured takes the guaranteed withdrawal amount it will deplete the Covered Investments sooner and trigger the CDA benefit earlier than compared to an up market scenario. 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 assets related 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 insureds 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”)).

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*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.*
CDA issuers also incur risks based on insured behavior, including lapse rates, investment decisions, and the amount and timing of withdrawals. In this regard, the value of the CDA to an insured and, correspondingly, the level of risk to the insurer are in many ways governed by insured behavior. An insured may wish to place his or her assets in more volatile investments because if the investments increase in value, the increase is added to the CDA’s benefit base, if the investments decrease in value, the benefit base is locked in at the portfolio’s peak. From the insured’s risk perspective, investment increases mean a higher benefit base and investment losses mean the CDA reaches the payout phase sooner.

Similarly, whether the payout phase will be reached also will depend in part on insured behavior, and in particular, when the insured commences withdrawals and whether the insured takes the maximum allowable withdrawal amount. An insured 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 insured behavioral risk through product design including restrictions on the type of investment assets that an insured may use with a CDA, limiting 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 insured behavior risks while not being overly restrictive in how insureds 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 insured changes the assets contained in the underlying account (to determine if the insured is invested in assets allowed under the CDA contract). If an insurer does not receive timely information from the third party asset manager, it will be difficult for the insurer to administer the CDA. Insurers will need to contract with these third-parties to clarify each party’s roles and responsibilities. Similarly, insurers face counterparty risks from the parties from whom they buy hedge instruments, 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 Covered Investments, 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 when 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 then 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 then 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. I. 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 insurance departments and 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
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Contingent Deferred Annuities
Proposed Cancellation Solutions

NAIC Contingent Deferred Annuity Working Group
Spring National Meeting
March 28, 2015
• Introduction and Overview
• Policyholder Initiated and Financial Institution Initiated CDA Cancellations
• Proposed Cancellation Solutions
• Flexibility - Product and Market Differences
• NAIC and State Implementation
Responding to CDA Working Group’s concerns and request, Industry is proposing cancellation solutions that:

• Protect the policyholder.
• Provide the insurer with product design flexibility to meet market needs and manage risks.
• Require at least one cancellation option available to policyholder following a Financial Institution triggered event.
Overview

- Proposed policyholder cancellation solutions made available if a Financial Institution triggers the cancellation of a CDA contract and replacement covered funds cannot be obtained.
- Provisions would apply to new product offerings.
- Provisions disclosed in the prospectus (or product disclosure) and contract, as applicable.
- Multiple options provide insurers the flexibility to protect the policyholder, develop innovative products, meet market needs and manage risk.
Policyholder and Financial Institution Initiated Cancellation Scenarios

**Policyholder Initiated**
- Policyholder Takes Excess Withdrawals
- Policyholder Completes a Full Surrender of Account Value
- Death Claim
- Policyholder Fails to Remit Contract Fees
- Policyholder Does Not Adhere to CDA Investment Guidelines
- Policyholder elects annuitization

**Financial Institution Initiated**
- Financial Institution Arrangement Dissolves
- Financial Institution Terminates Managed Account or no longer offers Investment Platform
- Financial Institution Fails to Remit Contract Fees
- Financial Institution Does Not Adhere to CDA Investment Guidelines
- Financial Institution Becomes Insolvent (e.g. receivership, bankruptcy)

Cancellation Provisions are triggered when a Financial Institution initiates the cancellation of a CDA Contract
# Cancellation Solutions

## 1. Annuity
- Variable Annuity with Guaranteed Living Withdrawal Benefit (GLWB) or
- Variable Annuity with Guaranteed Minimum Income Benefit (GMIB)
- Single Premium Immediate Annuity (SPIA)
- Deferred Income Annuity (DIA)

## 2. Lump Sum
- Present value of future guaranteed income

## 3. Return of Fees
- Portion of insurance fees paid in a lump sum
- Or alternatively in a lifetime income stream

## 4. Other
- Other provisions proposed by insurance company in contract filings (and approved by insurance department)

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*CDA Cancellation Provision Options available on new product offerings to a policyholder during a Financial Institution initiated CDA termination event if insurer cannot find an appropriate Financial Institution replacement. Options will be disclosed in the prospectus (or product disclosure) and contract as appropriate.*
CDA product designs may be different based on market needs and will drive the appropriate offering of Cancellation Provisions. The retirement market is an example of the need for flexibility.

- Retirement plans that offer CDAs are tax-deferred; therefore, tax consequences associated with product conversions most likely will not apply.
- Cancellation Provisions like “Lump Sum Present Value” may be considered plan contributions and could cause unintended consequences to the plan (e.g. contribution testing; violation of IRC contribution limits).
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<tr>
<th>NAIC</th>
<th>State Implementation</th>
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<tr>
<td>• Incorporate reference into the NAIC CDA Guidance Document</td>
<td>• Standard contract provisions at time of filing</td>
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<td>• Develop NAIC Sample Bulletin for states (i.e. RAA, STOA)</td>
<td>• Insurance Departments provide direction to insurers through form filing checklists</td>
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<td>• Implementation can be achieved without change to regulation or statute</td>
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