MEMORANDUM

TO: IIPRC Management Committee
FROM: Brad Harker, Director
Life Insurance Bureau, Pennsylvania Insurance Department
Chair of the Annuity Subgroup of the NAIC's Interstate Compact National Standards (EX) Working Group
DATE: December 3, 2009
RE: Product Standards for Guaranteed Living Benefits for Variable and Non-Variable Annuities, Guaranteed Minimum Death Benefits for Variable Annuities, and Proposed Amendments to the Annuity Application Standard

On behalf of the Pennsylvania Insurance Department, and as Chair of the Annuity Subgroup of the NAIC's Interstate Compact National Standards (EX) Working Group, I would like to offer the following commentary regarding the product standards for Guaranteed Living Benefits ("GLB") for Variable and Non-Variable Annuities, Guaranteed Minimum Death Benefits ("GMDB") for Variable Annuities, and Proposed Amendments to the Annuity Application Standard. These standards are currently pending before the Management Committee and are subject to a public hearing at the upcoming Management Committee meeting in San Francisco.

An issue has been raised regarding the termination provision in these standards, and I would like to provide the Management Committee with additional background pertaining to the development and drafting of these standards by the Annuity Subgroup. These standards were developed over a period of time spanning nearly 5 months, and much of that time was dedicated to discussing and addressing the impact of the sale of annuities containing the GLB and GMDB product features on the secondary market. Please note that these discussions occurred on telephone conferences that were open to participation by ANY interested party. The Annuity Subgroup was concerned that, without a tempered and reasoned limitation on the sale of these products on the secondary market, GMDB and GLB products could be priced so high that these important benefit features might become unafforable for the average consumer.

Concerns were raised by the insurance industry involved in the drafting of the standards that, without preserving their ability to terminate GLB and GMDB benefits upon a change in ownership, investors could have the ability to make significant gains beyond those envisioned by the insurance companies when the products were priced to be sold to individuals. Investors are likely to utilize these benefits in a manner that would always reap the maximum profitability of the contract, while individual annuity purchasers, as a whole, would not always be driven by a profit motive, but would instead utilize the benefits in a manner that best suits the individuals' needs and financial goals. Because of this, consideration was given to the possibility that, without the ability to terminate the benefits upon the sale to an investor, GMDB and GLB products would likely have to be priced significantly higher, taking them out of the range of affordability for consumers.

However, the Annuity Subgroup's consideration of permitting any termination of the GMDB and GLB features generated concerns that were raised by Right, LLC, on behalf of the Life Insurance Settlement Association, and several comment letters were submitted for the Subgroup's consideration. The comments in those letters focused on the premise that annuity owners have a property right in their contracts, including the product features that provide GLB and GMDB, and any restriction on ownership is improper.

Ultimately, after significant debate and consideration of several alternatives, the Annuity Subgroup reached a consensus of the participating regulators, and decided that certain ownership restrictions should be permitted, but only in very limited situations. As such, the "Termination" section in the GLB and GMDB product standards were drafted to provide that the benefit features may be terminated by the insurer when ownership is transferred, EXCEPT when (1) the new owner assumes full ownership of the contract; and (2) the new owner is essentially the same person as the original owner (*e.g.* an individual ownership changed to a personal revocable trust, a joint ownership of husband and wife changed to the surviving spouse when one of them dies, a change to the owner's spouse during the owner's lifetime, a change to a court appointed guardian representing the owner during the owner's lifetime, etc.). The standards also provide that termination is expressly NOT permitted where the assignment is for the purposes of effectuating a 1035 exchange of the contract (*i.e*. the rider may continue during the temporary assignment period and will not terminate until the contract is actually surrendered). It is very important to note that the termination would apply ONLY to the GLB and GMDB, and NOT the underlying annuity contract.

The Annuity Subgroup's decision to permit the limited termination of the additional benefits upon change of ownership rested on the fact that the termination provision is narrowly crafted to maintain an annuity purchaser's ability to transfer ownership without termination of the additional GMDB and GLB product features in situations where the contract is being maintained for essentially the same purpose as that which prompted the initial purchase of the contract. In addition, the Annuity Subgroup believed that limited termination provision achieved our goals of: (1) preserving the current pricing of these products; (2) mitigating against the need for insurers to substantially increase the cost of GLB and GMDB in order to hedge against the potential sale of such benefits to secondary market investors; and (3) preventing these valuable benefits from being priced where they will become unaffordable for many consumers.

The Annuity subgroup also gave much consideration to the fact that many states have approved forms that permit the UNFETTERED and UNLIMITED termination of the GLB and GMDB features by insurers upon change of ownership, so the limited termination provision that was drafted into the product standards actually provided additional consumer protections BEYOND those that are currently in place in many states. Finally, the heart of the Annuity Subgroup's decision to allow the limited termination rested on the fact that the underlying annuity contract is unaffected by the termination provision associated with these additional GMDB and GLB features.

Most recently, comments have been provided that state that the termination provision in the GMDB and GLB standards prevents consumers from being able to eliminate unsuitable annuity products, but I believe that these arguments are misplaced. If a consumer believed that the GMDB that he or she purchased is not an appropriate benefit feature, they can simply terminate it without terminating the contract as a whole. Also, there is a mechanism to address unsuitable sales through the suitability laws of the states, the goals of which are "unwind" unsuitable sales and put consumers who purchase unsuitable products in the same position they were in before the sale.

In sum, I do not believe that the termination provision at issue is anti-consumer. In fact, I think that it is a far better and more pro-consumer standard that what currently exists in most states, thereby meeting the IIPRC's goal of raising the bar in consumer protection via its uniform product standards. As such, I would recommend that the termination provision remain as it is currently drafted in the product standards under consideration before Management Committee.