

December 15, 2011

VIA ELECTRONIC DELIVERY

Department of the Treasury
Federal Insurance Office, MT 1001
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Committee of Annuity Insurers Response to Request for Input on the Report to Congress on How to Modernize and Improve the System of Insurance Regulation in the U.S.

Dear Sir or Madam:

We are submitting this letter on behalf of our joint client, the Committee of Annuity Insurers (the “Committee”),¹ in response to the Treasury Department’s request for *Public Input on the Report to Congress on How To Modernize and Improve the System of Insurance Regulation in the United States* (the “Request”).² Our comments focus on parts (ii) and (iii) of question 12 in the Request, which seek input on the potential consequences of subjecting insurance companies to a Federal resolution authority:

- “On policyholder protection, including the loss of the priority status of policyholder claims over other unsecured general creditor claims;” and
- “In the case of life insurance companies, on the loss of the special status of separate account assets and separate account liabilities.”

The Request relates to a study that the Federal Insurance Office (“FIO”) is preparing in response to a statutory mandate under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”).³ The Dodd-Frank Act did not establish a Federal resolution authority over insurance, and instead deferred to the existing resolution authority under state law.⁴ Congress directed the FIO to prepare a study, however, that considers, *inter alia*, the potential consequences if Congress were to establish a Federal resolution authority over insurance. Consistently with that directive, our comments discuss certain issues that might arise if Congress were to do so.

¹ The Committee is a coalition of life insurance companies formed in 1981 to participate in the development of Federal policy with respect to annuities. The law firm of Davis & Harman LLP represents the Committee on issues relating to Federal income tax laws and the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), and the law firm of Sutherland Asbill & Brennan LLP represents the Committee on issues relating to Federal securities laws and related matters. The Committee’s current 32 member companies represent more than 80% of the annuity business in the United States. A list of the Committee’s member companies is attached.

² 76 Fed. Reg. 64,174 (Oct. 17, 2011).

³ Pub. L. No. 111–203 § 502(p) (2010), *codified at* 31 U.S.C. § 313(p).

⁴ 12 U.S.C. § 5383(e) (generally providing that the liquidation or rehabilitation of insurance companies “shall be conducted as provided under applicable State law.”).

Each of the questions from the Request to which we are responding involves the potential implications of a Federal resolution authority altering the legal rights of persons who own insurance products. The first question relates to the rights of policyholders whose insurance products are backed in whole or part by the insurer's general assets. The second question relates principally to the rights of policyholders whose insurance products are backed by assets the insurer legally segregates from its other assets. A wide range of insurance products fall within these two broad categories, but we focus our comments on annuity and related retirement-funding products, which we refer to herein as "annuity products."

In that regard, the first part of this letter provides background on (A) the types of annuity products potentially affected by a Federal resolution authority, (B) the prioritization of policyholder claims and the special status of separate accounts under current law, and (C) the important public policy goals that annuity products serve and how the prioritization of policyholder claims and the special status of separate accounts help meet those goals. The second part of this letter elaborates on the foregoing by identifying various potential implications of a Federal resolution authority on the use of annuity products with tax-qualified retirement plans. The third part then elaborates on the potential implications of a Federal resolution authority under Federal securities laws that apply to certain types of variable annuity products. The letter concludes by recommending against the creation of a Federal resolution authority because such an authority could (1) usurp the important policyholder protections that state law currently provides to millions of individuals who purchase annuity products as a means of funding a safe and secure retirement, and (2) interfere with Federal securities laws that apply to "registered" annuity products that are based on separate accounts.

I. General Background on Annuity Products

A. Types of insurance products potentially affected by a Federal resolution authority.

Annuity products generally are used to accumulate and distribute retirement savings, including the payment of a retirement income stream that is guaranteed to continue as long as an individual lives. There are many possible ways to categorize annuity products, but for purposes of this letter the following two distinctions are appropriately descriptive.

(1) Qualified vs. non-qualified.

Qualified annuity products are generally purchased in connection with an employer-sponsored retirement plan such as a 401(k) or 403(b) plan, or as an individual retirement annuity ("IRA").⁵ Qualified annuities are subject to various rules under the Internal Revenue Code and ERISA, which in broad terms are aimed at protecting participants and ensuring that plan assets are used to provide retirement benefits. As discussed in more detail below, those rules generally allow annuity products to be used in lieu of (or in addition to) a trust in order to accumulate and distribute retirement benefits. The rules allow this, in part, due to the prioritization of policyholder claims over general creditors and the special status of separate accounts.

⁵ See, e.g., Code § 818(a) (defining "pension plan contract" as a contract purchased in connection with one of various types of tax-qualified retirement plans); Code § 408(b) (defining "individual retirement annuity"). The term "Internal Revenue Code" or "Code" refers to the Internal Revenue Code of 1986, as amended.

Non-qualified annuity products are purchased outside the context of an employer-sponsored retirement plan or IRA. They generally are purchased by individuals who do not have access to an employer-sponsored plan, or to supplement the retirement benefits an individual receives under such a plan. Because non-qualified annuities are not part of an employer plan, they are not subject to ERISA. They are, however, governed by their own set of rules under the Internal Revenue Code that ensure they are used for retirement purposes.⁶ Like qualified annuities, the prioritization of policyholder claims over the claims of general creditors and the special status of separate accounts are critical to the success of non-qualified annuities in providing retirement benefits to consumers.

(2) General account vs. separate account.

An insurer's obligations under the annuity products it issues are backed by its general asset account, one or more separate accounts, or a combination of both types of accounts. The general account holds all of the insurer's assets and supports all of the insurer's liabilities to its policyholders, as well as its liabilities to its general creditors (other than assets and liabilities allocable to certain separate accounts). To the extent that an annuity product is backed by an insurer's general account, all of the insurer's general account assets are available to pay claims under that product. Because those assets also are available to satisfy claims by the insurer's general creditors, a person whose annuity product is backed by the general account is exposed to the credit risk of the insurer as a whole. That risk is typically low, however, due to the comprehensive regulatory regime that governs insurers. That regime includes policyholder claims prioritization (discussed in more detail below), as well as mandatory participation in state guaranty associations, minimum reserve requirements, risk-based capital requirements, and restrictions on the types of investments that insurers can hold in their general accounts.

In contrast to the general account, a separate account holds assets that, pursuant to state law, are segregated from the insurer's general assets and liabilities. In other words, a separate account typically provides insulation from the insurer's general creditors by making the separate account assets unavailable to satisfy claims that are not derived from insurance products based on that separate account. Separate accounts also are given special status for a number of other purposes, as discussed in more detail below.

An insurer's obligations under some annuity products are backed solely by its general account. For example, under a traditional fixed annuity contract, the insurer guarantees a minimum rate of return or a specific dollar amount of annuity payments, and those guarantees are supported entirely by the general account.⁷ Other annuity products are backed principally by one or more separate accounts. For example, under a typical variable annuity contract, neither the rate of return on the policy value nor the dollar amount of variable annuity payments is guaranteed, but instead both fluctuate directly with linked assets such as mutual funds, which the insurer holds in a separate account. Variable annuities also are backed in part by the insurer's

⁶ See, e.g., Code § 72(e) (providing an "income-first" ordering rule for taxing withdrawals from a non-qualified annuity); Code § 72(q) (imposing a 10% penalty tax on certain distributions from a non-qualified annuity prior to age 59½, similar to a penalty tax that applies to qualified annuities); Code § 72(s) (requiring certain distributions from a non-qualified annuity after the holder's death, similar to the rules applicable to qualified annuities); Code § 817(h) (imposing certain investment diversification requirements on non-qualified variable annuities).

⁷ Similarly, fixed index annuities are typically supported by the insurer's general account. They generally provide a guarantee of principal and/or a guaranteed minimum interest crediting rate, coupled with the potential for additional interest credits depending upon the performance of a referenced index.

general account, to the extent that they provide guarantees in excess of the separate account assets (*e.g.*, the guarantee that the annuitant will not outlive an income stream elected under the contract). In addition, some non-variable annuity products are supported by assets that the insurer holds in a separate account, such as certain modified guaranteed annuity products, guaranteed investment contracts, single premium pension annuities, deposit administration contracts, and funding agreements.⁸ The manner in which the general account *vs.* separate account distinction affects policyholder rights if an insurer is financially impaired is discussed in more detail immediately below.

B. Claims prioritization and separate account special status under current law.

(1) Claims prioritization in connection with general account obligations.

Life insurance companies are exempt from Federal bankruptcy laws.⁹ As a result, such laws do not govern the rights of annuity policyholders in the event an insurer becomes financially distressed or insolvent. Rather, state law governs in such circumstances. These state laws generally are based on a model law promulgated by the National Association of Insurance Commissioners (“NAIC”), which establishes the priority that will be given to various classes of unsecured claims against the insurer.¹⁰ Under these laws, policyholder claims are given higher priority than unsecured claims of the insurer’s general creditors.¹¹

(2) Special status of separate accounts as related to policyholder rights.

The Request recognizes that separate account assets and liabilities are given “special status” under the law.¹² In that regard, such accounts are established and operated pursuant to state insurance laws. Those laws, which in general also are based on an NAIC model law,¹³ give special status to separate accounts in a number of ways, including with respect to reserves, permitted investments, valuation of assets, and providing that the income, gains, and losses (realized and unrealized) from separate account assets shall be credited to or charged against the account, without regard to other income, gains, or losses of the insurance company. All of these can be viewed as aspects of the “special status” of life insurance company separate accounts.

In the context of the potential consequences of subjecting insurance companies to a Federal resolution authority, however, the most relevant “special status” that separate accounts receive is that of asset insulation. In that regard, a state’s equivalent of the NAIC model law

⁸ A modified guaranteed annuity, also known as a market value adjusted annuity, is a fixed deferred annuity that provides for a guaranteed rate of interest and that imposes a “market value adjustment” to the cash value upon certain early withdrawals from the contract. Guaranteed investment contracts fund stable value investment options under defined contribution plans. Single premium pension annuities and deposit administration contracts fund defined benefit plans and allow for the plans to settle their benefit obligations with respect to identified participants.

⁹ See 11 U.S.C. § 109(b)(2) (2011) (excluding domestic life insurance companies from the definition of “debtor” for purposes of Federal bankruptcy laws).

¹⁰ Model Law 555, Insurer Receivership Model Act § 801 (NAIC 2007). Most states adopt laws based in large part on the NAIC’s model laws, but the specifics can and do differ from state to state.

¹¹ *Id.*

¹² See also 31 U.S.C. § 313(p)(3)(F)(iii) (2011) (requiring the FIO study to examine “the effects of any Federal resolution authority ... on the loss of the special status of separate account assets and separate account liabilities.”).

¹³ Model Law 260, Model Variable Contract Law § 1 (NAIC 1999).

typically will provide that, if and to the extent provided in the contract, the portion of a separate account's assets equal to the reserves and other contract liabilities with respect to the account will not be chargeable with liabilities arising out of any other business the company may conduct.¹⁴ This means, in effect, that the separate account assets equal to the cash values of the variable annuity products supported by the account are not subject to the claims of general account creditors in the event of receivership, liquidation, or otherwise. Thus, this protection of separate account assets is known as "asset insulation." As discussed in more detail below, when the Investment Company Act of 1940 applies, Federal securities law also effectively mandates insulation of separate account assets.

Asset insulation is a critical component of numerous types of annuity products, but particularly variable annuities. Variable annuity product owners accept and are subject to the risks (and potential benefits) of their selected separate account investments, so it follows that such investments should be segregated from the insurer's other investments. Aside from variable annuity products, life insurance companies may use separate accounts that provide asset insulation to support certain other, "non-variable," types of products, such as modified guaranteed annuity contracts,¹⁵ guaranteed investment contracts, single premium pension annuities, deposit administration contracts, and funding agreements.¹⁶

To the extent that the assets held in an insulated separate account are insufficient to pay claims under annuity products supported by that separate account (*e.g.*, in the case of guarantees in excess of the separate account assets), the policyholders enjoy priority claims against the insurer's general account in the same manner as other policyholders with contracts based on the general account.

C. Public policy benefits of annuity products and how policyholder claims prioritization and separate account asset insulation help achieve those benefits.

Achieving financial security in retirement is a critical goal of all Americans. With the decline of traditional employer-sponsored defined benefit "pension" plans,¹⁷ many struggle to save and build a retirement nest egg of their own, both in qualified defined contribution plans (such as 401(k), 403(b), and similar plans) and outside of such plans. Annuity products help individuals accumulate retirement savings that are protected by policyholder claims prioritization and the special status of separate accounts. Equally important, annuity products also help

¹⁴ *Id.*

¹⁵ See Model Law 255, Modified Guaranteed Annuity Regulation §7A(2)(c) (NAIC 2011).

¹⁶ Although state law facilitates asset insulation for separate accounts, whether such insulation occurs under state law typically depends on terms of the particular contract. For example, under state law asset insulation applies to separate account assets supporting a variable annuity contract, because the contract typically will include any provision that state law requires in order to ensure such insulation. On the other hand, some non-variable annuity products that are supported by separate account assets (such as a modified guaranteed annuity) might not include an asset insulation provision, in which case state law does not insulate the separate account assets supporting that contract from claims by the insurer's general creditors. The NAIC is currently reviewing the use of insulated separate accounts under some types of non-variable insurance products.

¹⁷ In 1975, the percent of private-sector active-worker participants in a defined benefit plan where the defined benefit plan was the only plan was 62%. By 2009, that number had shrunk to 7%. At the same time, the percent of private-sector active-worker participants in a defined contribution plan where the defined contribution plan was the only plan increased from 16% in 1975 to 67% in 2009. See Employee Benefit Research Institute, EBRI Databook on Employee Benefits, Ch. 1 (updated March 2011), available at <http://www.ebri.org/pdf/publications/books/databook/DB.Chapter%2001.pdf>.

individuals convert their nest eggs into a stream of retirement income, which also is protected by claims prioritization and separate account status.

In that regard, converting retirement savings into a sustainable stream of retirement income can be a daunting task for an individual to undertake. In addition to uncertainty about future personal expenses, inflation, and asset returns, it is impossible for an individual to predict how long he or she will live and therefore how long his or her retirement savings will need to last. The risk of guessing wrong on this question – commonly called “longevity risk” – is one that virtually every retiree faces.

Other than defined benefit plans and Social Security, annuity products are the only means by which individuals can obtain guaranteed lifetime income as protection against longevity risk. The Treasury Department has recognized the importance of promoting the use of annuity products to provide lifetime income options in retirement plans and is currently considering comments that the public submitted in response to a *Request for Information on Lifetime Income Options for Participants and Beneficiaries in Retirement Plans*.¹⁸ Annuity products that are based on the insurer’s general account or one or more separate accounts can provide such protection against longevity risk, along with other important protections on which retirees rely (such as protection against inflation or investment risk).

Annuity products have a long history in the employer-sponsored retirement plan context. Many of the earliest plans were arrangements where employers made contributions to group or individual annuity contracts. Today, annuities are used in plans in a variety of ways. For example, the rules governing qualified plans generally require that plan assets be held in trust for the exclusive benefit of plan participants, but a significant exception allows an annuity contract to be used in lieu of a trust – effectively equating an annuity to a trust established for the exclusive benefit of participants.¹⁹ In such cases, where an annuity replaces the function of a trust, the annuity contract will invariably provide an annuity distribution option that participants may elect. Likewise, even where a trust is used to hold plan assets, some plans will invest in annuities and/or provide for annuity distribution options. Other plans hark back to the earliest retirement plans by allowing participants to invest in deferred annuities. These in-plan annuity investment options typically operate as both savings and distribution options.

Annuity products provide benefit guarantees that extend over many years, and consumers have an enormous financial and personal stake in ensuring that the promised benefits will be paid. The state law system, summarized above, of prioritizing policyholder claims over those of the insurer’s general creditors and insulating separate account assets from claims of the insurer’s general creditors helps ensure that the retirement savings accumulation and distribution benefits that annuity products provide will remain available before and throughout retirement. Absent these assurances that an insurer will meet its long-term commitments under the annuity products it issues, consumers (including retirement plans) may be very reluctant to purchase them.

¹⁸ 75 Fed. Reg. 5253, 5255 (Feb. 2, 2010) (seeking input on whether and how the Treasury Department and Department of Labor (“DOL”) should take steps to facilitate “access to, and use of, lifetime income or other arrangements designed to provide a stream of lifetime income after retirement” in light of “the continuing trend away from traditional defined benefit plans to 401(k) defined contribution plans ...” under which employees are increasingly responsible “for ensuring that their savings last throughout their retirement years and, in many cases, the remaining lifetimes of their spouses and dependents.”).

¹⁹ See, e.g., Code §§ 401(f) and 403(a).

If consumers do not purchase annuity products, a significant source of retirement security for both current and future workers would evaporate. As a result, the Committee urges the Treasury Department and FIO to take these considerations into account when assessing the potential consequences of a Federal resolution authority over insurance companies. Policyholder claims prioritization and separate account insulation are critical to the retirement security of millions of Americans who purchase annuity products to fund their retirement. Those protections, as well as other important protections such as state guaranty associations, are based on an interwoven network of state insurance laws that depend on the initiation of a state court proceeding to trigger the protections. As a result, the creation of a Federal resolution authority over insurance could eliminate or seriously disrupt the availability of these important protections to policyholders. For this reason, we recommend against the establishment of a Federal resolution authority over insurance. The remainder of this letter elaborates on these points by discussing the potential implications of a Federal resolution authority on the nation's private retirement plan system and under Federal securities laws.

II. Retirement Plan Implications of a Federal Resolution Authority

American employers and workers have put aside over \$18 trillion in assets to fund retirement,²⁰ and annuity products play a crucial role in that regard. Since 1974, when ERISA was enacted, the law has recognized – and in some cases required – that annuity products support the retirement security of Americans. Annuity products are particularly important as the employment-based private retirement system has shifted from a focus on defined benefit plans to defined contribution plans, because of the need for workers to turn their account-based savings into a stream of income at retirement and the unique ability of annuity products to provide guaranteed lifetime income.²¹

The ways in which annuity products are used in our retirement system are discussed in more detail below. As that discussion explains, such uses generally rely upon both the priority status of policyholder claims over other unsecured general creditor claims and the special status of separate account assets. Accordingly, it is critical to preserve these features of the current insurance regulatory system.

A. The key protections in insurance regulations substitute for trust law protections otherwise applicable to retirement plan assets.

A central goal of ERISA is to ensure the “soundness and stability” of retirement plans and that assets set aside to pay promised benefits are available when employees retire.²² Accordingly, ERISA requires that all retirement plan assets be held in a trust, separate and apart from the general assets of the employer and not subject to the employer's creditors.²³ Congress provided, however, that the trust requirement does not apply where the retirement plan purchases

²⁰ Investment Company Institute, U.S. Retirement Market, Second Quarter 2011 Update (Sept. 30, 2011), available at http://www.ici.org/pressroom/news/ret_11_q2. Total U.S. retirement assets were \$18.2 trillion as of June 30, 2011. This figure includes IRAs, defined contribution plans, private defined benefit plans, government plans, and annuity reserves. Retirement savings accounted for 37% of all household financial assets in the United States at the end of the second quarter of 2011.

²¹ See *supra* notes 17 and 18.

²² ERISA § 2(a).

²³ ERISA § 403(a).

contracts issued by an insurance company qualified to do business in a state.²⁴ An important premise underlying this exception is that an insurance contract provides the kinds of protections afforded to employees when plan assets are held in a trust. This includes the comprehensive regulation of insurance under state law, protection under state guaranty associations, the preferred status of policyholders vis-à-vis other creditors of an insurer, and in the case of a separate account, that under state law the account assets are held separate and apart from the general account assets of the insurer.

B. Only annuities may be used to provide benefits upon the termination of a defined benefit plan.

Congress recognized that pension plans do not last indefinitely and designed orderly procedures for their termination. There are two ways to terminate a defined benefit plan. If the employer is bankrupt and insufficient assets are available to pay all promised benefits, the Pension Benefit Guaranty Corporation (“PBGC”) takes over the plan and pays any shortfall from the premiums it collects under its insurance program. But in a “standard” termination, where an employer terminates a healthy and fully funded plan, Congress provided that the plan must use the plan assets to purchase irrevocable commitments from an insurer to provide all benefits under the plan.²⁵ Congress decided that requiring plans to turn over liabilities for benefit payments to insurance companies was better than allowing terminating plans to continue as “wasting trusts” that ultimately may not be able to pay all retirement benefits. The premise behind this policy is that only annuity products provide the kind of protection to assure that an individual will be paid his or her accrued benefit, an obligation that may not come due for many years.

C. Plan fiduciaries might be precluded from using annuity products if the priority status of policyholder claims and the special status of separate accounts were ended.

Annuity products are used in connection with retirement plans in five primary ways:

- (1) They may be used to fund the plan itself in lieu of a trust.²⁶
- (2) They may be held as an investment asset in a trustee plan.
- (3) In the case of a plan that allows participants to direct the investment of their account, a general account or separate account product may be available as an investment option.
- (4) They are available for purchase when a participant receives his or her benefit (a pay-out annuity).
- (5) They are used to settle a plan’s benefit obligation upon plan termination.

²⁴ ERISA § 403(b). Assets held in ERISA-governed 403(b) plans are required to be invested either in annuity contracts or in custodial accounts that are invested solely in investment companies registered under the Investment Company Act of 1940. *See* ERISA § 403(b)(5).

²⁵ ERISA § 4041(b)(3). In cases where a plan allows for a payment of benefits in an immediate lump sum, the plan may also make a lump sum payment to an employee. In addition, solely where an employee due a benefit is missing, the plan may transfer assets to the PBGC to provide the benefit. ERISA § 4041(b)(3)(A)(ii).

²⁶ *See* Code §§ 401(f) and 412(e)(3).

Under ERISA, plan decisions are made by fiduciaries that are required to act solely in the interests of plan participants and beneficiaries and to act with a high standard of care and prudence.²⁷ In the case of a retirement plan subject to ERISA, the decision to use an annuity product and the selection of the particular insurer are fiduciary acts.

So, for example, the DOL generally requires fiduciaries, in making annuity products available as distribution options from 401(k) plans, to consider the features of the annuity and the ability of the insurer to make future payments due under the contract.²⁸ Similarly, where the fiduciary transfers liabilities of a pension plan to an insurance company, the fiduciary generally must take steps “calculated to obtain the safest annuity available,” considering factors like the lines of business of the annuity provider and other indications of an insurer’s exposure to liability, the structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts, and the availability of additional protection through state guaranty associations and the extent of their guarantees.²⁹

Both the priority status of policyholder claims over other unsecured general creditor claims and the special status of separate account assets are key features of annuity products. While a fiduciary will consider a range of factors in deciding whether to purchase or offer to participants a variable or fixed annuity, depending on the product and its intended use, a fiduciary may be unable to conclude that it can use an insurance product that lacks these features.

D. Insurance companies might be unable to compete effectively for asset management and retirement plan services if the special status of separate accounts is lost.

Insurance companies compete primarily against mutual fund firms and banks to manage retirement assets and provide retirement services.³⁰ Nearly half of the companies in the top 25 defined contribution recordkeepers are insurance companies, and insurance companies appear frequently throughout the list of the largest defined contribution plan asset managers.³¹ These insurance companies commonly offer group variable annuity contracts that facilitate participant investment direction among a menu of investment options. The investment options typically correspond to individual separate accounts or discrete investment divisions, called subaccounts, of the separate account that supports the contracts. These group variable annuity contracts are attractive to plans because the annuity writer or an affiliate provides all of the recordkeeping, distribution, and investment services that are necessary to plan administration.

²⁷ See ERISA § 404(a)(1) (“[A] fiduciary shall discharge his duties with respect to the plan solely in the interest of the participants and beneficiaries and . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”).

²⁸ See 29 C.F.R. § 2550.404a-4.

²⁹ See 29 C.F.R. § 2509.95-1.

³⁰ A number of ERISA provisions suggest that Congress intended robust competition between investment managers, banks, and insurers. See, e.g., ERISA § 3(38) (allowing registered investment advisers, banks, and insurance companies all to act as “investment managers”); § 408(g) (allowing registered investment advisers, banks, broker-dealers, and insurance companies to act as “fiduciary advisers”).

³¹ Pensions and Investments, April 4, 2011, p. 15-16; *id.*, Aug. 8, 2011, p. 14. Many large retirement plan service providers are integrated financial service companies that offer annuities, mutual funds, trust products, and other investments.

To make sense in the market, a group variable annuity product must be competitive with other similar legal structures. Mutual fund firms, for example, hold client assets separate from the assets of the fund manager. If the fund manager goes bankrupt, the fund assets are not at risk.³² Similarly, collective trust products are required under banking and trust law to be held separate from the bank's general account.³³ Where an investor – in this case the retirement plan and its participants – bears the investment risk, it is only fair that the assets are irrevocably “devoted” to that investment. If the separate account supporting the group variable annuity product is not truly “separate” from the insurer, these products could be at a significant competitive disadvantage. Given the unique ability of life insurance companies to provide life annuities, such a result would run contrary to public policy.³⁴

In addition to variable annuity products, in some cases separate accounts also can provide asset insulation for non-variable annuity products, such as modified guaranteed annuity contracts, single premium pension annuities, guaranteed investment contracts, and funding agreements. These types of products can be important components of retirement plans and provide safety and security for retirement plan assets (and, of course, plan participants). To the extent that the separate account assets supporting these annuity products benefit from asset insulation, they may be more attractive and therefore better encourage adequate retirement plan funding.

III. Securities Law Implications of a Federal Resolution Authority

Many variable annuity products (both qualified and non-qualified) are registered as securities under the Securities Act of 1933.³⁵ Likewise, the insurance company separate accounts supporting such “registered” variable annuity products are almost always required to be (and are) registered as investment companies under the Investment Company Act of 1940. Through various provisions noted below, the 1940 Act in effect mandates “insulation” of all registered separate accounts, whether supporting qualified or non-qualified annuity products.³⁶ A Federal resolution authority over insurance companies could be inconsistent with the 1940 Act and its fundamental purpose of protecting investors in investment companies.

The special, protected status of registered separate accounts is provided through a “penumbra” of provisions of the 1940 Act. Section 27(i)(2)(A) of the 1940 Act provides that registered variable annuity products must be “redeemable” securities, and section 2(a)(32)

³² Investment Company Act of 1940 § 17(f) (mandating that the fund's assets be held separately in a custodial arrangement). The Investment Company Act of 1940 is codified at 15 U.S.C. § 80a-1 *et seq.*, and is referred to herein as the “1940 Act.”

³³ *See, e.g.*, 12 C.F.R. § 9.18 (b)(8)(i) (“A bank administering a collective investment fund may not have an interest in that fund other than in its fiduciary capacity.”). In addition, ERISA requires that bank collective trust assets be held in trust. ERISA § 403.

³⁴ *See* United States Department of the Treasury and Department of Labor, *Request for Information on Lifetime Income Options for Participants and Beneficiaries in Retirement Plans*, *supra* note 18 (generally extolling the public policy virtues of lifetime income options in retirement plans).

³⁵ 15 U.S.C. § 77a *et seq.*, as amended.

³⁶ Separate accounts exclusively supporting certain corporate and governmental retirement plans may be excluded from 1940 Act registration and regulation pursuant to section 3(c)(11) of the 1940 Act. In such cases, the asset insulation provisions of the 1940 Act described herein do not apply to the separate account. Nonetheless, such separate accounts may benefit from asset insulation under state law, and in all cases will benefit from the policyholder claims prioritization protection that state law affords to all annuity products.

defines redeemable security to mean that the security holder is entitled to receive approximately his proportionate share of the issuer's current net assets (or the cash equivalent thereof). The "issuer" in this case is the separate account.³⁷ Hence, holders (owners) of variable annuity products supported by separate accounts registered under the 1940 Act are entitled, under the Federal securities laws, to receive their proportionate share of the separate account assets.

Moreover, they are entitled to receive such assets (or the cash equivalent thereof) within seven days. Section 22(e) of the 1940 Act provides that redemption (withdrawal) proceeds must be paid within seven days. Rule 22c-1 under the 1940 Act effectively mandates that the calculation (valuation) of the amount of the redemption proceeds must be as of the close of business on the day of receipt of the redemption request.³⁸ These provisions mean that owners of registered variable annuity products are entitled to withdraw their share of the separate account's assets at any time, and that amount must be paid within seven days. Accordingly, the 1940 Act in effect provides that, to the extent that they represent policy owners' cash values, assets of registered separate accounts are not available for general creditors of the insurance company. Under the 1940 Act, then, these separate account assets are effectively "insulated" from other liabilities of the insurance company.

In addition, the definition of separate account in section 2(a)(37) of the 1940 Act provides that the income, gains and losses from assets allocated to such account are credited to or charged against such account without regard to other income, gains or losses of the insurance company. Perhaps more importantly, Rule 0-1(e)(2) under the 1940 Act addresses asset insulation even more directly: it provides that, as conditions to the availability of numerous exemptive rules (as a general matter, registered separate accounts cannot operate without reliance on at least some of these rules), the separate account assets equal to reserves and other liabilities of the separate account shall not be chargeable with liabilities arising out of any other business of the insurer. Policy owners' cash values in the account are "reserves and other liabilities" of the account. As a practical matter, this Federal rule requires that the assets of registered separate accounts must be insulated from general account liabilities. A Federal resolution authority over life insurance companies might overrule or nullify the separate account asset insulation and other important investor protections provided by the 1940 Act, and for that reason we recommend against the creation of such an authority.

In that regard, SEC-registered separate accounts are a crucial element in the retirement savings of millions of Americans, both in the context of qualified plans (including IRAs) and in the context of non-qualified annuity products. For example, variable annuity products are an extremely valuable way for millions of Americans to save for retirement with the opportunity to keep pace with (or outpace) inflation, and otherwise realize the potential returns of market investments. The owners of such products accept and are subject to the risks (and potential benefits) of their selected separate account investments; those investments should not also be subject to the insurer's general account investment risks and other general account liabilities.

³⁷ See *Prudential Ins. Co. v. SEC*, 326 F.2d 383, 388(3rd Cir. 1964) (holding that the separate account is the issuer of the security and that variable separate accounts are investment companies under the 1940 Act). See also section 2(a)(22) of the 1940 Act.

³⁸ Specifically, paragraph (a) of Rule 22c-1 requires that the redemption or surrender value must be based on the current net asset value next computed after receipt of the redemption request, and paragraph (b) generally requires that the net asset value must be computed at least once daily, Monday through Friday. As a practical matter, registered separate accounts compute their accumulation unit values (their equivalent of a mutual fund's net asset value) every business day as of the close of regular trading on the New York Stock Exchange.

IV. Conclusion

The loss of either policyholder claims priority or separate account insulation could thwart the expectations and legal protections for the retirement funding and financial security of millions of Americans. Those legal protections, as well as other important protections such as state guaranty associations, are based on an interwoven network of state insurance laws that depend on the initiation of a state court proceeding to trigger the protections. As a result, the creation of a Federal resolution authority over insurance companies could eliminate or seriously disrupt the availability of these important protections to policyholders, and also could overrule or nullify the separate account asset insulation and other important investor protections provided by the 1940 Act. For these reasons, we recommend against the establishment of a Federal resolution authority over insurance companies.

* * * * *

The Committee appreciates this opportunity to comment. Should any questions arise in connection with our comments, or if we can be of any further assistance to the FIO in preparing its report, please contact either of the undersigned.

Respectfully submitted,



Joseph F. McKeever, Esq.
Davis & Harman LLP
1455 Pennsylvania Avenue, NW, Suite 1200
Washington, DC 20004
202.347.2252
jfmckeever@davis-harman.com



Stephen E. Roth, Esq.
Sutherland Asbill & Brennan LLP
1257 Pennsylvania Avenue, NW
Washington, DC 20004
202.383.0158
steve.roth@sutherland.com

Attachment

The Committee of Annuity Insurers

The Willard Office Building

Suite 1200

1455 Pennsylvania Ave., NW

Washington, D.C. 20004

AEGON Group of Companies, Cedar Rapids, IA
Allstate Financial, Northbrook, IL
Aviva USA, Des Moines, IA
AXA Equitable Life Insurance Company, New York, NY
Commonwealth Annuity and Life Insurance Co.
(a Goldman Sachs Company), Southborough, MA
CNO Financial Group, Carmel, IN
Fidelity Investments Life Insurance Company, Boston, MA
Genworth Financial, Richmond, VA
Great American Life Insurance Co., Cincinnati, OH
Guardian Insurance & Annuity Co., Inc, New York, NY
Hartford Life Insurance Company, Hartford, CT
ING North America Insurance Corporation, Atlanta, GA
Jackson National Life Insurance Company, Lansing, MI
John Hancock Life Insurance Company, Boston, MA
Life Insurance Company of the Southwest, Dallas, TX
Lincoln Financial Group, Fort Wayne, IN
MassMutual Financial Group, Springfield, MA
Metropolitan Life Insurance Company, New York, NY
Nationwide Life Insurance Companies, Columbus, OH
New York Life Insurance Company, New York, NY
Northwestern Mutual Life Insurance Company, Milwaukee, WI
Ohio National Financial Services, Cincinnati, OH
Pacific Life Insurance Company, Newport Beach, CA
Protective Life Insurance Company, Birmingham, AL
Prudential Insurance Company of America, Newark, NJ
RiverSource Life Insurance Company (an
Ameriprise Financial Company), Minneapolis, MN
SunAmerica Financial Group, Los Angeles, CA
Sun Life of Canada, Wellesley Hills, MA
Symetra Financial, Bellevue, WA
The Phoenix Life Insurance Company, Hartford, CT
TIAA-CREF, New York, NY
USAA Life Insurance Company, San Antonio, TX

The Committee of Annuity Insurers was formed in 1982 to participate in the development of federal tax and securities law policies with respect to annuities. The member companies of the Committee represent more than 80% of the annuity business in the United States.

December 15, 2011