SUTHERLAND

THE Committee OF Annuity Insurers
www.annuity-insurers.org

January 17, 2017

VIA ELECTRONIC MAIL
William.Carmello@dfs.ny.gov.

Mr. William B. Carmello
Chief Life Actuary
New York State Department of Financial Services
One Commerce Plaza, 19th Floor
Albany, New York 12257

Re: Life Insurance and Annuity Non-Guaranteed Elements
Proposed Regulation 210
I.D. No. DFS-48-16-0006-P

Dear Mr. Carmello:

We are writing on behalf of our client, the Committee of Annuity Insurers (the "Committee"). The Committee is a coalition of 29 of the largest and most prominent issuers of annuity contracts whose member companies represent more than 80% of the annuity business in the United States. Many member companies, either directly or through affiliates, do business in New York and some are domiciled in New York.[1]

We thank you and your colleagues for having taken the time to meet with several Committee member representatives on January 6, 2017, and for your consideration of the Committee's significant concerns. As a follow-on to that discussion, we appreciate the opportunity to submit these comments to the New York State Department of Financial Services (the "DFS") regarding the proposed addition of Part 48 to Title 11 NYCRR ("Regulation 210").

We respect your objectives of ensuring that life insurance and annuity purchasers understand how the various elements of the products they've purchased will perform, and that insurers do not change those elements improperly. As issuers of annuity contracts, the Committee's member companies share your objectives, recognizing that product designs responsive to consumer needs are not always simple or easy to understand. Nevertheless, for the reasons discussed during our meeting and outlined below, we respectfully submit that applying the Regulation 210 framework to annuities would be misplaced and have serious negative consequences for the annuity market in New York.

---

[1] A list of the Committee's member companies is attached as Appendix A.

I. Introduction

These comments relate solely to the potential application of Regulation 210 to annuity contracts, including both individual annuity contracts and participant certificates under group annuities (collectively, "annuity contracts" or "annuities"). This letter expresses no views regarding the application of Regulation 210 to life insurance policies, and nothing in the comments set forth below is intended to, or should be taken to, infer or imply anything regarding life insurance policies.

As proposed, Regulation 210 would apply to all types of annuity contracts, including traditional fixed annuities, excess interest annuities, multi-year guarantee annuities ("MYGAs"), modified guaranteed annuities (with market value adjustments), fixed indexed annuities (including equity indexed annuities) ("FIAs"), and variable annuities; it would apply to both immediate and deferred annuities (including longevity annuities); and it would apply to various types of optional benefits (including both guaranteed living benefits and death benefits). These comments generally apply to all of the above, unless otherwise stated or the context otherwise requires.

II. Applying the Regulation 210 Framework to Annuities Would be Misplaced and Have Serious Negative Consequences for the Annuity Market in New York

We recognize that the important province of insurance regulation generally is both to protect consumers and to help ensure insurance company solvency, and with respect to any particular regulatory initiative to balance those goals in an appropriate manner. However, for the reasons discussed below, we respectfully submit that (1) applying Regulation 210 to annuities would further neither of these goals in any meaningful or significant way, and indeed may be contrary to both of them; (2) Regulation 210 does not take into account significant differences between annuities and life insurance policies; and (3) the DFS has other methods to address any concerns or abuses relating to non-guaranteed elements in annuities. Therefore, we respectfully submit that annuities should be completely excluded from Regulation 210. We suggest possible alternative approaches in Part III of this letter, below, that we believe will better achieve DFS's goal of protecting New York annuity purchasers.

A. Background: The Use and Importance of Non-Guaranteed Elements in Annuities

Like Americans nationwide, New York consumers have been losing, and will continue to lose, access to the retirement benefits afforded by defined benefit or traditional pension plans. Instead, for retirement and other long-term financial planning they must increasingly rely on defined contribution plans (including 401(k) plans and IRAs) and their own "non-qualified" savings and investments. Annuities of all types are a key if not essential component in both of these areas. Annuities provide significant benefits to those saving for retirement and those already in retirement, such as payouts that are guaranteed for life (only annuities can provide this guaranteed benefit), guaranteed safety of principle and a minimum rate of return, competitive

rates of return (on fixed annuities) or a multitude of investment choices (on variable annuities), tax deferral on inside build-up, and a variety of optional living and death benefit guarantees.

Annuity purchasers have benefited greatly from the ability insurers have had for many decades to offer annuity contracts with meaningful guarantees that also afford the opportunity for greater benefits and contract values through the use of a variety of non-guaranteed elements. Traditional nonparticipating fixed annuities locked in one stated interest rate and offered no opportunity for greater benefits. Long ago, the annuity industry and state insurance regulators realized that for annuity products to be attractive to consumers – indeed even to remain relevant and to compete with other investment vehicles – annuity contracts generally needed to offer more than benefits tied solely to conservative long term interest rate guarantees. The advent of variable annuities in the 1950s and 1960s, the introduction of fixed annuities with excess interest rate crediting features in the 1970s, and the invention of fixed indexed annuities in the 1990s all have been important engines for the survival and growth of the annuity market. They all sprung from the premise that annuity products whose benefits and values cannot keep up with inflation or offer the possibility of returns comparable to other investments likely would be unattractive to consumers.

However, the fundamental actuarial underpinnings of annuity contracts with non-guaranteed elements turn on the ability of insurers to adjust the non-guaranteed elements in response to a variety of factors – factors that often change very quickly. This in turn means that insurers must be able to change non-guaranteed elements in annuities reasonably quickly. For example, many factors go into the determination of declared interest rates on fixed annuities and into the interest rate crediting formulas in fixed indexed annuities and index linked variable (or structured) annuities. These factors not only include expected investment income, but also the market environment, market trends and competitive pressures, and expected inflows and outflows from the product line (*i.e.*, policy owner behavior). For fixed annuities, Treasury and other market interest rates that insurers look to in order to set current interest crediting rates can change very quickly, and for fixed indexed annuities, the rapidly changing prices of options on market indexes affect the participation rates and caps that insurers can offer on their products – both for new issues and for the amount of interest that can be credited during new terms on in-force contracts.[2] For variable annuities, maintaining insurers' ability to reasonably adjust non-guaranteed elements, such as annuity purchase rates, is critical to avoid the potential mispricing of long-term obligations related to lifetime annuity payouts.

Put another way, insurers must utilize significant risk management techniques in order to set the non-guaranteed elements in their annuity products – particularly the credited interest rate component. They often must be able to do so quickly in a competitive marketplace taking the various factors noted above into account without risking or endangering their solvency. This includes both the asset side (managing their investments, including hedging activities utilizing options) and the liability side (managing their obligations to fulfill their guarantees and promised

[2] Changes in these various factors of course mean that interest rate spreads (profit margins) necessarily change over time, sometimes rapidly if measured over short periods of time. Insurers therefore adjust non-guaranteed elements in order to reflect changes in these factors in an attempt to maintain their intended profit margin, not to increase profit margins.

benefits under their outstanding annuity contracts). Non-guaranteed elements ("NGEs"), and the ability to adjust them as and when needed, are a very essential component of insurers' risk management.

B. The Current Regulatory Framework in New York is Robust in Addressing NGEs in Annuities

To our knowledge, there have not been any complaints or any widespread problems identified that involve the non-guaranteed elements of annuity contracts. In addition, the DFS has not stated any annuity-specific public policy reason for applying Regulation 210 to annuity contracts. The lack of complaints or problems related to annuities should confirm that the existing New York regulatory framework applicable to annuity contracts and their non-guaranteed elements has served the public well, and that there is no need for imposing an additional framework such as that set forth in Proposed Regulation 210 on annuity contracts.

Of course, under the existing New York regulatory framework, the DFS has general approval authority over policy forms, including disapproving forms that are prejudicial to policyholders, or unjust, unfair or inequitable (Section 3201(c)(1) and (2)).[3] In addition, the standard nonforfeiture law for annuities (Section 4223), in prescribing minimum surrender values for fixed and fixed indexed annuities, effectively requires annuity contracts to credit guaranteed minimum interest rates to contract value. Importantly, Section 4232(a) already regulates the crediting of "additional amounts" of interest to annuity contracts subject to Section 4223, since it provides that no such additional amounts shall be credited except upon (i) reasonable assumptions as to investment income, mortality, and expenses; (ii) a basis equitable to all contract holders of a given class; and (iii) written criteria approved by the board of directors or a committee thereof.

Moreover, the DFS has specific approval authority over variable material (*i.e.*, non-guaranteed elements), that requires the filing and prior DFS approval of a Memorandum of Variable Material (*aka* Statement of Variability).[4] Only specified items may be variable. The filing with the DFS must contain a "detailed explanation of how and when the item may vary" and "sufficient detail to determine the nature and scope of variation for each variable item." All variable numerical items must provide the range (*i.e.*, a minimum and maximum) and "all ranges must be reasonable." Any other variation is considered the use of an unapproved policy form. Taken together, this existing regulatory framework already significantly limits the extent and circumstances when insurers can change non-guaranteed elements in annuities.

[3] All statutory references are to the New York Insurance Laws.

[4] Life Bureau Filing Guidance Note, Guidance Date: 08/08/2008; Updated 11/01/2010: "Filing Guidance on the Use of Variable Material for Individual Annuity Contracts and Life Insurance Policy Forms" (the "Guidance"). (See also "New Procedure and Filing Guidance for Approval of Memorandum of Variable Material" from the DFS, 9/16/2005).

In addition, insurance companies and their agents are subject to market conduct regulations covering advertising (Regulation 34-A), suitability (Regulation 187), and replacement (Regulation 60). Existing disclosure regulation, including regulations governing illustrations, effectively address the manner in which non-guaranteed elements can be presented and described to prospective purchasers and existing contact owners.[5] Also, the Annual New York Market Conduct Profile provides DFS with information regarding compliance controls on Board responsibilities on non-guaranteed elements under Sections 4231(g)(1) and 4232 of the New York Insurance Law.[6]

Therefore, the DFS already has tools that are more than sufficient to regulate the use of and changes in non-guaranteed elements in annuities.

C. Applying Regulation 210 to Annuities Would Be Contrary to the Interests of Annuity Purchasers and Insurers

Against this backdrop, Proposed Regulation 210 would impose significant unworkable impediments to insurers' ability to change the non-guaranteed elements in their annuity contracts. We respectively submit that the framework set forth in Proposed Regulation 210 as applied to annuity contracts would work to the detriment of consumers and, although clearly not intended, also would impede insurers' risk management functions, which could ultimately impact insurers' solvency.

Regulation 210 would impose onerous requirements for disclosure and specified notice and filing periods that must elapse (60 days, 120 days, and/or 15 days) before the insurer could make an "adverse" change to a NGE (even where the change is within the range already approved by DFS in the Memorandum of Variable Material filing, and previously disclosed to contract owners).[7] Accordingly, the practical impact of Regulation 210 is to require insurers to set and file any change in credited interest rates or FIA factors,[8] and other NGEs) months in advance, and require months to effect any changes (at least for in-force annuities).[9] These

---

[5] We note that DFS has under consideration amendments to Regulation 74 (Life and Annuity Cost Disclosure and Sales Illustrations).

[6] *See* Market Conduct Profile, COMPLIANCE §8; *see also* SUPPLEMENT (addressing discretionary rates and other discretionary elements).

[7] We understand that, although not clearly stated in the proposed regulation, the intent of DFS is that each of the advance disclosure and notice and filing requirements would apply only to adverse changes in NGEs as defined in the regulation, and that DFS intends to revise the proposed regulation to make this clear.

[8] The term "FIA factors" includes FIA caps, participation rates, and spreads, as well as other specifications such as crediting methods (monthly, annually, averaging, point to point), the length of crediting periods, and other variable items that affect the amount of interest credited to a FIA contract.

[9] It generally will not be possible to 'predict' financial markets far enough in advance (with sufficient reliability and accuracy) to decide on crediting rates and FIA factors, and then to make the required filings with DFS early enough so that DFS has sufficient time to review and respond to the change prior to the effective date of the change.

advance disclosure, notice and filing requirements are simply not economically feasible for annuities. They would severely limit the ability of insurers to respond flexibly to market changes – including financial, operational and competitive market changes. This lack of nimbleness to make appropriate adjustments will in turn have negative consequences for both New York consumers and insurers.[10]

Moreover, it is not only the time periods for the notices and filings that are untenable. The notice requirements in their entirety would not be workable or suitable for annuities. Under Proposed Regulation 210, annuity issuers likely will feel compelled to file most rate decreases (for both in-force contracts and new issues) with DFS. Any requirement for a filing with respect to each particular change, even if limited to adverse changes, would not be practical. Regardless of when such filings are made, they would be burdensome to prepare, will likely overwhelm DFS with notifications, and will not accomplish the goal that we understand DFS is trying to achieve (a system whereby DFS can provide guidance to insurance companies before they implement changes). Any notification period is unlikely to be effective in accomplishing that goal.

To understand this, it is important to recognize that annuity pricing is more sensitive to changes in economic and financial market conditions and market interest rates than pricing for life insurance policies. Although annuities have a number of NGEs (credited interest, annuity purchase rates, and perhaps certain fees and charges), annuities generally have only one principal source of revenue – the interest rate margin or spread on fixed and fixed index annuities.[11] Annuity issuers are very sensitive to changes in this source as a result. In contrast, life insurance products have other sources of revenue, particularly through the use of mortality margins.

In addition, life insurance policies typically are managed on a portfolio basis due to the expectation of periodic premium payments. This means that the effects of economic changes can be layered in over time. Most annuities, even flexible premium annuities, receive one lump sum payment. There is a fundamental difference between managing a periodic premium product and a single premium product especially when the interest rate margin is the only significant source of revenue. Similarly, changes in mortality rates (that ultimately may affect COI charges) develop relatively slowly, over time. But changes in market interest rates and hedging costs,

---

[10] Because the requirements of Proposed Regulation 210 are so prescriptive and detailed, and in many respects unclear, insurance companies will face challenges in continuously meeting all the requirements. For annuity issuers, these compliance challenges will be magnified by the frequency of certain adjustments (*e.g.,* changes in new interest rates) and the large number of products that many annuity issuers offer and have in force. The requirements of Proposed Regulation 210 therefore could have the unintended consequence of setting up insurers for regulatory compliance failures. Insurers could find themselves in a vulnerable position of being found to have failed the Regulation 210 requirements in some way, subjecting them to potential fines, penalties, and unknown remediation, despite a full-scale good faith effort to comply with the Regulation.

[11] The equivalent for variable annuities would be the mortality and expense risk charge and possibly an asset-based administrative charge; these are more likely to be guaranteed rather than non-guaranteed elements, and if they are NGEs then any changes are limited and circumscribed by the terms of the contract, the Memorandum of Variable Material filed with and approved by DFS, and for SEC registered variable annuities, by the disclosure, anti-fraud, and other applicable provisions of the federal securities laws.

which significantly affect annuity pricing, can and often do occur very rapidly.[12] This makes the notice and filing requirements in Regulation 210 very onerous for annuities to an extent vastly different than life insurance.

Finally, for annuities, the standard non-forfeiture law (Section 4223; the "SNFL") provides minimum interest rate and other related consumer protections. The SNFL's minimum interest rate requirement for annuities contrasts with the non-forfeiture requirements for life insurance which do not have explicit minimum interest rate requirements. The express requirement for a minimum rate of interest on annuities subject to Section 4223, combined with the fact that annuity writers look principally to interest margin or spread, creates a fundamentally different financial and regulatory backdrop for NGEs in annuities than for life insurance.

Moreover, the Committee notes that adverse consequences that changes in NGEs can have for life insurance policies (potential policy lapse, possible loss of insurance protection that may not be replaceable, or the need to pay substantially higher premiums) do not apply to annuities. Changes in annuity non-guaranteed elements, such as charges or crediting interest rates (generally) only affect the rate of cash value build-up; they do not result in loss of benefits, lapse, or require additional or higher premiums to prevent lapse. A lower rate of return on annuities does not lead to the same consequences as COI increases in life insurance policies.

The Committee submits that, because the advance disclosure, notice and filing requirements in Regulation 210 would severely constrain the ability to change NGEs in annuity contracts, it would result in insurance companies doing business in New York establishing more conservative NGEs both at annuity contract issue and thereafter. This will generally mean lower interest credits, lesser benefit levels, and/or higher charges for annuity purchasers and owners in New York (resulting in less retirement income) than are now available.[13] Some annuity writers could even be forced to consider shutting down certain annuity product lines in New York due to a determination that the strictures on annuity pricing changes imposed by Regulation 210 either will ultimately make the product line nonviable from a competitive perspective or create unacceptable risk management challenges. This could lead to a less competitive annuity marketplace in New York and result in consumers, needing the unique longevity protection that only annuities can provide, purchasing other, less suitable, investments instead.

[12] For example, with respect to hedging (investing and risk management) for a fixed index annuity contract or an index linked variable annuity contract, option costs and values can change substantially from day to day, let alone over a 60 or 120 day (or even 15 day) period.

[13] Alternatively, this could cause some insurers to set interest rates and optional benefit levels and guarantees (and other NGEs) more generously, which may not be financially maintainable, and significantly delay insurers from adjusting them appropriately, both of which could lead to solvency concerns.

III. Possible Alternative Approaches

Because of the significant differences in how NGEs operate and function in annuity contracts as opposed to in life insurance policies, annuities should not, in the Committee's opinion, be subject to the same regulatory requirements governing NGEs as life insurance and therefore should be excluded from Regulation 210. However, if the DFS has remaining concerns regarding changes in NGEs in annuities, then the issuance of a circular letter (or other Guidance) could be a more appropriate method of addressing them. For example, NY § 4232(a) allows NGEs in annuities, subject to certain conditions and requirements, so DFS might consider issuing a circular letter that requires annuity issuers to file an "annual certification" of compliance with NY §4232(a) with respect to any adverse changes in NGEs in annuity contracts delivered or issued for delivery in New York. Presumably, the certification would have to be made by an appropriate company officer; in this regard, we note that Proposed Regulation 210 contains a definition of "qualified actuary" that could be used in any such circular letter.

Apart from the advance disclosure and notice and filing requirements, we understand that Regulation 210 also was intended to implement certain DFS interpretations of §4232, and these interpretations could be included in the same circular letter. Finally, a circular letter could express any concerns that DFS has on particular matters relating to NGEs in annuities (*e.g.*, adverse changes in NGEs following a sale of a block of business, or change of ownership or management of an insurer) and explain how various requirements of New York insurance laws and regulations apply in such situations and what obligations they impose on insurers.[14]

As we've suggested here, the Committee is confident that the concerns the Department may have with respect to NGEs in annuities can be handled in their entirety in a circular letter so that annuities can be completely excluded from Regulation 210. However, if the DFS isn't comfortable with a circular letter approach, then another option might be incorporating an annual Section 4232(a) certification requirement for annuities into Regulation 210 while excluding annuities from the rest of the Regulation's requirements.

* * * * *

[14] The DFS has used the circular letter process very effectively to communicate its views and interpretations for many years. For example, DFS recently addressed certain types of unsuitable annuity replacements in Insurance Circular Letter No. 7, "Unsuitable Deferred-to-Immediate Annuity Contract Replacements and Betterment of Rate Calculations" (December 8, 2016); in 1998, it addressed the applicability of Section 4232(a)(2) to the crediting of enhanced interest rates on dollar cost averaging accounts in Circular Letter No. 33, "Dollar Cost Averaging Accounts" (November 23, 1998).

Please feel free to contact the undersigned at 202.383.0528 (steve.roth@sutherland.com) or Maureen Adolf at 212.389.5028 (maureen.adolf@sutherland.com) if you have any questions or if there is anything we can do to assist you.

Sincerely,

THE COMMITTEE OF ANNUITY INSURERS

By: Stephen E. Roth

Stephen E. Roth
Sutherland Asbill & Brennan LLP

cc: Scott Fischer, Executive Deputy Superintendent
James Regalbuto, Deputy Superintendent for Life
Maureen Adolf, Sutherland Asbill & Brennan LLP

APPENDIX A

THE COMMITTEE OF ANNUITY INSURERS

AIG
Allianz Life
Allstate Financial
Ameriprise Financial
Athene USA
AXA Equitable Life Insurance Company
Fidelity Investments Life Insurance Company
Genworth Financial
Global Atlantic Life and Annuity Companies
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Jackson National Life Insurance Company
John Hancock Life Insurance Company
Life Insurance Company of the Southwest
Lincoln Financial Group
MassMutual Financial Group
Metropolitan Life Insurance Company
Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Pacific Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
Symetra Financial Corporation
The Transamerica companies
TIAA
USAA Life Insurance Company
Voya Financial, Inc.