NATIONAL CONFERENCE OF INSURANCE LEGISLATORS
LIFE INSURANCE & FINANCIAL PLANNING COMMITTEE
LAS VEGAS, NEVADA
NOVEMBER 18, 2016
DRAFT MINUTES

The National Conference of Insurance Legislators (NCOIL) Life Insurance & Financial Planning Committee met at the Paris Las Vegas Hotel on Friday, November 18, 2016 at 3:45 p.m.

Senator Mike Hall of West Virginia, Chair of the Committee, presided.

Other members of the Committee present were:

Sen. Jason Rapert, AR	Sen. Jerry Klein, ND
Rep. Martin Carbaugh, IN	Sen. David O'Connell, ND
Rep. Joseph Fischer, KY	Rep. Don Flanders, NH
Rep. Jim Gooch, KY	Sen. Bob Hackett, OH
Rep. Jeff Greer, KY	Sen. Roger Picard, RI
Rep. Bart Rowland, KY	Rep. Bill Botzow, VT
Rep. George Keiser, ND	Rep. Kathie Keenan, VT

Other legislators present:

Rep. Matt Lehman, IN	Rep. Marguerite Quinn, PA

Also in attendance were:

Commissioner Tom Considine, NCOIL Support Services, LLC
Paul Penna, Executive Director, NCOIL Support Services, LLC
Will Melofchik, Legislative Director, NCOIL Support Services, LLC

MINUTES

Upon a motion made and seconded, the Committee unanimously approved the minutes of its July 14, 2016 meeting in Portland, Oregon.

FOLLOW-UP DISCUSSION REGARDING DOL FIDUCIARY RULE/UPDATE ON LITIGATION

Tom Roberts, Esq., of Groom Law Group, provided a brief update on the litigation challenges facing the DOL Fiduciary Rule. Mr. Roberts stated that the Rule is probably the most sweeping revision to the laws effecting the sales of financial products. The rule makes anyone who is engaged in the process of selling a financial product, including an insurance contract, a fiduciary, and therefore requires them to comply with the "Best Interest Standard of Conduct." The "Best Interest Standard of Conduct" requires the salesman to make recommendations that are not only prudent and but without regard to his/her own financial interest. There were six separate cases challenging the Fiduciary Rule, the three most significant have been consolidated in the case in Texas: US Chamber of Commerce, the ACLI and the Indexed Annuity Leadership Council vs. the Department of Labor.

The three other cases were brought by groups that were affected by the way the rule treated the sale of fixed index annuity products: One case was the NAFA case brought in Washington DC the second being the Market Synergy Group vs. the DOL brought in Kansas. Both cases argue that the way the DOL treated sellers of fixed index annuity products was fundamentally unfair, arbitrary, and capricious and requires them to comply with conditions that are virtually impossible to comply with. Another case was brought by Thrivent Financial for Lutherans which has embedded in its Articles of Incorporation an obligation to arbitrate claims and one element of the DOL Rule is that it prohibits arbitration clauses involving class action cases.

He went on to review the substantive claims underlying these cases. He continued by saying that the cases challenge the DOL's statutory authority to have enacted the rule, and what the department did was take a particular term that was in the ERISA statute of 1974 which stated that providers of "investment advice" are fiduciaries and they reinterpreted in a way that it captured virtually all sales people. One of the industries claims is that the department has taken a term that was well understood for more than 40 years and they reinterpreted it in a way that it was never meant to be interpreted. He went on to say that the cases have argued that the DOL has stretched its rulemaking authority to reach not only sales to employer based plans, plans that are subject to ERISA, but also tried to extend its reach to the IRA market and by trying to reach the IRA market, the litigants argue that the DOL is really acting well beyond their statutory boundaries. He continued by stating that there is a fundamental argument that Congress has been clear that it intends for securities to be regulated by the SEC and fixed annuity products to be regulated by the states - and now the DOL is coming in in a way that Congress never intended and is heavily regulating the sale of the fixed annuity products and fixed indexed annuity products and there are also very interesting claims about the fiduciary rule hampering commercial free speech in violation of the first amendment.

He continued by saying that procedural claims are what you would expect. There are claims that the Department acted arbitrarily and capriciously, particularly in regard to its treatment of fixed indexed annuity products – where at the last minute they took them out of the key exemptions. And there are also issues about the attention that was given to the costs of complying with the rule vs the societal benefits of applying the rule.

Mr. Roberts stated that there were three hearings which were held to date on the cases. He continued by saying that one of the cases had led to a published decision – the NAFA vs. Perez case, brought in the District of Columbia. The Judge issued a 92-page opinion in favor of the DOL. Judge Moss rejected all of the industry claims and stated that he thinks that when Congress chose to use term "Investment Advice" as a definition of what a fiduciary is, he believes it is a reasonable construction of that term to extend to all people who advise in the sale of investment products. Judge Moss found no problem with the Departments requirement as a condition of compliance that parties to a transaction enter into a private contract, a best interest contract, in which the seller of a financial product agrees with the buyer that any recommendation of the product would be in the buyers best interest. Mr. Roberts stated that the DOL required the parties to enter into a contract in an effort to create an enforcement right on the part of IRA holders as under current law they have no enforcement rights. By requiring parties to enter into a contract the DOL gives IRA's holders a basis to bring future class action claims against sellers of financial products.

Mr. Roberts then mentioned that yesterday at a hearing in the case brought by ACLI and others, Judge Lynn had a very different view in that she was more favorably disposed to the industry than Judge Moss had been in the DC case.

John Magnan from ACLI stated that their senior council was at the hearing and it was his understanding that the judge was trying to make the distinction between the consolidated case and the NAFA case. Mr. Mangan stated that they were encouraged by the tone of the questions asked by Judge Lynn about the private right of action and perhaps that this rule overstepped Congress. Mr. Mangan stated that within the next 30 days Judge Lynn would be writing her opinion and that we would know pretty soon what her position is and whether she has a chance to stay this or not. Mr. Roberts added that if the DC circuit holds in favor of the Department and the 5th Circuit in Texas holds in favor of the industry, there would be a split and that split would most likely be headed to the US Supreme Court.

Mr. Roberts moved on to speak about President Elect Trump. Many members of the public, as well as the industry, were surprised with the result of the election but the industry was particularly surprised as they did not foresee the possibility of what a Trump administration might mean to the DOL Fiduciary Rule. He stated that the President Elect has a member of his economic team, Anthony Scaramucci, who stated that President-Elect Trump was going to repeal the Fiduciary Rule as soon as he gets into office. He added that, perhaps, President-Elect Trump, being a populous as he is widely regarded, might support the rule. He went on to say that most folks are expecting that when he takes office, he will delay the applicability of the rule and he can do that through an interim final rule making process without going to notice and comment and so right now there is a rule that is scheduled to become applicable on April 10, 2017 and the expectation is that it would get bumped some months down the road. He added that President-Elect Trump can also choose to change the rule by reopening the rule making process for public comment but he can't do that with a stroke of a pen and needs to be deliberate with the way he intends to proceed. Another thing he might do is to instruct his justice department not to defend the rule in litigation. He added that Congress could override a piece of rulemaking - you need 60 Senators to cut off a debate on an act of the nature. He concluded that it seems like we are heading toward a likely split through the two circuits.

Mr. Magnan added that there were so many moving parts and that he felt that the main issue all along is that the rule will have a detrimental effect on small investors and small employers access to retirement plans. He went on to say that they are working with the NAIC to strengthen state regulation of suitability. They are also looking at the regulatory possibilities that could exist under a new President – a delay in the operational date is something that seems possible.

Sen. Keiser asked Mr. Roberts to explain the difference between Suitability and Best Interest Standard. Mr. Roberts stated that Suitability is the standard of conduct that governs the sale of securities by broker dealers. Under the Suitability standard, a broker dealer must make a recommendation of a product to his client that is suitable for meeting the clients needs. In other words, the client needs to be fitted with an appropriate product. That being said, the broker is permitted to recommend products that would generate compensation for him – that of course is the broker's business, the business of selling. The Best Interest Standard focuses on the compensation element of the recommendation. It states that the seller of a product must not only recommend a product that is suitable but must make a recommendation that is “without regard to the salespersons own financial interests.” That is the crux of the debate – is it possible/feasible to take commission salespeople and say “you must sell products that are not only suitable but when you make a recommendation you must do so without regard to your financial interest.”

Sen. Keiser asked that, hypothetically, if he is sold a product and it is front end loaded and it costs $20,000 and he gives the seller $100,000, he then has $80,000 going to work for him. There is another product that is 1% but he paid throughout so he invested $99,000 today vs. $80,000, he is going to make more money assuming they are on the investment pattern. Sen. Keiser stated that he could argue that the first product was not well suited to him and that suitability is part of the cost of that product – whether it is a commission or any other form of remuneration. Mr. Roberts responded by stating he agreed that the cost of services is an element of suitability and FINRA has brought regulatory action over the years to brokers who have recommended inappropriately costly products. Mr. Roberts stated that he struggles with how one can reconcile the need to incentivize a sales force with a rule that says that the salesforce may not consider their own financial interests.

Sen. Hall asked doesn’t a broker have to disclose, very clearly, in the documents given to a client what commissions is being paid under the new rule. Mr. Roberts responded by stating that under the new rule if you are proposing to sell a financial product and are hoping to earn a commission, you are a fiduciary with an impermissible conflict of interest. The rule says you are a fiduciary because you are recommending a product, you hope to earn a commission so, therefore, you are conflicted from proceeding unless you can fit into an exemption that the DOL has designed and the exemption that they hope to channel most selling activity through is called the “BIC (best interests contract) Exemption” which is very complex and has a number of disclosure elements in it.

Sen. Hall stated that, in other words, it requires the customer to ask for the disclosure and it is not ordinarily just given to them. Some companies, however, can ask their brokers to disclose if they want. The broker can choose the level of compensation that they could take and then disclose it. Mr. Roberts stated that what Sen. Hall stated was the law as it existed today. Under the DOL regime, that would cease to be the case because the BIC exemption requires that all salespeople who are customer facing be financially indifferent about what product they sell. They would be earning the same amount whether they sold a mutual fund, a fixed annuity or a variable annuity.

Sen. Hall asked that if you are in the managed money world, and you are not a commissioned sales person or you’re not commission driven, don’t you have a fiduciary standard already? Mr. Roberts said they are. Mr. Roberts went on to say that not all fiduciaries are equal in the eyes of the law. There are fiduciaries in the securities world who are registered under the Investment Advisors Act of 1940 and those fiduciaries are permitted to have conflicts provided that they disclose to their clients in writing what the conflicts are and the client authorizes the advice notwithstanding the conflicts. There are also ERISA fiduciaries - the legal ramifications are quite different than those under the securities law because under ERISA, it would be illegal for a fiduciary to proceed in the face of a conflict unless an exemption is available to relieve the conflict.

Sen. Rapert stated that he appreciated Mr. Roberts update and added that on Sunday there is a Resolution being considered by the Executive Committee that was passed out of this Committee at the last meeting to oppose the Fiduciary Rule. He asked if it is proper to say that, the most egregious thing about the Fiduciary Rule from the DOL is that they have not only have gone out of bounds on what would normally be their turf, but that it seems they have gone against all recommendation to slow down and take input from the SEC and Congress? Mr. Roberts responded by stating that that was a fair statement and that the DOL would argue with that and they would say that they have consulted with the SEC. Mr. Roberts agreed with Sen. Rapert's statement that the DOL has entered an area of rulemaking where they are fundamentally engaged in rules that would govern the distribution of financial products in a way that they have never done before.

Sen. Rapert stated to Sen. Hall that he received a letter on November 16th that was address to the executive committee, which will be provided to the executive committee, from the Financial Services Institute in Washington D.C. that represents nearly 20,000 independent financial advisors – they have added their voice to a list of other organizations that are involved in a lawsuit with the federal government, asking that the DOL listen to Congress and to slow down.

RECENT ACTIVITY SURROUNDING PRINCIPLE BASED RESERVING (PBR)

Eric Cioppa, Superintendent of the Maine Bureau of Insurance and Secretary-Treasurer of the NAIC, began by stating that in July of this year, PBR became effective by a super majority of states adopting the model legislation. PBR will become effective 1/1/17 with a three-year phase in period. He went on to say that what it does is moves us away from the old way that life insurers calculate reserves to contemplate the new complex products that are out there and modernizes how life insurers set reserves in the life insurance space. He added that one of the reasons why the NAIC has been so aggressive in pushing this is because the NAIC has been criticized for allowing a lot of captives that work around the reserves and it is hoped that by the implementation of PRB, it will eliminate the need for captives that are dealing with what they feel are redundant reserves with term-life and whole-life.

Supt. Cioppa stated that this is a complex area that will be new to everyone so what NAIC has done is set up what they call the "Valuation Analysis Working Group" which is going to be a subset of experts from the States. They are going to help states review their models, review what life insurers are doing on PBR and the NAIC has also hired three additional actuaries to review the models. He stated that this is a solvency issue and some insurers are going to reduce their reserves and some insurance will have to increase their reserves. They can use their own experience to help set their reserves. He did note that there were some exemptions. (i.e.- if you have less than three hundred million for an individual or six hundred million for a group, and an RBC of over 450% you would be exempt from PBR). He concluded by thanking the committee and the states for their implementation.

Kate Kiernan of ACLI stated that the threshold for enacting PBR was 42 states, 75% of premium volume and, to date, they have actually reached 46 states and 85.7% of the US Life Insurance market. She went on to say that they are awaiting some legislation in MA that has made it way out of the joint committee of financial services and they are hopeful that it will pass before the end of the year and the changes would go into effect as of January 1st. Ms. Kiernan stated that they were looking at Alaska, NY and Wyoming and that there has been some activity NY and the new superintendent of the Department of

Financial Services has indicated that she is interested in moving forward with implementation. Ms. Kiernan stated that there was some movement in Alaska during their last legislative session but that it did not pass and they are hopeful that the other two states will be passing the legislation.

Nancy Bennett, Senior Life Fellow with the American Academy of Actuaries (ACA) stated that she cannot underestimate the importance of moving to this new regime. She went on to say that as exciting as PBR is, it does bring some challenges to both regulators and insurers. Consequently, there are some “guard rails” that were built into the methodology. She stated that PBR is a risk focused dynamic method for calculating reserves and will be used in the calculation for capital requirements as well. PBR has been in the making for 15+ years and it has taken so long because this idea had a lot of merit but there was also a lot of reluctance to move to this paradigm for calculating reserves. The framework first began with variable annuities which started back in the early 2000’s but what is in the valuation manual that has passed is really a hybrid between what could be described as a rule based approach or a pure PBR and economic based approach. It will have limited scope in terms of products and restraints in methodology. The PBR method by design is a dynamic method that is intended to change over time as things change over time subject to continuous review and improvement. If it is seen in 3, 4, or 5 years from now that the results are not as intended or desired, changes could be made from there.

She went on to say that it was important to remember why we are here and that it is because the current valuation methods have a lot of shortcomings. The current reserving has fundamentally been unchanged for 150 years and even though there are more complex products being offered, the reserving mythology was not keeping up with the changes. PBR modernizes the valuation framework so that it is consistent with the products and the benefits that are being desired by consumers and sold by insurance companies. It is more principle based/economically focused rather than a rigid rule. The current valuation process is formula based. With the principle based approach, we are moving more toward a more complex approach but instead of being based on a one size fits all formula, with prescribed one size fits all assumptions, it is a more model based calculation. It uses a model of an insurance companies’ policies and therefore reflects all the risks the insurance company takes in selling those policies. It is based on the actual experience of that particular insurance company. As a dynamic approach, it reflects the current economic conditions so it doesn’t just lock things in at issue.

There are several benefits that come with PBR for both regulators as well as consumers and insurers. One key issue is that it addresses/incorporates all of the risks the insurer takes on with issuing some of these policies. The previous one size fits all approach, although it was easy to calculate, had certain risks that were missing from calculating the reserve. The PBR approach addresses all the identifiable and material risks that an insurer takes on. The result of a PBR approach is that it right sizes the reserve. It was known that the existing reserve system produced redundant or over reserves for some products but for other products the reserve were not sufficient. The benefit to the consumer is that they are not being over charged because the insurer has to hold overly redundant or excessively conservative reserves. Moreover, the reserve and the reserve methodology is more consistent with how an insurance company manages its risk. You don’t have the system where the insurance company goes off and calculates a regulatory requirement. You are able to leverage off the systems the insurance company uses to manage its risk with the systems that are used to calculate the required reserves. Also, one of the aspects of the PBR approach or, more specifically, the valuation manual, is that it simplified or facilitated an easier way for the reserve standards to be updated. In the current approach, if there was a new product that came out and it was identified that the reserve formula doesn't really address it, you would go through it and update it with an actuarial guideline or maybe a regulation that would update it and then it would have to pass through all the different states. With the valuation manual that is in place today, it is much simpler to make the changes to the valuation manual and then have that follow through in the different states. What it means is that the valuation standards will stay more up to date with changes of the product that are offered.

Most importantly, the principle based reserve does come with a minimum floor. It is recognized that with all the benefits of PBR, it is a new paradigm and there will be challenges. For regulators, we are looking at a system now that is based on a model, a very complex model of an insurance company's assets and the liability of the products that it holds. That is a much different approach of calculating a reserve than just a simple formula on a spreadsheet. Developing modeling expertise within the regulatory community will be essential to have a successful implementation of PBR. The regulators will also be getting much more information about a company's experience which is good, but that means that they will also be getting a lot more data and it will impose a data management challenge particularly at the beginning. The other item is that regulators like to have a system that allows them to compare reserves across companies, so right now because everything is so customized with PBR, it will take a little while to develop or have some industry wide benchmarks based on experience data.

Life insurers are also going to have some implementation challenges, notably, there is going to be more governance as well as more sophistication required in the valuation process and their ability to model. The reserves themselves will also be more volatile because they are not set as they will change from period to period therefore explaining that volatility and explaining those financials will take more time. PRB is a good thing but it is seen by some as a "brave new world". It is important to understand that there are certain prescriptive and limiting elements that have been built into the system and it is understandable that there would be some discomfort among regulators and others that monitor or look or review the financials of an insurance company. Some of these prescriptive and limiting guardrails could be considered traditional guardrails. It is likely that some may go away once everyone gets more comfortable and some may remain permanent. PBR only applies to new policies issued after the first of the year and it will not have any effect on existing policies in place. The effect of PBR on a company's processes and financial results will take several years to see how that will come into play. Reserves will also remain subject to an asset-adequacy analysis and an actuarial opinion.

In terms of the impact on PBR, because it is going to be phased in over a long period of time, it is difficult to predict. It would be fair to say that on the vast majority of policies there won't be a great deal of impact. On whole life policies, you will see very little impact, on term insurance policies you will probably see a reduction in reserves and then on some universal life policies, you will see some reserves go down and some reserves go up. It is further anticipated that insurance companies will likely change their product design so, for those products, if left unchanged, would have seen a large increase in reserves but because of the PBR, it is likely that those products will be modified so that they do not see that big reserve increase.

PBR is a major paradigm shift and many people have been working on this for many years and while it comes with challenges, it really modernizes the valuation techniques. Sen. Keiser stated that when PBR was passed, a provision was put in that gave the commissioner the authority to exempt specialized and small companies from PBR. He then asked if the working group was going to establish baseline criteria that commissioners can use across the states for consistency for that exclusion? Supt. Cioppa stated that premiums thresholds were put in -- three hundred million for individual insurers and six hundred million for groups along with the 450 RBC requirement.

UPDATE ON NAIC UNCLAIMED PROPERTY MODEL

Supt. Cioppa stated that the NAIC established the Unclaimed Life Insurance Benefits Working Group - they completed their work on their model and they will be voting on it shortly. He stated that it is not intended to duplicate the good work that NCOIL has done. They looked at the model, kept a lot of the same features and added an 18 month look-back period for lapsed policies, a semi-annual look-back for lapsed policies as well as a number of other features. He stated that consumers are going to benefit from both models if they have any unclaimed life insurance policies. He stated that 19 states have a lost policy locator which was implemented and the NAIC is in the process of implementing one nationally that will help as well. Supt. Cioppa acknowledged that NAIC needs to communicate better with NCOIL when developing Models that NCOIL has already weighed in on.

John Mangan stated that a letter was written to the NAIC working group on October 25 outlining some of the ACLI's remaining concerns with the draft NAIC model. He went on to state that the ACLI raised the question of whether the second model is necessary given the fact that there is an NCOIL model that they have supported and is in effect in 23 states and pending in a couple more states. Further, he added that he knows that the NCOIL model is an effective approach and has resolved many of the issues that came up during some of their settlement conferences ACLI has had with some of their companies. Even in states that do not have the NCOIL model, they have started to modify their practices to in essence comply with it. The Uniform Law Commission has also updated it Uniform Unclaimed Property Act and it is consistent with what NCOIL put together. Mr. Mangan concluded by stating that they wanted to congratulate the NAIC on its lost policy locator service.

LIFE INSURANCE DISCLOSURES PROVIDED TO CONSUMERS

Kate Kiernan stated that currently there are comprehensive regulations protecting consumers' interests in annuity sales. From product development to advertising to sales, life insurers offering annuities must comply with state and federal laws and rules that help protect consumers' interest. On the State regulatory side, as insurance products, annuities are regulated by the insurance department and the laws and regulations include product and content marketing rules, sales practice requirements, and free-look provisions – if an annuity purchaser is not satisfied with the product, it can be returned to the insurance company for a full or partial refund depending on the type of annuity. Most "free look" periods last 10 days but rules vary from state to state.

Ms. Kiernan went through a few of the NAIC models: Annuity Disclosure Model Regulation; Variable Annuity Model Regulation; Suitability in Annuity Transactions Model

Regulation; the use of Senior-Specific Certification and Professional Designations; and the Life Insurance and Annuities Replacement Model Regulation. There are two other models but not many states have adopted them and the NAIC is looking at whether they need to amend them: the Modified Guaranteed Annuity Model Regulation and the Annuity Non-Forfeited Model Regulation. Ms. Kiernan touched briefly on the federal laws and regulation stating that federal securities laws give the SEC authority to supervise securities including variable annuities. FINRA, a self-regulatory organization which the SEC oversees, sets rules that governs the sales practices of broker-dealers. There are a number of rules under both of those entities. Ms. Kiernan stated that two disclosure documents must be given to individuals at the time of an annuity application: NAIC Annuity Buyers' Guide and a Comprehensive Annuity Disclosure Document. The NAIC Buyers' Guide covers both fixed and variable deferred annuities. The fixed guide includes a separate section for Indexed Annuities. The Buyer's Guide covers a lot of information in easy to understand language and includes: The different types of annuities, how they work, how they accumulate and pay out, a description of fees, charges, adjustments and different options such as guaranteed living benefits, taxation of annuities; for variable annuities, how account values may change, and for index annuities, how different crediting rates work.

She stated that the NAIC Annuity Disclosure Model outlines a comprehensive list of elements that need to be in the disclosure document that is given to applicants. They include: information about the insurer, a description of the contract and benefits, the guaranteed and non-guaranteed elements of the contract, how interest is credited, the available benefit income options, how withdrawals and surrenders may reduce the contract value, death benefits, a summary of the tax status of the contract, the impact of riders such as guaranteed living benefits, fees, and how guaranteed and index rates are applied. She continued by adding that companies may provide prospective purchasers with illustrations governed by statutory law. If provided, they must include both the narrative and numeric portions and include how benefits may be calculated; and there are standards to ensure they are easy to understand and are not misleading. Sales of variable annuity products must be accompanied by a prospectus and on at least an annual basis, companies must provide contract holders with a report of the status of their annuity contracts including cash values, amounts credited, loan activity, etc. Ms. Kiernan added that companies must make their annuity disclosure recordkeeping available to state regulators for market conduct purposes. She also stated that State adoption of the NAIC Suitability in Annuity Transactions Model Regulation, the NAIC Annuity Disclosure Model Regulation, Use of Senior-Specific Certifications has been robust and ACLI actively supports further state adoption of those models.

Tomasz Serbinowski, an Actuary from the Utah Insurance Department, stated that he went on to say that he is speaking for himself and not his employer. Mr. Serbinowski stated that Guaranteed Lifetime Withdrawal Benefits (GLWB's) and CDA's are very similar. GLWB's, offered typically with a variable annuity, allows you take a certain number of withdrawals without worrying about depleting your fund. CDA's have almost the same features but stands alone and could be offered to someone who has a 401 (k) and doesn't want to move the money to a variable annuity. This would afford them the opportunity to make safe withdrawals.

He proceeded by saying that what CDA's typically help you withdraw money from a 401(k) or a similar account. The insurers are not underwriting the life in this case but are underwriting the fund. They look at how risky the fund is. It will typically have restrictions on the fund and typically will define a benefit base that would be used to determine fees and allowable withdrawals, the purpose to make sure if your fund goes down before you start withdrawing, somehow the amount of money you can take out is specified upfront. He stated that more and more people face retirement without defined benefit plans. In the old paradigm, you typically retired with a pension and if you had a fund on the side it might be used to supplement. Today, when people retire with 401(k) and other assets you have to figure out how to manage withdrawals. Retirees have the risk of outliving their assets – known as longevity risk. CDA's major attraction is that it does not require anyone to turn over assets at once to the insurance company. There are other tools but they require you to take assets and turn them over on day 1 to the insurance company. People are reluctant to do that.

Mr. Serbinowski stated that the problem with whether consumer disclosures are adequate is that CDA's and GLWB's are insurance features – when you buy insurance consumers know they are spending money, not making money. Consumers buying homeowners insurance, auto insurance, health insurance, etc. generally view such products as an expense. Consumers don't expect to be financially be "better off" when they purchase insurance. However, current illustrations of GLWB's and CDA's may lead consumers to believe that such products are likely to increase their wealth. Consumers may not be able to gauge the level of fund performance under which they are better off with the insurance. Additionally, GLWB's and CDA's typically allow insurers to control the risk through changes to allowable funds and feel levels. Current illustrations also do not explicitly state the fees. In realty, over the first 10 years, fees may add up to a third of the initial investment. Under many scenarios, over the lifetime of the product, fees may exceed initial investment. Illustrations also do not differentiate between the fund depletion due to fees vs. market performance and longevity.

In response to a question of whether a CDA is likely to pay off, Mr. Serbinowski stated it depends on the allowable investments and fees charged – more aggressive investments will tend to increase the value to consumers but it may be limited by the insurer. Also, higher fees will tend to lower the value to the consumer. Mr. Serbinowski stated that showing cumulative fees and fund value in the absence of a CDA might improve consumer understanding of the product and enhanced disclosures may help consumers make informed decisions and lead them to alternative solutions. Enhanced disclosures may also result in changes to marketing practices.

Sen. Hall stated that Mr. Serbinowski was correct in that fees were not laid out as they were contained in the prospectus and asked if his suggestion was to see the fees laid out as he presented. Mr. Serbinowski stated that if he were to buy the product, he would like to see all fees but he is not an average consumer. Sen. Hall asked if Mr. Serbinowski felt the fees were fair in terms of the risk the company was taking on in hedging the position in case of a bad market. Mr. Serbinowski stated that they may very well be fair but he is not trying to say they are not fair. He is saying that if you look at it in a different way, maybe you would buy a different product.

Cmsr. Considine asked if there were any comparisons to see what is the impact on the consumer of instead of the percentage of the investment on a year by year basis, if the consumer paid a much larger upfront investment (on a $500,000 corpus, if they paid a $50,000 upfront) and there was no percent on a year by year basis, which of those scenarios is the consumer better off? Mr. Serbinowski stated that If you pay up front, it may be very risky to the insurance company. These products pose some very big challenges to the insurance company as well. Cmsr. Considine asked a question about the rate of the return being phantom - if the value goes down below a certain level, are you still charged as if it hit at a certain level. Mr. Serbinowski stated he was not sure if he understood the question but 2% is charged to the benefit base, not to the account value. Cmsr. Considine asked if he was correct in stating that the actual value in the account might be $200,000 but the consumer pays 2% on $400,000? Mr. Serbinowski said yes, that is how most operate.

ADJOURNMENT

There being no further business, the Committee adjourned at 5:22 pm.