AMERICAN ACADEMY *of* ACTUARIES

An Overview of Contingent Deferred Annuities

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Nancy Bennett, FSA, CERA, MAAA
Senior Life Fellow, American Academy of Actuaries[1]

A Contingent Deferred Annuities (CDAs) is a relatively new product that offers longevity risk protection, thus providing a possible solution to protect against a person's risk of outliving one's assets in retirement:

- A CDA provides guaranteed lifetime income payments if an investment account is exhausted during the life of the annuitant through allowable lifetime withdrawals and/or poor investment performance.

- The investment account contains the "covered assets"— typically mutual funds or managed accounts. The covered assets are not owned by the insurance company and remain under the control of the policyholder.

- A designated portion of the policyholder's investment account is "wrapped" with the CDA in order to guarantee a stream of income payments. In other words, the CDA provides a benefit layered on top of the investment account. The policyholder begins a withdrawal program defined within the CDA contract, such as, for illustrative purposes only, withdrawing 5% from the covered assets annually. In the event the value of the covered assets drops below zero, the insurance company would guarantee the 5% withdrawal benefit and make the annual payments to the policyholder.

- Whether or not the policyholder receives any benefit from the CDA policy is *contingent* upon the covered assets dropping below zero. The covered assets will drop below zero if the market performance has depleted the value of the assets or if the policyholder's withdrawals have depleted the assets due to the number and/or amount of the withdrawals over the policyholder's lifetime.

- A CDA may not be suitable for all consumers, but can provide an effective solution to protect against longevity risk – a risk that many consumers are not prepared to face.

[1] The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

The CDA design establishes a lifetime income floor for purchasers at or near retirement while still allowing them to take advantage of potential market returns. A CDA is essentially a stand-alone *guaranteed living withdrawal benefit*, thus providing many of the same benefits and sharing many of the same risks associated with the guaranteed living benefits issued as part of *variable annuity* (VA) contracts with living benefits. A guaranteed living benefits feature is part of most variable annuity sales today; however, many consumers and advisors prefer to leave the consumer's assets in managed investment accounts, rather than transferring the investments to an insurer's VA. CDAs provide a guaranteed living benefit to those consumers that do not want to transfer their investments to an insurance company.

The current regulatory environment surrounding CDAs can be characterized as uncertain:

- Regulatory Authority
  - Whether to define product type – annuity or financial guaranty product?
  - Do existing state laws allow this type of product to be sold?
- Consumer Protections
  - Suitability standards
  - Disclosure requirements
  - Do CDAs provide sufficient value to the consumer? Are CDAs a valuable product for the consumer?
- Financial Solvency Requirements
  - Do existing capital and reserve regulations cover CDAs?
  - Are CDAs covered by state Guaranty Fund Associations?
  - Are company risk management practices sufficient to manage the risks of CDAs? Are regulators equipped with sufficient information from companies and with sufficient tools and capabilities to regulate the risks created by CDAs?

Summary Conclusions:

The potential size of the CDA market is significant due to retirees' need for longevity protection. However, a CDA is may not be suitable for all consumers, but can provide an effective solution to protect against longevity risk – a risk that many consumers are not prepared to face. Careful evaluation of the product by regulators is important to protect consumers and ensure that insurers are able to manage the risks and pay the promised benefits. Contingent deferred annuities highlight the general need for a demonstrated understanding of the risks created by these products through both sophisticated company enterprise risk management practices and appropriate regulatory oversight.

The American Academy of Actuaries is currently engaged in a year-long initiative to examine existing public policy measures to promote lifetime income and approaches to protect against longevity risk. In the view of the Academy's Life Practice Council, CDAs can be part of the solution because they provide protection against longevity risk. From a consumer's perspective, CDAs can be a beneficial product because the product offers a solution to longevity risk exposure.

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For more information, contact Academy Senior Life Fellow Nancy Bennett (bennett@actuary.org) or Academy Life Policy Analyst John Meetz (meetz@actuary.org; 202/223-8196).

Additional Resources
http://www.actuary.org/pdf/naic/CAWG_final_comment_Letter_to_A_Committee_111028.pdf
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