Draft: 9/19/10 with AAA Annuity Illustration Work Group Comments as of 9-30-10
Model 245

The NAIC solicits comments on this draft. Underlining and overstrikes show the changes from the existing model. Comments should be sent by email to Jennifer Cook at jcook@naic.org.

ANNUITY DISCLOSURE MODEL REGULATION

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Section 1. Purpose

The purpose of this regulation is to provide standards for the disclosure of certain minimum information about annuity contracts to protect consumers and foster consumer education. The regulation specifies the minimum information which must be disclosed and the method for disclosing it in connection with the sale of annuity contracts. The goal of this regulation is to ensure that purchasers of annuity contracts understand certain basic features of annuity contracts.

Section 2. Authority

This regulation is issued based upon the authority granted the commissioner under Section [cite any enabling legislation and state law corresponding to Section 4 of the NAIC Unfair Trade Practices Act].

Section 3. Applicability and Scope

This regulation applies to all group and individual annuity contracts and certificates except:

A. Immediate and deferred annuities that contain no non-guaranteed elements;

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B. (1) Annuities used to fund:

(a) An employee pension plan which is covered by the Employee Retirement Income Security Act (ERISA);

(b) A plan described by Sections 401(a), 401(k) or 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer,

(c) A governmental or church plan defined in Section 414 or a deferred compensation plan of a state or local government or a tax exempt organization under Section 457 of the Internal Revenue Code; or

(d) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor.

(2) Notwithstanding Paragraph (1), the regulation shall apply to annuities used to fund a plan or arrangement that is funded solely by contributions an employee elects to make whether on a pre-tax or after-tax basis, and where the insurance company has been notified that plan participants may choose from among two (2) or more fixed annuity providers and there is a direct solicitation of an individual employee by a producer for the purchase of an annuity contract. As used in this subsection, direct solicitation shall not include any meeting held by a producer solely for the purpose of educating or enrolling employees in the plan or arrangement;

C. Structured settlement annuities;

D. [Charitable gift annuities;]

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E. [Funding agreements; and].

F. Non-registered variable annuities issued exclusively to an accredited investor or qualified purchaser as those terms are defined by the Securities Act of 1933 (15 U.S.C. Section 77a et seq.), the Investment Company Act of 1940 (15 U.S.C. Section 80a-1 et seq.), or the regulations promulgated under either of those acts: and offered for sale and sold in a transaction that is exempt from registration under the securities Act of 1933 (15 U.S.C. Section 77a et seq.).

Drafting Note: States that regulate charitable gift annuities should exempt them from the requirements of this regulation. States that recognize or regulate funding agreements as annuities should exempt them from the requirements of this regulation.

G. (1) Transactions involving variable annuities or other registered products in compliance with Security and Exchange Commission (SEC) rules and the Financial Industry Regulatory Authority (FINRA) rules relating to disclosures and illustrations, provided:

(a) That this exemption will not be in effect on and after January 1, 2013 unless the SEC has adopted and implemented the use of summary prospectus form or forms to be used applicable to variable annuities transactions;

(b) That this exemption will be in effect again if the SEC adopts and implements the use of such summary prospectus form or forms after January 1, 2013.

(2) The delivery of the Buyers Guide specified in Appendix A is not exempt from this regulation for sales of variable annuities

(3) Nothing in this subsection shall limit the commissioner's ability to enforce the provisions of this regulation or to require additional disclosure.

Section 4. Definitions

For the purposes of this regulation:

A. ["Charitable gift annuity" means a transfer of cash or other property by a donor to a charitable organization in return for an annuity payable over one or two lives, under which the actuarial value of the annuity is less than the value of the cash or other property transferred and the difference in value constitutes a charitable deduction for federal tax purposes, but does not include a charitable remainder trust or a charitable lead trust or other similar arrangement where the charitable organization does not issue an annuity and incur a financial obligation to guarantee annuity payments.]

B. "Contract owner" means the owner named in the annuity contract or certificate holder in the case of a group annuity contract.

Deleted: C. "Determinable elements" means elements that are derived from processes or methods that are guaranteed at issue and not subject to company discretion, but where the values or amounts cannot be determined until some point after issue. These elements include the premiums, credited interest rates (including any bonus), benefits, values, non-interest based credits, charges or elements of formulas used to determine any of these. These elements may be described as guaranteed but not determined at issue. An element is considered determinable if it was calculated from underlying determinable elements only, or from both determinable and guaranteed elements.

C. ["Funding agreement" means an agreement for an insurer to accept and accumulate funds and to make one or more payments at future dates in amounts that are not based on mortality or morbidity contingencies.]

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D. “Generic name” means a short title descriptive of the annuity contract being applied for or illustrated such as “single premium deferred annuity.”

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E. “Guaranteed elements” means the premiums, credited interest rates (including any bonus), benefits, values, non-interest based credits, charges or elements of formulas used to determine any of these, that are guaranteed and determined at issue. An element is considered guaranteed if all of the underlying elements that go into its calculation are guaranteed.

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F. “Illustration” means a presentation or depiction prepared for and provided to an individual consumer that includes non-guaranteed elements of an annuity contract over a period of years.

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Note: need to revise language to ensure that this covers a group situation.

G. “Market Value Adjustment” or “MVA” means a contract feature of a deferred annuity that could increase or decrease the value of a withdrawal, annuitization or death benefit based on changes in an index or changes to the company’s current guaranteed interest rate being offered on new premiums or for renewal periods.

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H. “Non-guaranteed elements” means the premiums, credited interest rates (including any bonus), benefits, values, non-interest based credits, charges or elements of formulas used to determine any of these, that are subject to company discretion and are not guaranteed at issue. An element is considered non-guaranteed if any of the underlying non-guaranteed elements are used in its calculation.

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I. “Structured settlement annuity” means a “qualified funding asset” as defined in section 130(d) of the Internal Revenue Code or an annuity that would be a qualified funding asset under section 130(d) but for the fact that it is not owned by an assignee under a qualified assignment.

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Section 5. Standards for the Disclosure Document and Buyer’s Guide

A. (1) Where the application for an annuity contract is taken in a face-to-face meeting, the applicant shall at or before the time of application be given both the disclosure document described in Subsection B and the Buyer’s Guide contained in Appendix A.

(2) Where the application for an annuity contract is taken by means other than in a face-to-face meeting, the applicant shall be sent both the disclosure document and the Buyer’s Guide no later than five (5) business days after the completed application is received by the insurer.

(a) With respect to an application received as a result of a direct solicitation through the mail:

(i) Providing a Buyer’s Guide in a mailing inviting prospective applicants to apply for an annuity contract shall be deemed to satisfy the requirement that the Buyer’s Guide be provided no later than five (5) business days after receipt of the application.

(ii) Providing a disclosure document in a mailing inviting a prospective applicant to apply for an annuity contract shall be deemed to satisfy the requirement that the disclosure document be provided no later than five (5) business days after receipt of the application.

(b) With respect to an application received via the Internet:

(i) Taking reasonable steps to make the Buyer’s Guide available for viewing and printing on the insurer’s website shall be deemed to satisfy the requirement that the Buyer’s Guide be provided no later than five (5) business day of receipt of the application.

(ii) Taking reasonable steps to make the disclosure document available for viewing and printing on the insurer's website shall be deemed to satisfy the requirement that the disclosure document be provided no later than five (5) business days after receipt of the application.

(c) A solicitation for an annuity contract provided in other than a face-to-face meeting shall include a statement that the proposed applicant may contact the insurance department of the state for a free annuity Buyer's Guide. In lieu of the foregoing statement, an insurer may include a statement that the prospective applicant may contact the insurer for a free annuity Buyer's Guide.

(d) Where the Buyer's Guide and disclosure document are not provided at or before the time of application, a free look period of no less than fifteen (15) days shall be provided for the applicant to return the annuity contract without penalty. This free look shall run concurrently with any other free look provided under state law or regulation.

B. At a minimum, the following information shall be included in the disclosure document required to be provided under this regulation:

(1) The generic name of the contract, the company product name, if different, and form number, and the fact that it is an annuity;

(2) The insurer's name and address;

(3) A description of the contract and its benefits, emphasizing its long-term nature, including examples where appropriate:

(a) The guaranteed and non-guaranteed elements of the contract, and their limitations, if any, and an explanation of how they operate;

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(b) An explanation of the initial crediting rate or indexed interest crediting rate formula, if applicable, specifying any bonus or introductory portion, the duration of the rate and the fact that rates may change from time to time and are not guaranteed;

(c) Periodic income options both on a guaranteed and non-guaranteed basis;

(d) Any value reductions caused by withdrawals from or surrender of the contract;

(e) How values in the contract can be accessed;

(f) The death benefit, if available and how it will be calculated;

(g) A summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract; and

(h) Impact of any rider, such as a long-term care rider.

(4) Specific dollar amount or percentage charges and fees shall be listed with an explanation of how they apply.

(5) Information about the current guaranteed rate or indexed interest crediting rate formula, if applicable, for new contracts that contains a clear notice that the rate is subject to change.

C. Insurers shall define terms used in the disclosure statement in language that facilitates the understanding by a typical person within the segment of the public to which the disclosure statement is directed.

Section 6. Standards for Annuity Illustrations

A. An insurer may elect to to provide a consumer an illustration at any time, provided that the illustration is in compliance with this section and:

(1) Clearly labeled as an illustration;

(2) Includes a statement referring consumers to the disclosure document and Buyer's Guide provided to them at time of purchase for additional information about their annuity; and

(3) Is prepared by the insurer or third party using software that is authorized by the insurer prior to its use.

(4) Used for all sales of that product form.

Note: industry is working on re-working (3) to make clear that company is responsible for monitoring and overseeing content and use all forms and information, but not each form filled out.

B. If an annuity contract form is identified by the insurer as one to be marketed with an illustration, an illustration prepared and delivered in accordance with this regulation is required, except that an illustration need not be provided to individual members of a group or to individuals insured under multiple lives coverage issued to a single applicant unless the coverage is marketed to these individuals. The illustration furnished an applicant for a group annuity contract or contracts issued to a single applicant on multiple lives may be either an individual or composite illustration representative of the coverage on the lives of members of the group or the multiple lives covered.

C. The illustration shall become a part of the disclosure document referenced in Section 5.

Note: Industry wants to delete B and C.

D. When using an illustration in the sale of an annuity contract, the illustration shall not:

(1) Describe non-guaranteed elements in a manner that is misleading or has the capacity or tendency to mislead;

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(2) State or imply that the payment or amount of non-guaranteed elements is guaranteed;

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(3) Depict contract performance more favorable to the contract owner than that produced by the current annuitization rate of the insurer whose contract is being illustrated;

(4) Be incomplete;

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E. Costs and fees of any type shall be individually described and explained.

F. An illustration shall conform to the following requirements:

(1) The illustration shall be labeled with the date on which it was prepared.

(2) Each page, including any explanatory notes or pages, shall be numbered and show its relationship to the total number of pages in the disclosure document (e.g., the fourth page of a seven-page disclosure document shall be labeled "page 4 of 7 pages").

(3) The assumed dates of payment receipt and benefit payout within a contract year shall be clearly identified.

(4) If the age of the proposed insured is shown as a component of the tabular detail, it shall be issue age plus the numbers of years the contract is assumed to have been in force.

(5) The assumed premium on which the illustrated benefits and values are based shall be clearly identified, including rider premium for any benefits being illustrated.

(6) Any charges assessed against the account value or the crediting rate should be recognized in the illustrated values.

(7) Guaranteed death benefits and values available upon surrender, if any, for the illustrated contract premium shall be shown and clearly labeled guaranteed.

(8) The non-guaranteed illustrated values must be reflective of current conditions and must not include any assumed improvement of any underlying assumptions.

(9) The guaranteed elements, if any, shall be shown before corresponding non-guaranteed elements and shall be specifically referred to on any page of an illustration that shows or describes only the non-guaranteed elements (e.g., "see page 1 for guaranteed elements").

(10) The account or accumulation value of a contract, if shown, shall be identified by the name this value is given in the contract being illustrated and shown in close proximity to the corresponding value available upon surrender.

(11) The value available upon surrender shall be identified by the name this value is given in the contract being illustrated and shall be the amount available to the contract owner in a lump sum after deduction of surrender charges, contract loans, contract loan interest and application of any market value adjustment, as applicable.

(12) Illustrations may show contract benefits and values in graphic or chart form in addition to the tabular form.

(13) Any illustration of non-guaranteed elements shall be accompanied by a statement indicating that:

(a) The benefits and values are not guaranteed;

(b) The assumptions on which they are based are subject to change by the insurer; and

(c) Actual results may be higher or lower.

(14) Illustrations based on non-guaranteed credited interest and non-guaranteed annuitization rates shall contain equally prominent comparisons to guaranteed credited interest and guaranteed annuitization rates.

(15) The credited interest illustrated at any future duration shall reflect any expected reductions and shall not be greater than the current credited interest unless the contract guarantees such greater rate at that duration.

(16) The annuitization rate illustrated shall not be greater than the current annuitization rate unless the contract guarantees are in fact more favorable.

(17) Illustrations shall be concise and easy to read.

(18) Key terms shall be defined and then used consistently throughout the illustration.

(19) Illustrations shall not depict benefits beyond the maximum annuitization age or date.

(20) Annuitization benefits shall be based on contract values that reflect surrender charges or any other adjustments, if applicable.

(21) Illustrations shall show both annuitization rates and the dollar amounts of the periodic income payable.

G. An annuity illustration shall include a narrative summary that includes the following unless provided elsewhere in the disclosure document:

Comment [AAA1]: This is not applicable to fixed indexed annuities. The Academy Annuity Illustration work Group believes that additional guidelines need to be developed for fixed indexed annuities to appropriately address "current conditions," considering acceptable and unacceptable approaches used in the marketplace. Once these guidelines are developed, it would likely necessitate other changes in the model.

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(1) A brief description of any contract features, riders or options, guaranteed or non-guaranteed, shown in the basic illustration and the impact they may have on the benefits and values of the contract;

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(2) Identification and a brief definition of column headings and key terms used in the illustration;

(3) A statement containing in substance the following:

This illustration is based upon specified assumptions, including assumptions that non-guaranteed elements, which will be declared by the company in the future, will remain at the current level. It is likely that those elements will emerge differently than illustrated, meaning that actual values may be higher or lower than those in this illustration.

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The values in this illustration are **not** guarantees or even estimates of the amounts you can expect from your annuity. Please review the entire Disclosure Document and Buyer's Guide provided with your Annuity Contract for more detailed information.

(4) A description of any other optional benefits or features, if included, along with the additional cost of each item, if any, to the policyholder (may be done on a separate page).

(5) Additional explanations as follows:

(a) Minimum guarantees shall be clearly explained, not generic examples which are higher.

(b) The effect on policy values of a contract surrender shall be explained.

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(c) Any conditions on the payment of bonuses shall be explained.

(d) For annuities sold as an IRA, qualified plan or in another arrangement subject to the required minimum distribution (RMD) requirements of the Internal Revenue Code, the effect of RMDs on the contract values shall be explained.

(e) For annuities with recurring surrender charge schedules, a clear and concise explanation of what circumstances will cause the surrender charge to recur.

(f) A brief description of the types of annuity income options available shall be explained, including:

(i) The periodic income payment amount of at least one of the annuity income options available based on the guaranteed rates in the contract, at the later of age 70 or 10 years after issue, but in no case later than maximum annuitization age or date in the contract; and

(ii) The periodic income payable based on currently available annuitization rates.

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H. Numeric summary. Following the narrative summary, an illustration shall include a numeric summary which shall include at a minimum:

(1) The value available upon surrender on a guaranteed basis at the following durations:

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(a) (i) First 10 contract years; or

(ii) Surrender charge period if longer than 10 years;

(b) (i) Every tenth contract year thereafter, but are not required to be shown beyond the later of 30 years or age 70; or

(ii) The end of the renewal surrender charge period if less than 10 years, but are not required to be shown beyond the later of 30 years or age 70; and

(2) (a) Required annuitization age; or

(b) Required annuitization date.

I. If the annuity contains a market value adjustment, hereafter MVA, the following provisions apply to the illustration:

(1) The MVA shall be referred to as such throughout the illustration.

(2) The narrative shall include an explanation, in simple terms, of the potential effect of the MVA on the value available upon surrender.

(3) The narrative shall include an explanation, in simple terms, of the potential effect of the MVA on the death benefit.

(4) A statement, containing in substance the following, shall be included:

When you make a withdrawal the amount you receive may be increased or decreased by a Market Value Adjustment (MVA). If interest rates on which the MVA is based go up after you buy your annuity, the MVA likely will decrease the amount you receive. If interest rates go down, the MVA will likely increase the amount you receive.

(5) Illustrations shall include both upside and downside aspects of the product features relating to the market value adjustment.

(6) The illustrative effect of the MVA shall be shown under at least one positive and one negative scenario. This demonstration shall appear on a separate page and be clearly labeled that it is information demonstrating the potential impact of a MVA.

(7) Actual MVA floors and ceilings as listed in the contract shall be illustrated.

(8) Appendix B provides an example of an illustration of an annuity containing an MVA that addresses items (1) – (6) above. If the MVA has significant characteristics not addressed by items (1) – (6), the effect of such characteristics should be shown in the illustration.

J. If the illustration is for a fixed indexed annuity the following provisions apply:

(1) The narrative shall include an explanation, in simple terms, of the elements used to determine the index based interest. This includes, but is not limited to, the following elements:

(a) The Index(es) which will be used to determine the index-based interest
(b) The Indexing Method – such as point-to-point, daily averaging, monthly averaging
(c) The Index Term – the period over which indexed-based interest is calculated
(d) The Participation Rate, if applicable
(e) The Cap, if applicable
(f) The Spread, if applicable

(2) The narrative shall include an explanation, in simple terms, of how index-based interest is credited in the indexed annuity.

(3) The narrative shall include a brief description of the frequency that the company can re-set the participation rate, the cap, and the spread, if applicable.

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(4) If the product allows the policyholder to make allocations to declared-rate segment, then the narrative shall include a brief description of:

(a) Any options to make allocations to a declared-rate segment, both for new premiums and for transfers from indexed segments

(b) Differences in guarantees applicable to the declared-rate segment and the indexed segments

(5) The numeric summary shall include, at a minimum, the following elements:

(a) The assumed growth rate of index

(b) The assumed values for the participation rate, cap, and spread, if applicable

(c) The assumed allocation between indexed-based segments and declared-rate segment, if applicable

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Comment [AAA2]: The assumed growth rates would need to comply with the guidelines developed for "current conditions" referred to in item F.(8) of Section 6.

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K. If the contract is issued other than as applied for, a revised illustration conforming to the contract as issued shall be sent with the contract, except that non-substantive changes, including, but not limited to changes in 1035 amounts and additional premium, which do not alter the key benefits and features of the annuity as applied for will not require a revised illustration unless requested by the applicant.

Section 7. Report to Contract Owners

For annuities in the payout period that include non-guaranteed elements and for the accumulation period of a deferred annuity, the insurer shall provide each contract owner with a report, at least annually, on the status of the contract that contains at least the following information:

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A. The beginning and end date of the current report period;

B. The accumulation and cash surrender value, if any, at the end of the previous report period and at the end of the current report period;

C. The total amounts, if any, that have been credited, charged to the contract value or paid during the current report period; and

D. The amount of outstanding loans, if any, as of the end of the current report period.

Section 8. Penalties

In addition to any other penalties provided by the laws of this state, an insurer or producer that violates a requirement of this regulation shall be guilty of a violation of Section [cite state's unfair trade practices act].

Section 9. Separability

If any provision of this regulation or its application to any person or circumstance is for any reason held to be invalid by any court of law, the remainder of the regulation and its application to other persons or circumstances shall not be affected.

Section 10. [Optional] Recordkeeping

A. Insurers or insurance producers shall maintain or be able to make available to the commissioner records of the information collected from the consumer and other information provided in the disclosure statement (including illustrations) for [insert number] years after the contract is delivered by the insurer. An insurer is permitted, but shall not be required, to maintain documentation on behalf of an insurance producer.

Drafting Note: States should review their current record retention laws and specify a time period that is consistent with those laws.

B. Records required to be maintained by this regulation may be maintained in paper, photographic, microprocess, magnetic, mechanical or electronic media or by any process that accurately reproduces the actual document.

Drafting Note: This section may be unnecessary in states that have a comprehensive recordkeeping law or regulation.

Section 11. Effective Date

This regulation shall become effective [insert effective date] and shall apply to contracts sold on or after the effective date.

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