

# Hot Topics in the Annuity Space

# Disclosure Reform (Federal)

- Summary Prospectus Proposals
- Possible Changes for Registered Non-Variable Products (Index-Linked, MVAs, CDAs)
- Rule 30e-3 Update

## Key Elements of SEC Proposals

- Initial Summary Prospectus (ISP)
- Updating Summary Prospectus (USP)
- Optional Access = Delivery Model for Underlying Fund Prospectuses
- Statutory Prospectus and Registration Form Amendments
- Nullification of Great-West Line of No-Action Letters
- 1940 Act Rule Amendments

## Proposed Rule 498A Summary Prospectus Framework

- Paper or Electronic Delivery of ISP or USP (as applicable)
- ISP and USP Must Meet Prescribed Content Requirements
- ISP, USP and Contract Statutory Prospectus and SAI Must Be Posted on Website and Formatted in Prescribed Manner
- Website Address Must be Included in ISP and USP
- Paper or Electronic Delivery of Contract Statutory Prospectus or SAI Upon Request Within 3 Business Days
- ISP and USP Binding Limitations and Prominence Requirements

# Initial Summary Prospectus

- Used at Point of Sale
- Would be Optional
- May Describe only Single Contract Being Offered
  - Multiple Classes Permitted
- Prescribed Content, Order and Headings
- Delivery Satisfies Section 5 Obligation to Deliver Full Statutory Prospectus

# Prescribed Content of the Initial Summary Prospectus

- Cover Page
- Contract Overview
- Important Considerations – Key Information Table
- Benefits Table
- Buying the Contract
- Surrenders and Withdrawals
- Fee Table
- Fund Appendix
- Special Terms

## Updating Summary Prospectus

- Delivered Annually to Existing Contract Owners
- Could Cover All Contracts Described in Contract Statutory Prospectus
- Would be Optional
- Can Only be Used if ISP Used for All Currently Offered Contracts
- Prescribed Content and Order
- Delivery Satisfies Section 5 Obligation to Deliver Statutory Prospectus

## Prescribed Content of the Updating Summary Prospectus

- Cover Page
- Updated Information About Certain Contract Features
  - Underlying Fund Availability
  - Contract Fees
  - Available Benefits
- Important Information to Consider – Key Information Table
- Fund Appendix



# Key Information Table

- Required in ISP, USP and Contract Statutory Prospectus
- Tabular Presentation Covering the Following:
  - Fees and Expenses (Fee Table is a Separate Requirement)
  - Risks
  - Investment Restrictions
  - Taxes
  - Conflicts of Interest

# Fund Appendix

- For All Available Underlying Funds
  - Type or Investment Objective
  - Name and Adviser/Subadvisers
  - Gross Expense Ratio
  - 1, 5 & 10 Year Average Annual Total Returns
- Tables Showing Which Funds Available with Each Insurance Benefit Restricting Eligible Funds

# Discontinued Contracts

- Great-West No-Action Letter Could Not Be Relied Upon Going Forward
  - Contracts Relying on Great-West on Rule Effective Date Could Continue to Rely on the Relief Subject to the Stated Conditions
  - For Other Discontinued Contracts Would Need to Annually Update Statutory Prospectuses and Provide USPs
- Possible Approaches for Discontinued Contracts Going Forward

## Conditions for Online Delivery of Fund Prospectuses

- Initial Summary Prospectus Used for Each Currently Offered Contract in Registration Statement
- Fund Uses Summary Prospectus
- Fund Prospectuses, SAI and Most Recent Shareholder Reports Posted Online in Prescribed Manner
- Website Address Must be Disclosed in the Contract Prospectuses
- Must Be Posted on Same Website Where Contract Materials are Posted
- Paper or Electronic Delivery Upon Request Within 3 Business Days

## Comments on SEC Proposals

- Strong Support for Proposals From Insurance and Fund Trade Groups
  - Would Enhance Main Street Investors Experience and Understanding of Variable Products
  - Would Provide Parity with the Mutual Fund Disclosure Framework
- Specific Comments Related to Proposed Prescribed Content of the ISP, USP and Contract Statutory Prospectuses
- Strong Support for the Optional Method of Underlying Fund Prospectus Delivery
- Urge that Great-West No Action Letters be Retained and Modernized
- Comments Urging that the SEC Go Further in Permitting Optional Website Delivery of Contract and Mutual Fund Prospectuses

## Comments on Disclosure Content

- Specific Terminology Relating to Contracts and Benefits Should Not be Prescribed
- Key Information Table: Fee & Expense Information That Is Repetitive of Information in Other Parts of the Summary Prospectus Should be Eliminated
- Fund Appendix Comments
  - Underlying Fund Expense Ratio and Performance Information Should Not be Required
  - Separate Investment Restrictions Appendix Should be Eliminated
- For Optional Online Fund Delivery Method, Permit Insurer's Website to Redirect Customers to Underlying Funds' Websites for Fund Prospectuses, SAIs, and Shareholder Reports
- AUV Tables Should be Eliminated From Variable Annuity Prospectuses and SAIs

## Transitioning to the New Regime

- Rule 485(a) Filings Will be Required to Add ISPs, USPs and Revised Statutory Prospectus
- Possible Availability of Template Relief (Rule 485(b)(i)(7))

## Disclosure Regime for Non-Variable Products

- Currently Must Be Registered on Form S-1 or S-3
  - Calls for Extensive Company Related Disclosure
- Limited Relief Available
  - From GAAP Financial Statement Requirements
  - From Executive Compensation Disclosure Requirements
- Prospects for Future Relief
  - New Registration Form Tailored to These Products?
  - Limited Relief From S-1/S-3 Requirements?



## Update on Rule 30e-3

- Will Permit Default Website Delivery of Underlying Fund Annual and Semi-Annual Reports Beginning January 1, 2021
- Prospectus Notices Must be Sent to Investors in May, 2019 and May, 2020 Permitting Them to Opt Out
- Fund Participation Agreements Should be Amended to Delineate Insurer and Fund Roles and Responsibilities
  - Website Responsibility
  - Other Matters

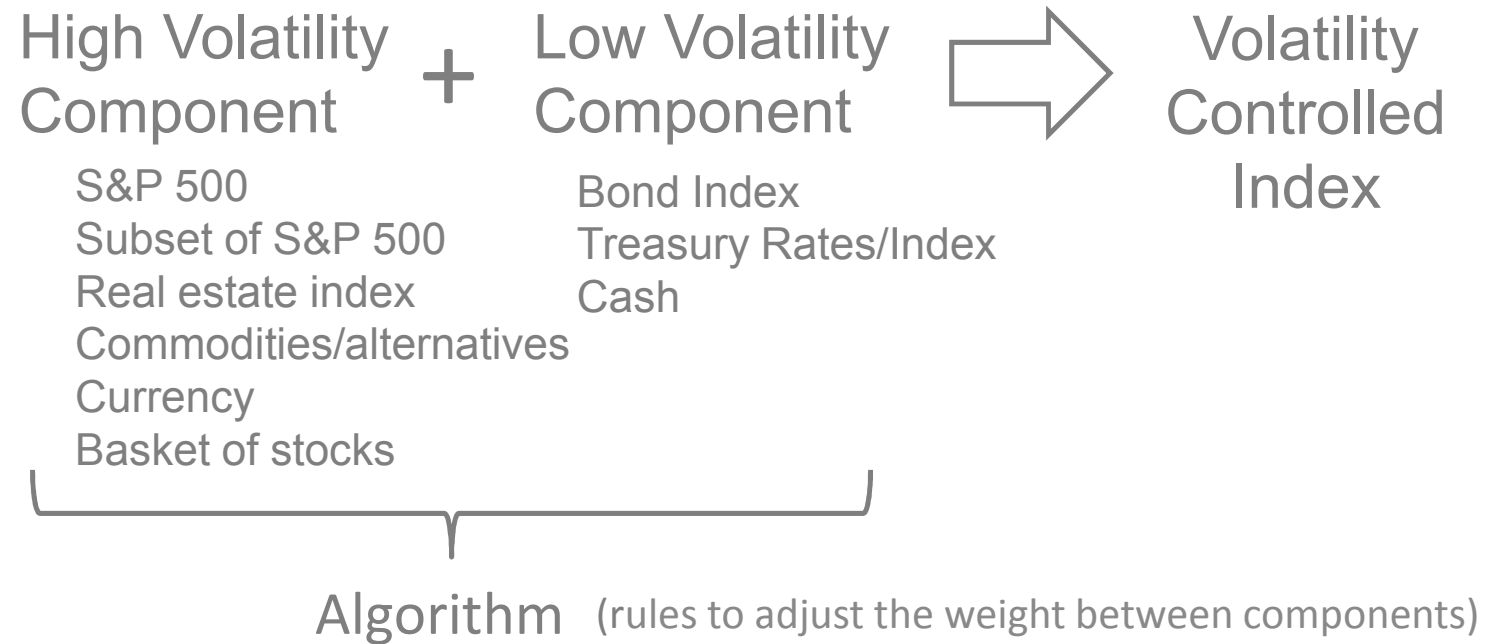
## Disclosure Reform (State)

- NAIC Annuity Disclosure Model Regulation (MDL-245)
  - Adopted in eight states, this model has specific illustration standards that require nonguaranteed annuity values be based on actual historical index performance
- Section 6 has the standards for annuity illustrations
  - Subsection F(9)(b), in pertinent part, provides: If any index utilized in determination of an account value has not been in existence for at least ten (10) calendar years, indexed returns for that index shall not be illustrated

## Indexed Interest with FIAs

- The annuity contract offers one or more indexes
  - Indexes can track segments of the U.S. or other markets
  - Other designs manage market volatility via rules to adjust the weight between components (e.g., indexes, ETFs)
- One or more crediting methods are also available
  - A formula that tracks the changes in index values to determine indexed interest and can be subject to a limiter
- Indexed interest is usually calculated annually
  - If the result is positive, indexed interest is credited
  - If the result is negative, the annuity value is unchanged

# Volatility Controlled Indexes Overview



## Industry Proposal #1 (Spring 2017)

- Made by several companies
- Add a drafting note to permit illustrations of volatility controlled indexes, subject to the following criteria:
  - Index is comprised of components that have been existence for at least ten (10) calendar years
  - Weighting algorithm uses a formula without discretion
  - Index is independently calculated by an entity different from the insurance company using the index

# Outcome of Industry Proposal #1

- Charge of Annuity Disclosure (A) Working Group in light of product innovation
- Drafting note was determined not to be the appropriate method
  - The purpose of a drafting note is to provide nuance, or to explain the rationale behind a requirement
- Working group moved to open the model
  - The industry-requested changes constituted substantive changes requiring a full change to the model

## Industry Proposal #2 (Summer 2018)

- Made by several companies to revise the model
- Add parameters to allow illustrations of volatility controlled indexes existing for less than ten years:
  - The index is comprised entirely of components that have been in existence for at least ten (10) calendar years
  - The index value is calculated according to an algorithm that is not subject to discretion
  - If the insurance company is affiliated with the index provider, indexes published by the index provider are also used by entities unaffiliated with the insurance company

## Industry Proposal #2 (cont.)

- New consumer disclosure requirements to include:
  - That the index has existed for less than ten (10) calendar years and the date the index was created
  - That the index components each existed for at least ten (10) calendar years
  - That the algorithm does not change regardless of situation
  - That any estimates of how the index would have performed before its creation are hypothetical and based on past performance of the components in the index
  - That future results will be different than the index's past performance



## Outcome of Industry Proposal #2

- Consumer advocate opposition to allow illustrations of indexes that have existed for fewer than ten years, and that the current limitation be increased to 20 years
  - The purpose of the 10-year limitation is to prevent illustrations that misrepresent the longer-term risk/return of an annuity
  - Ten years is now too short a period to capture a full economic cycle
- RI and MN collaboration to attempt to find a middle ground with revisions to the model

## Regulator Proposal (Winter 2019)

- Illustration of any index is prohibited that has not existed for at least twenty (20) calendar years, unless:
  - The index is a combination of indices each existing at least twenty (20) calendar years
  - Method of combination is such that a unique twenty (20) calendar year history can be constructed
  - Any algorithm will be fixed from the creation of the index
  - Any algorithm will be available to inspect by a the commissioner or consumer
  - Illustrations of allocations to an index not existing for at least twenty (20) calendar years will be assumed to be zero

## Regulator Proposal (cont.)

- New consumer disclosure requirements to include:
  - That for an index not existing for twenty (20) calendar years, it is a weighted average of indices existing for at least twenty (20) calendar years
  - Because index has not existed for twenty (20) calendar years, that some of the values shown are hypothetical
  - That weights based on an algorithm that is consistently applied but may produce different weights in different years
  - That the consumer may request further explanation of the algorithm used to determine the weights

## Current Status

- 5/13 call of the Annuity Disclosure (A) Working Group to discuss the regulator proposal
  - Extensive discussion, but no consensus
  - Perhaps the model could be closed, without any changes made, to allow regulators to move on to other priorities
- Industry outreach continues to:
  - Promote a compromise on the model changes
  - Persuade more regulators to engage in dialogue
- 7/15 call scheduled to continue discussing the regulator proposal and decide the next steps

## Update on Tax Issues Relating to Advisory Fees Paid from Cash Values of Annuity Contracts

- Background
  - Policyholder of a deferred annuity chooses a third party advisor
  - Advisor provides advice and services relating to the contract
  - A fee is charged against the account value and paid to the advisor
  - Old model, but becoming more common
- Qualified plans, IRC § 403(b) contracts, and IRAs
  - Account / annuity contract was “solely liable” for paying the fee
  - The fee is an expense of the arrangement
  - The assessment of the fee does not constitute a distribution
  - See PLR 9845003 (Aug. 3, 1998), PLR 9047073 (Aug. 30, 1990), PLR 8951910 (Sep. 18, 1989), PLR 9005010 (Nov. 2, 1989)

## Investment Advisory Fees (cont.)

- Non-qualified annuity contracts
  - Only one ruling – PLR 9342053 (Jul. 28, 1993)
  - Facts indistinguishable from “qualified” arrangements
  - IRS was adverse
    - The fee is an expense of the policyholder for services the advisor provided to the policyholder
    - The fact that the contract was solely liable for the fee does not “convert” the fee into an expense of contract
    - The policyholder is the only party directly benefiting from the advisor’s services
    - The assessment of the fee constitutes an amount received that is includible in gross income under IRC § 72(e) (income-first rule)
  - Why the different (worse) result?
  - IRS reconsidering position on non-qualified contracts

# Implications of Retirement Legislation

## Overview of Current Legislative Proposals

- Setting Every Community Up for Retirement Enhancement (SECURE) Act (H.R. 1994, 116th Congress)
- Retirement Enhancement and Savings Act (RESA) (S. 972, 116th Congress)
- Retirement Security and Savings Act (S. 1431, 116th Congress)

## Fiduciary Safe Harbor for Selecting Annuity Providers

### Current Law

- ERISA imposes fiduciary requirements on plan sponsors when making decisions affecting a plan
- DOL regulations provide a safe harbor to satisfy those requirements when selecting an annuity provider for the plan
- But the existing safe harbor is widely viewed as insufficient, so many plan sponsors are reluctant to offer in-plan annuity options

### SECURE Act / RESA

- New statutory safe harbor:
- Reliance on representations about state law status for insurers' financial capabilities;
- Not required to select lowest-cost provider;
- Not required to review after purchase for a participant or beneficiary; and
- Allow reliance on annual representations from insurers



## Annuity Portability

### Current Law

- Retirement plans are subject to in-service withdrawal restrictions
- Plan investment options, including those with lifetime income features, can change
- If participants must liquidate a plan investment because the plan changes its options, they may not be able to preserve their lifetime income features through a rollover or otherwise

### SECURE Act / RESA

- Create an exception to the withdrawal restrictions for lifetime income investments
- Directly roll the investment to an IRA or another plan, or a plan-distributed annuity
- Only if the lifetime income investment is no longer authorized to be held under the plan

## Lifetime Income Disclosure

### Current Law

- DC plans must provide participants with benefit statements that include account balance, vesting, and investment information
- The statements must be provided each calendar quarter or each calendar year, depending on whether the participant has the right to direct investments

### SECURE Act / RESA

- Require DC plan statements to include a lifetime income disclosure annually
- Disclosure would illustrate monthly payments if the participant's total benefits were used to provide a single life annuity and a QJSA
- No ERISA liability solely for providing the disclosure if certain rules are met and certain assumptions are used

## Contributions to Traditional IRAs

### Current Law

- No contributions after age 70½, even if still working
- Contributions to Roth IRAs still allowed, if otherwise eligible

### SECURE Act / RESA

- No age limit for contributions to Traditional IRAs
- Must still have compensation (generally from work)

## Changes to Required Beginning Date (“RBD”)

### Current Law

- IRA and qualified plan distributions must begin by April 1 the year following:
- The year in which the individual reaches age 70½, or
- For plans, the year the individual retires (except for 5% or more owners)

### SECURE Act / RESA

- Increases RBD to April 1 of the year following
- The year in which the individual reaches age 72, or
- For plans, the year the individual retires (except for 5% or more owners)
- Would apply to distributions required to be made after December 31, 2019, with respect to individuals who attain age 70½ after such date

## “Stretch” RMDs

### Current Law

- After-death RMD regulations permit a beneficiary to draw down the remaining plan or IRA benefits over the beneficiary’s life expectancy

### SECURE Act / RESA

- Require distributions within 10 years of death
- Exception for spouse, disabled and chronically ill, beneficiary within 10 years of decedent, minors until age of majority
- Applies to deaths in 2020 and later
- Senate RESA package uses five years, but includes \$400,000 per beneficiary exception

## Retirement Security and Savings Act (S. 1431, 116<sup>th</sup> Congress)

- Expands access to workplace retirement savings plans and access to guaranteed lifetime income
- Repeals certain limits and provides Treasury with authority necessary to enhance qualifying longevity annuity contracts (QLACs)
- Treats change of record keeper with annuity as distributable event, permits participants to preserve lifetime income option
- Raises RMD age to 75
- Modifies RMD rules to facilitate life annuities with increasing payments