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# GA Coverage of Variable Products

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# Today's Presentation

- Overview of Variable Products
- History of NOLHGA Work on Variable Products
- GA Coverage Analysis (NAIC Model GA Act)
- GA Assessments of Variable Products

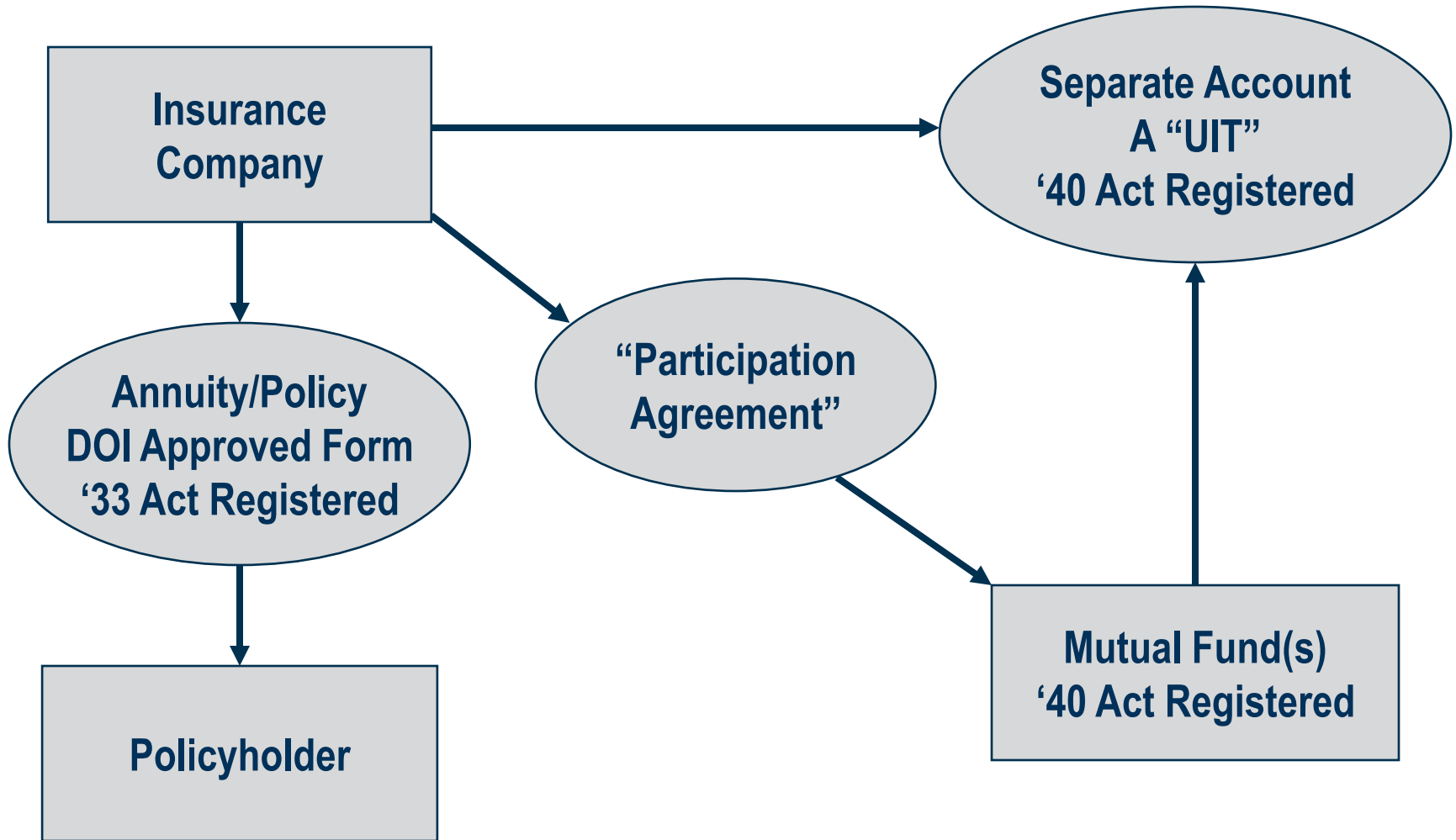
# Overview of Variable Products

- All Variable Products involve Separate Accounts
- What are they?
- How do they work?
- What do the insurance companies promise?

# Overview of Variable Products—Types of Products

- Deferred Annuities
- Immediate Annuities/Payout Annuities
- Life Insurance

# Overview of Variable Products—Simplified Structure



# What are The GA and Receivership Concerns?

- Policyholders bear investment risk
- Separate Account backs the benefits
- Why be concerned about insolvency protection of Variable Product owners?

# Overview of Variable Products—Evolution

- Originally no investment guarantees
  - Excluded from coverage (Model Act 3B2(a))
- Guaranteed Death Benefits (ROP)
  - Recognized as potentially covered by GAs
  - Not material for assessment purposes
- Enhanced Death Benefits
- Guaranteed Living Benefits arrive and affect market

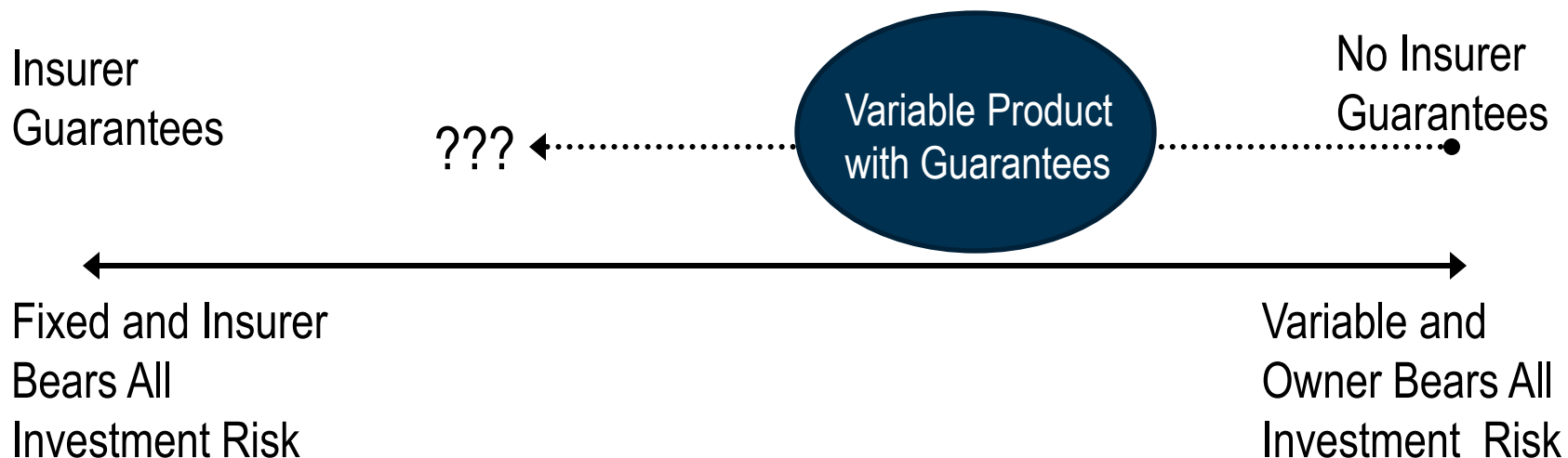
# Overview of Variable Products—Types of Guarantees

- Variable Annuities
  - Guaranteed Minimum Death Benefits (GMDBs)
  - Guaranteed Minimum Living Benefits (VAGLBs)
- Variable Life Policies
  - Guaranteed Minimum Death Benefits (GMDBs)

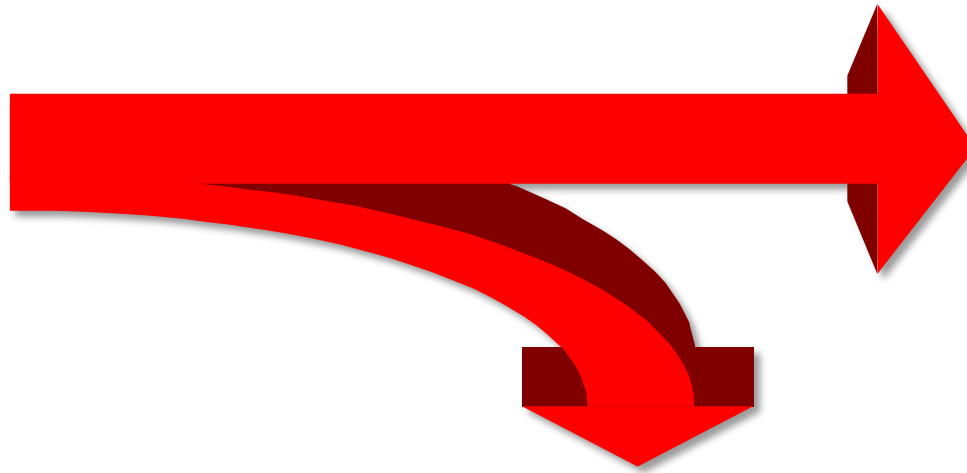


# Overview of Variable Products—Who has the Risk??

- Variable Product guarantees shift risk
  - Insurer assumes some level of investment risk
  - How much depends upon design of guarantee
- Insurer offers Variable Product guarantees in exchange for higher fees



# Overview of Variable Products—Simplified GMDBs



Variable Annuity  
Account Value  
can decrease

Death Benefit stays  
constant or increases

GMDB covers the  
risk of loss resulting  
from death during a  
market downturn

# Overview of Variable Products—Types of VAGLBs

- **Guaranteed Minimum Withdrawal Benefit (GMWB)**
  - Guarantees annual withdrawals at specified level
- **Guaranteed Minimum Income Benefit (GMIB)**
  - Guarantees amount available to apply to annuitization benefit (pay-out) after waiting period
- **Guaranteed Pay-out Annuity Floor (GPAF)**
  - Future periodic payments won't be less than the first one
- **Guaranteed Minimum Accumulation Benefit (GMAB)**
  - “Tops-up” account value after waiting period
- **New Guarantees Continue to Emerge**

# Overview of Variable Products—Basis of Guarantees

- High Watermark Ratchet
  - Sets base (Not Necessarily Cash Value) guarantee at account value on specified dates:
    - Contract anniversary
    - Quarterly
    - Monthly
    - Daily
- Minimum growth of guarantee base
  - Sets base (Not Necessarily Cash Value) guarantee by applying interest at specified rate on specified premium paid regardless of Separate Account performance
- Combination
  - High Watermark **PLUS** guaranteed rate of growth
- Variations

# History of NOLHGA Work on Variable Products

- **2002-03:** NOLHGA conducts initial evaluation of possible GA coverage based on NAIC Model GA Act
- **2003-05:** NOLHGA exposes result of initial evaluation to:
  - State Guaranty Associations, and
  - Life Insurance Industry Trade Association (ACLI)
- **2004-05:** NOLHGA works with life industry to develop GA assessment reporting changes for Variable Products that NAIC adopts
- **2009-Present:** NOLHGA evaluates under NAIC Model GA Act technical issues associated with potential GA coverage obligations related to Variable Products

# Elements of GA Coverage Analysis

- Consideration of scope of GA coverage provisions under NAIC Model GA Act
- Are Variable Products “Covered Contracts”?
- Are Variable Products subject to a complete exclusion from GA coverage?
- If not excluded completely, how are Variable Products covered?

# GA Coverage Analysis—Scope

- GAs created to protect identified persons “against failure in the performance of contractual obligations, under life and health insurance policies and annuity contracts specified in [GA Statutes], because of the impairment or insolvency of the member insurer that issued the policies or contracts.” NAIC Model GA Act 2A.
- If Covered, GAs:
  - Guaranty, assume or reinsure, or cause to be guaranteed, assumed or reinsured, the policies or contracts of the insolvent insurer;
  - Assure payment of the contractual obligations of the insolvent insurer;
  - Provide monies, pledges, loans, notes, guarantees, or other means reasonably necessary to discharge the Association’s duties; or
  - Subject to certain requirements, provide “substitute” or “alternative” benefits to replace benefits in contracts issued by insolvent insurerNAIC Model GA Act 8B.

# GA Coverage Analysis—Scope, Cont'd

- A “Covered policy” means a policy or contract or portion of a policy or contract for which coverage is provided under GA statutes. NAIC Model GA Act 5H.
- Policies and contracts covered under NAIC Model GA Act:
  - Individual life, health, or annuity policies or contracts, and
  - Certificates under group life, health, or annuity policies and contracts
  - Except as limited by the GA StatutesNAIC Model GA Act 3B(1).



# GA Coverage Analysis—Classifying Variable Products

- Variable Products qualify as either annuities or life insurance under:
  - State Insurance Laws. See e.g., NAIC Model Variable Contract Law; NY Ins. Law 4240; and
  - The Internal Revenue Code, which permits internal build up to be tax deferred. See e.g., IRC 72(s) (annuities) and 7702 (life)). See also IRS Rev. Rul. 2003-91 & Rev. Rul. 2003-92.
- Variable Products fall within the scope of Covered Contracts under NAIC Model GA Act as either life insurance policies or annuities subject to applicable exclusions and limits

# GA Coverage Analysis—Exclusion

- Must determine if any statutory exclusion would completely exclude an otherwise Covered Contract from GA coverage
- Exclusions from GA coverage include:
  - A portion of a policy or contract not guaranteed by the insurer, or under which the risk is borne by the policy or contract owner  
NAIC Model GA Act 3B(2).
- Exclusion has been in NAIC Model GA Act in one form or another since originally promulgated in 1971
  - Official NAIC Drafting Comments have consistently said it excludes GA coverage of “some aspects of [variable products] . . . [but] the obligations of the insurer (e.g., mortality and expense guarantees) are covered.” 1976 Proc. I 299.
- No provision of the NAIC Model GA Act excludes entirely either “Variable Contracts” or contracts supported by a “Separate Account”

# GA Coverage Analysis—Coverage and Exclusion

- **Conclusion:**

- Variable Products fall within the scope of "covered policies" in the NAIC Model GA Act. NAIC Model GA Act 3(B)(1) & 5H.
- The Model GA Act contains no limits or exclusions that would exclude Variable Products in their entirety from GA coverage
  - Insurer obligations are outside the scope of the coverage exclusion for "a portion of the policy or contract not guaranteed by the insurer, or under which the risk is borne by the policy or contract owner." 1976 Proc. I 299.
  - Variable Product owner's Investment risk is excluded from any GA coverage

# GA Coverage Analysis—Coverage Methodology

- GA coverage based on the insolvent insurer's contractual obligations to the insurance policy or annuity owner
- Evaluation of the features of the annuity or life policy and the contractual obligations created necessary to apply GA coverage and limitations

# GA Coverage Analysis—Key Product Features

- Insurer is the sole obligor under the annuity or life insurance policy
- Insurer is the owner of the separate account.
- Insurer uses separate account and the assets it contains to honor insurer's obligations to annuity and life policy owners.
- Insurer is prohibited from using separate account assets in any other way or for any other customers
- Owners of a Variable Products own the annuity or life insurance policy, but do not own assets held in the separate account or any part of the separate account itself.

# GA Coverage Analysis—Key Product Features, cont'd

- Insurer owes Contract Owners, among other benefits, unit values determined daily by a formula that monetizes a proportionate share of the investment values in the various subaccounts identified by each Contract Owner, but not any specific assets in or portion of the separate account itself
- Prospectus' Disclosure Statements frequently recognize "The Company owns the assets in the Separate Account and . . . All obligations arising under the Contract are general corporate obligations of the Company."
- Insurers report their obligations under Variable Products as the insurers' liability, and the separate account as the insurer's asset.

# GA Coverage Analysis—Statutory Factors

- GA Coverage Limits “are limitations on the benefits for which the Association is obligated **before taking into account** either its subrogation and assignment rights or **the extent to which those benefits could be provided out of the assets of the impaired or insolvent insurer attributable to covered policies.**” NAIC Model GA Act 3C(2)(f)
- GA is subrogated to, and may require assignment of, all rights under a covered policy as a condition for providing coverage. NAIC Model GA Act 8K(1).
- GA may reduce its coverage obligations by the "amount realized by any other person with respect to the person or claim that is attributable to the policies (or portion thereof) covered by the Association." NAIC Model GA Act 8K(4).

# GA Coverage Analysis—Conclusion

- GAs provide coverage and apply limits based on the total value of contractual benefits the insurer owes to owners of Variable Products (Like traditional Fixed Products).
- GA coverage and limits determined before consideration of assets available in either Separate Account or General Account to meet the benefit obligations .
- GAs would rely upon all assets of insurer that may be used to discharge obligations under the Variable Product, whether those assets are in the General Account or a Separate Account.
- Places GAs in same position to Variable Product Owner as insurer prior to insolvency.



# GA Coverage of Variable Products—Assessments

- NOLHGA, ACLI and life insurance company representatives agreed that premium for Variable Products should not be excluded entirely from GA assessment base
- Effort led to approach adopted by NAIC requiring insurers to report as assessable all fees charged for insurer guarantees on Variable Products
- Fees on Variable Products will be in the GA annuity assessment base like premiums on fixed annuity products



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# Questions

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