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CFA Consumer Federation of America

**CFA and CEJ Call for Essential Consumer Protection Amendment to RESA**

Dear Senator:

We understand the Retirement Enhancement and Savings Act (RESA) may soon come to the floor for a vote. While there are many provisions of the bill that we support, we urgently request an essential consumer protection amendment. The amendment would modify the annuity safe harbor provision (Section 204) to reflect the reality of the current state of complex and confusing annuity products and the evolving, in-process regulation of these products by state insurance regulators.

The amendment we seek would do three things:

1. Revise the definition of Guaranteed Retirement Income Contact (i.e., annuity) to include only those products without an accumulation feature (i.e., fixed income annuities);
2. Add a measure of financial strength in addition to state insurance regulation in order to limit the safe harbor to those annuity providers with the most reliable long-term claims-paying ability; and
3. Clarify that the safe harbor applies only to the selection of annuity providers, and not to the selection of individual products to be made available in retirement plans.

<u>We Support a Reasonable Safe Harbor, Not an Unlimited One</u>

We believe that insurance companies offer potentially valuable products for consumers seeking lifetime income and retirement security in the form of fixed annuities, which exchange a lifetime income stream for the premium payment. And we support efforts, such as a fiduciary safe harbor, to promote the availability of these types of products to retirement savers. However, the majority of annuities marketed by insurers – including variable and fixed indexed annuities – are focused on accumulation and promised market return guarantees. As we explain below, these products do not have the same regulatory track record as simple fixed annuities and typically include high fees that strip, not build, consumer retirement assets.

<u>Limiting the Definition of Guaranteed Lifetime Income Contract to Fixed Annuities without Accumulation Features</u>

Simple annuities – fixed annuities – provide lifetime income in exchange for premium. We call these simple because the products reflect the risk-pooling strength of insurance companies. Like traditional life insurance, fixed annuities allow for a pooling of risk, whereby the insurer distributes the risk of consumers’ dying early or late (mortality risk) into a risk pool. Insurers – and the regulators monitoring the insurers for financial solvency – have a long history of managing mortality risk and interest rate risk.

In contrast, the accumulation-type annuities – variable annuities and fixed indexed annuities, often with guaranteed lifetime withdrawal benefit riders – add a third risk for insurers – the market risk associated with the market return guarantees the products offer. Instead of diversifying mortality or interest rate risk, these market-guarantee products concentrate market risk with the insurer.

There are two characteristics of market-guaranty annuity products that require exclusion from the RESA safe harbor – an untested and evolving state regulatory framework and the consumer protection problems of high fees and misleading products.

The safe harbor appropriately vests most of the responsibility for ensuring a strong insurer able to pay benefits with state insurance regulators. As mentioned above, the states have a long history supervising products with mortality and interest rate risk. But the new market-guaranty annuity products have posed a challenge for insurance regulators, and the regulatory framework for such products is a work-in-progress. State regulators are in the midst of a multi-year project to move from insurer reserves established by regulatory formula to reserves set largely by the insurers’ actuaries (“principles-based reserving”). Regulators are also in the midst of a multi-year project – including the retention of consultants – to establish a capital and reserving framework for variable annuities. And state insurance regulators are also in the midst of multi-year projects to rein in unreasonable and misleading disclosures and illustrations for life insurance and annuity products.

In summary, while state insurance regulators have a long – and successful – track record regulating the solvency and consumer protection aspects of simple fixed annuities without accumulation features, the same cannot be said for annuities with accumulation features. Consequently, limiting the safe harbor definition of Guaranteed Retirement Income Contracts to annuities without an accumulation feature would ensure stronger financial oversight of the insurers offering the annuity and essential consumer protections against high-fee, complex and misleading products. We propose the following revisions to the definition:

> *‘(B) GUARANTEED RETIREMENT INCOME* CONTRACT.*—The term ‘guaranteed retirement income contract’ means an annuity contract without an accumulation feature for a* fixed *term or a contract (or provision or feature* thereof*) which provides guaranteed benefits annually (or more frequently) for at least the remainder of the life of the participant or the joint* lives *of the participant and the participant’s* designated *beneficiary as part of an individual* account *plan.’’.*

<u>Financial Security In Addition to State Insurance Regulation Through an Independent Measure of Financial Strength</u>

Section 204 provides a fiduciary safe harbor for any insurer meeting the following criteria:

- The insurer is licensed by the state insurance regulators to sell annuities;
- The insurer has been licensed by the state insurance regulator continuously for 8 years;

- The insurer files financial reports required by the state insurance regulator;
- The insurer is not operating under an order of supervision, rehabilitation or liquidation by the state insurance regulator;
- The insurer maintains reserves required by the state insurance regulator; and
- The insurer is audited/examined at least every five years by the state insurance regulator.

These criteria provide a safe harbor for any insurer not in financial distress – even insurers whose state insurance regulator risk-based capital ratio is barely above the action level or whose rating agency ratings are relatively weak. In addition, reserve and capital standards vary by state from the standard Statutory Accounting Principles (SAP) through a mechanism called "state permitted practices." Such state permitted practices can have a huge impact on the financial presentation of the insurer. In one instance, for example, an insurer re-domesticated from Washington to Iowa and, as a result of Iowa's state permitted practices, showed about $1 billion more in admitted assets than it had under the SAP utilized by Washington.

In summary, the current safe harbor criteria for insurers rely exclusively on state insurance regulators. They are so expansive they would allow even financially-weak insurers to qualify for the safe harbor. To address this problem, we suggest the addition of a criterion based on a high credit rating or some other independent measure of financial strength. The addition of such a financial strength measure becomes all the more important if Congress fails to adopt our above suggested changes to the definition of guaranteed retirement income contract.

<u>Additional Clarification Regarding the Scope of the Safe Harbor</u>

It is our understanding that the safe harbor is intended to allow for a more streamlined selection and monitoring of annuity providers, but not to relieve plan sponsors of liability with regard to the selection of individual annuities to be included on plan menus. However, as a result of what may be nothing more than a simple drafting error, one of the bill's subheads creates some ambiguity regarding whether the safe harbor would also extend to the selection of specific annuities to be offered through plans. The legislation must be crystal clear that the safe harbor applies only to the selection of providers, and that the selection of annuities based on price and terms of those annuities remains subject to ERISA liability. While this would not always require the selection of the lowest cost annuity, as the legislation specifies, it should not permit plan sponsors to ignore costs in the selection of plan offerings.

Thank you for your consideration, Please feel free to contact any of us for further information.

Respectfully submitted,

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