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To: Annuity Disclosure (A) Working Group

re: Illustration Guidelines

I previously stated my desire for certain changes to the illustration guidelines, (for ease of reference, I have copied the text as an appendix to this memo, while the original remains on NAIC website. I have borrowed from the exhibits provided by the Academy of Actuaries to demonstrate what I would like to see.

I suggest three changes.

- A) The first is elimination of redundant information on the illustration, presuming the illustration would be integrated into the Disclosure. Beyond the redundant warnings and explanations, I would also suggest elimination of redundant customer information. A contractholder will know his/her gender and age. The "Disclosure" is to be specific to the contract under consideration, so no additional contract identifying information is necessary, i.e. a single premium deferred annuity cannot be illustrated with an indexed annuity disclosure. If the customer is considering two annuities, two disclosures will be required, and each should have its own illustration.

The attached illustration shows how much white space this generates on the example. I have carried all the non-illustration material to the first page and eliminated most of it. The front page now contains minimal contract and customer identification, as well as key variables used in the calculations. We can consider other eliminations or necessary additions after interested parties offer comments.

- B) The second is inclusion of a "Liquidity" illustration in all Disclosures. We are aware that one of the most frequent complaints we receive is the inability to reverse a purchase (buyer's remorse) without incurring surrender charges. I am suggesting that every illustration document include at least two scenarios, one presuming the contract is held to maturity, and a second presuming the maximum free withdrawals are made. Additional illustrations can be provided, allowing the customer to see how any special plans can be attained.

Recognizing we are only providing guidelines which would dictate required information, I did not follow through on my earlier suggestion of eliminating columns, such as the withdrawal column when no withdrawals are illustrated. I suspect companies will want to develop consistent formats for ease of comprehension and we would be overstepping our regulatory responsibilities in dictating style.

The attached illustration includes three scenarios. The first is the standard "hold to maturity" scenario. Second is the "Liquidity" scenario, in this case presuming free withdrawals are equal to 10% of the initial premium. Third is the scenario suggested by the ACLI showing interest only withdrawals for 10 years.

I do want to note one stylistic point I believe we could reasonable require, (despite the last sentence in the paragraph above). My personal experience is that I find illustrations using contract years are confusing. I would suggest we include in our illustration requirements the use

of calendar dates and ages, both of which are familiar to the contract holder. I suspect use of contract anniversaries dated from a time when computing capacity was not at current levels.

- C. Finally, I have inserted available income at each point as an alternative to a cash withdrawal. As I previously stated, this is intended to emphasize the purpose of the annuity, the life time income. In my illustration, I have chosen the option generating the largest income, the life only option, and have used the Account Value to fund the purchase. If a company has different rules, it would have to illustrate based upon those rules.

I hope this "sample illustration" is able to drive discussion leading us to the best possible decision. I see difficulties in some of my proposals, but wanted everyone to have an opportunity to see the possibilities in what I proposed in September. I look forward to responses, not only from my fellow regulators on the committee, but also from interested parties, including the Academy, ACLI, and our funded consumer representatives.

I have attached both the Excel version of the sample, and a PDF version.

Thank you for the opportunity to hopefully move our discussion forward.

Appendix:

Text of September 18 e-mail

Jim, in the interest of clarity of discussion at our meeting Monday, I wanted to provide some of my thoughts in writing. I have copied members of the Academy committee and staff, so they might have time to respond.

First I am very pleased by the efforts of the Academy committee, as I believe standard illustrations can greatly improve the disclosure process for annuity sales. You know I have encouraged their use, and I suggested the Academy be consulted in their development. I know the Academy has made great progress in dealing with several significant issues in an annuity illustration. The task is not easy. At this point, I believe the Academy would benefit from direction by our Working Group.

The first issue I see for which we could provide direction is the duplication of information presented. Since the illustration will be a part of the disclosure, I believe specific disclosure elements need not be repeated in the illustration. The illustration should be required to disclose specific elements used in the illustration affecting the calculation, but should not repeat information required to be contained elsewhere in the disclosure. The two elements of the disclosure should be considered as a single document, not stand alone documents. This risks the consumer reading one, and not the other, i.e. looking at the illustration without reading the disclosure. I do not believe this is likely to harm the consumer, because the illustration will be required to abide by the limitations in the disclosure. The duplication of information is likely to be counter-productive, resulting in information overload, as the Working Group has noted previously in other efforts. I believe this is a policy decision that should be made by the Working Group, which would then be communicated to the Academy. The Academy is unlikely to assume such an approach independently, not being responsible for the content of the other portions of the disclosure. In addition, without indicating the connection, the Academy, and member actuaries, are professionally bound to document the elements of their work product. Assurance needs to be provided the illustration will not be a standalone product.

The second issue I see is the choice of scenarios being illustrated. The current example provides information for a consumer who would choose to withdraw interest earnings until age 65, in my mind an unlikely scenario. I think this example was chosen to demonstrate how scheduled free withdrawals would be illustrated. I believe this "choice of scenarios" should be limited for companies providing illustrations. If a company is going to provide illustrations, I believe they should be required to illustrate a relevant scenario reflective of current consumers' misunderstandings. I would initially propose that if a company provides illustrations, it provide at least two illustrations. First, one to illustrate the situation when the consumer holds the contract to maturity as intended. This illustration would be similar to the current example, deleting the two "Withdrawals" columns. Second, one to illustrate how fast the consumer could cash out of their contract without penalty. This illustration would be similar to the current example, deleting the three "Cash Surrender Value" columns, (including the last column). Of course in most situations this "cash scenario" will be relatively short, 11 to 12 years under the 10% free withdrawal provision, so each year should be illustrated.

I believe these two illustrations provide the pertinent information most consumers might want. The company should then be allowed to provide additional illustrations if desired. For example, the producer should be allowed to illustrate the specific strategy the consumer has agreed to pursue, for example withdrawing the interest earned as in the current example.

The third issue concerns the role of the annuity. If our intention is to focus the consumer's attention on the retirement income generation, we should include a column displaying the monthly income available at each point in time. If the consumer is not allowed to annuitize at any point in time, we could include an "asterisked" \$0, while when annuitization is available, we should show the monthly income that could be generated. This raises questions as to the annuity option to be shown, I would suggest the option generating the greatest income be used, presumably the Life option, with no guaranteed periods or death benefits (i.e. not joint and survivor). The monthly income available can be added as a column, replacing those I suggested deleting earlier.

Again I commend the Academy on their work, without the initial template we would have difficulty seeing the possibilities. I just believe our Working Group should build on their efforts and provide direction to them.