SEC: VA closures, buybacks send wrong message

By Editorial Staff *Thu, Nov 8, 2012*

The director of the SEC Division of Investment Management said VA issuers seem to be telling investors, 'Here is the deal we are offering you, unless we find out later that we miscalculated.'

In late 2011, when word first trickled out that some life insurers might try to de-risk their books of variable annuity business by encouraging owners of contracts with rich riders to exchange them for less risky new ones, observers wondered how the SEC might react.

Similar concerns arose last summer after the decision by several of the largest VA writers to block new contributions to contracts that were purchased a few years ago, when living benefits were rich.

The carriers involved in the closures included Allianz, AXA, John Hancock, MetLife, Prudential and Transamerica, according to Morningstar's third-quarter variable annuity update.

[Last week, the Associated Press reported that Hartford Financial Services Group has offered some of its annuity clients cash for their contracts. "We are making this offer because high market volatility, declines in the equity markets and the low interest rate environment make continuing to provide the Lifetime Income Builder II rider costly to us," Hartford said in a Securities and Exchange Commission filing last Thursday. CEO Liam McGee said during a conference call on Friday that the offer will be made to annuity holders that make up almost 45% of the net amount at risk on the contracts.]

The SEC has since taken notice of the situation, according to an attorney who is a consultant to life insurers. One of its responses has been to approach the major insurers and ask them to answer eight questions about the prospectuses of the contracts that were closed to subsequent contributions, or sub-pays, and whether they had properly disclosed their right to shut off contributions. The SEC delivered the questions orally, but asked for written answers, the attorney said.

Both of these issues—the exchanges and the closures—were addressed by Norm Champ (below right), the director of the SEC's Division of Investment Management, in a speech at the ALI CLE (American Law Institute-Continuing Legal Education) 2012 Conference on Life Insurance Company Products in Washington, D.C. on November 1.

In prepared remarks, Champ articulated the same concerns that a few VA distributors voiced months ago. He urged life insurers to prevent the current situation in the future by risk-testing their products more thoroughly before marketing them to the public.

> "The [SEC] staff has noted that several recent filings announced companies' decisions to stop accepting additional purchase payments on outstanding contracts," Champ said. "In most cases, the affected contracts were those with a living or death benefit that appears to have been too generous for the issuing insurer to maintain in a sustained environment of low interest rates and volatile equity markets.
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> "These actions may have surprised some investors who had hoped to fund their retirement income over time through ongoing purchase payments, including established automatic purchase plans.
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> "Regardless of whether any or all of the companies had effectively reserved the right to suspend payments, one has to question the message this course of action sends to investors in these products generally. I fear the message might read something like this: 'Here is the deal we are offering you, unless we find out later that we miscalculated, in which case you may have to go elsewhere to build annuity value and possibly pay a surrender charge on your investment with us on your way out.' "

On the question of life insurers offering to exchange new contracts for existing contracts with rich benefits, Champ said:

> "Several issuers of variable annuities, again generally those with generous living benefits, have recently made exchange offers for newer contracts that do not feature those benefits. Some insurers have also offered inducements, such as cash bonuses, to contract owners who surrender their contracts or terminate living benefit riders.
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> "These actions raise questions about the suitability of both the original transaction and the exchange, where the original transaction was perhaps premised on the value and importance of the living benefits and the exchange removes or reduces those same benefits.
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> "A careful consideration of the risks associated with the design of any product could assist in avoiding the scenarios playing out now. Going forward, the Division urges you to keep in mind steps you may have to take in the future to limit your risk, think through how this affects your customers, and consider how you can make your customers aware of the risks they may face with the product you are selling them."

The eight questions that the SEC sent to variable annuity issuers asked them to identify the contracts that were being closed to new payments and to identify the specific prospectus language that supported the closure, and whether the decision to block new contributions had been vetted by an attorney. The questions also sought to identify the exact dates when the products were sold and the dates when prospectus language was added.

Asked what might occur if the prospectus didn't support the closures, the attorney said, "The SEC could bring an action against the company that had no contractual right to do it. There could be fines, and if the

prospectus was false and misleading, and if the SEC can show that it was willful, the fines can go up."

In other comments, Champ noted that the Investor Advisory Committee, created by the Dodd-Frank Act, had recently published its first recommendations on the general solicitation in Rule 506 of Regulations D offerings. This year's JOBS Act requires the SEC to lift the ban on general solicitation and advertising in Rule 506 private placements. The ban had confined hedge funds and private equity firms to promoting securities only to "accredited investors," such as wealthy investors and institutions.

The Insured Retirement Institute issued a press release Monday praising Champ for a part of his speech where he favored the development of a summary prospectus for variable annuities. Champ noted that a recent financial literacy study showed that investors liked the mutual fund summary prospectus.

In a release Monday, IRI President and CEO Cathy Weatherford said, "We are encouraged by Director Champ's remarks and agree with his optimism that a variable annuity summary prospective would benefit investors by providing better information. "There remains a strong demand by investors for clear and concise variable annuity information. IRI research shows that 95% of investors prefer a shorter paper summary prospectus. As it stands today, the length of the full prospectus—in and of itself—is a barrier to investor education and informed decision making.

"Only 17% of investors reported reading any part of the full prospectus in 2012. And even among those that have, they are only reading a small fraction of the full prospectus, which often times can be between 150 to 300 pages long. The research is clear that now is the time for a summary prospectus to facilitate more informed decision-making."

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