Retirement Income
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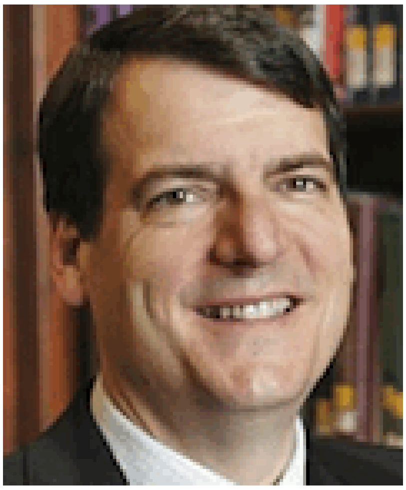
VA closures, buy-backs send wrong message: SEC

By Kerry Pechter *Tue, Nov 6, 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.'

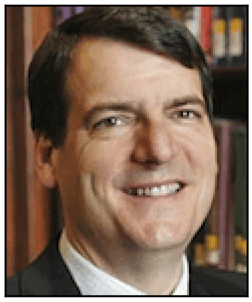


In late 2011 and early 2012, when it first became known that variable annuity issuers might try to de-risk their books of business by offering to exchange existing rich contracts for less risky ones, some close observers wondered how the SEC might react.

Last summer, the decision by several of the largest issuers to block new contributions to variable annuity contracts that were purchased a few years ago, when living benefits were rich, raised similar concerns.

Both of these issues were addressed by Norm Champ (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 many 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. He did not, however, mention taking any action against the practices.



"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.

"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.

"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.

“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.

“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.”

In other comments, Champ noted that the Investors Advisory Committee, created by the Dodd-Frank law, had recently published its first recommendations on the general solicitation in Regulation D Rule 506 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 like the mutual fund summary prospectus.

That study “provides grounds for optimism that a variable annuity summary prospectus, if designed and implemented effectively, could provide better disclosure for investors in your products,” Champ said. “The framework that was designed for mutual funds — that is, the provision of key information in a summary prospectus, together with online delivery of the statutory prospectus and paper delivery upon request — may provide a useful model for improving the disclosure that variable annuity investors receive.

“I know, and appreciate, that the industry has worked hard to try to adapt the mutual fund summary prospectus in a way that is workable for variable annuities. That effort involves difficult decisions about how to adequately convey to investors and financial advisors the terms of complicated products, with a wide variety of benefits, risks, and costs. Like you, we are committed to making improvements in the important area of helping variable annuity investors to make informed investment decisions. Investors in variable annuities deserve our best efforts on this important initiative.”

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. That is why IRI remains committed and resolved to work with the SEC to ensure that relevant, clear and concise information, via a variable annuity summary prospectus, is made available to investors.”