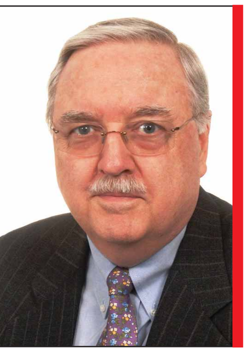
 By Peter H. Bickford

The Wonderful World of Annuities

Picture the child sent out to play in the snow so bundled up with layers upon layers of protective clothing that the child is barely able to move or to enjoy the experience. Keep that picture in mind if you want to buy an annuity in New York. The statutory and regulatory requirements for such a purchase are time consuming and daunting, even for a knowledgeable purchaser, including tons of explanatory materials, forms, questionnaires, directives, time periods and sundry other requirements. On the flip side, the process is daunting as well for the producers – particularly the conscientious producers as the foot soldiers who are the first casualties if all the requirements are not met. I suspect many of these play-by-the-rules producers view the requirements as straight jackets rather than as protective clothing.



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Then there are the annuity issuers who have to provide annuity products within the extensive statutory and regulatory constrictions that are appealing and meaningful to consumers while also profitable for the issuers. On top of the already existing requirements, the NY Department of Financial Services and other state regulators have begun imposing additional capital and reporting requirements on private capital groups purchasing existing annuity businesses. For instance, DFS's approval of two recent acquisitions of annuity issuers were conditioned on the purchasers' agreements to accept "heightened capital standards; the establishment of a separate, additional 'backstop' trust account dedicated to further safeguarding policyholder claims; enhanced regulatory scrutiny of investments, operations, dividends, and reinsurance; and other strengthened disclosure and transparency requirements."

A first reaction to the announcement of these increased regulatory controls by many industry observers was twofold: What is the justification for imposing greater requirements on private equity investments in the annuity business? And why would any sane investment firm agree to the conditions? The DFS has expressed its justification as follows: "DFS has highlighted a spike in private equity firms and other investment companies moving into the annuity business. This trend raised concerns since such firms typically have a more short-term oriented business model than traditional insurers, and the annuity business is focused on ensuring long-term security for policyholders."

The answer to the second question is not as readily ascertainable, but it may be that the willingness of these investment firms to accept the regulators' terms is a sign that the regulators may, in fact, be onto something. Notwithstanding the current low interest rate environment, the stifling regulatory requirements for the marketing and sale of annuity products, and the failure of annuity issuers like Executive Life Insurance Company of New York (ELNY), investment firms apparently have concluded that there is still "gold in them thar hills."

There is no question that annuities are a complex product with many iterations that can be confusing to even sophisticated investors let alone the general public. In this respect I strongly recommend a pamphlet titled "A Consumer Guide for Annuity Products in New York" available on the DFS website. The superbly written pamphlet should be required reading (except for the penultimate page – see below) for anyone considering the purchase of an annuity, whether in New York or elsewhere. Its descriptions of the various annuity products are precise, clear and readable even if you do not have an MBA degree. Unfortunately, the pamphlet is not that easy to find on the less-than-user-friendly DFS website, so here is a link to the pamphlet: http://www.dfs.ny.gov/consumer/life/cli_annu_guide.pdf

Although undated, the pamphlet was certainly written prior to the merger of the insurance department into the DFS. This forensic conclusion is based on a note at the end of the document stating: "This publication was prepared by the New York State Insurance Department," which of course ceased to exist in October 2011.

The pamphlet's description of guaranty fund coverage is also telling: "Generally, immediate and deferred annuity contracts issued to a New York resident by a licensed life insurance company that provide fixed benefit guarantees are covered by the Life Insurance Company Guaranty Corporation of New York for up to $500,000." As of the closing of the ELNY restructuring plan this

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past August, all of the assets of the life guaranty funds in New York were transferred or committed to the new DC captive assuming the restructured ELNY contracts. As a result, the life guaranty funds in New York have no assets available for the protection of life or annuity products, and no means of obtaining additional assets without a change in the law. Any discussion of guaranty fund coverage for annuity contracts in DFS publications should reflect this fact. (the life industry, on the other hand is precluded by law from mentioning guaranty fund coverage in its marketing material. Here is the rare instance where that restriction happens to be a good thing.)

As a guide to all the different types of annuities and how they each work, the pamphlet is a tribute to the professionalism and expertise of its original drafters. As a publication issued and posted by the current administration on its website, however, the pamphlet is misleading and a reminder of the hypocrisy of the current DFS. While Superintendent Lawsky and the DFS are currently flying the flag for consumer protection against greedy capitalists entering into the annuity business, they do so against the background of their choosing to protect those responsible for the $2 billion failure of ELNY under two decades of mismanagement by the New York Liquidation Bureau, while failing to protect the most seriously affected class of annuitants.

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After discussing guaranty fund coverage, the pamphlet also exudes with great pride: "**Buy New York**. Annuity products approved for sale in New York generally provide greater consumer protections than products sold elsewhere. The minimum account values are higher, charges are lower and annuitization and death benefits are more favorable." It is highly unlikely that in view of the stifling new regulatory restraints the second sentence is true, but it is a certainty that without any current means providing guaranty fund coverage, the first statement is not true.

(There is an interesting brochure dated June 2013 prepared by the DFS but posted on the life guaranty fund web site titled "Policyholder Protection" that, after four pages describing NY the scope and benefits of NY guaranty fund coverage for life products – including annuities — acknowledges the funding issue on the final page with assurances that the issue is being addressed. I could not find reference to this brochure on the DFS website.)

While an annuity purchaser may feel all warm and cozy wrapped in the protective layers and glossy assurances provided by the regulators and the guaranty associations, the reality may not be so comforting or rewarding! Just ask the 1500 ELNY annuitants whose payments have been slashed. [IA]