

STATE OF MINNESOTA
DEPARTMENT OF COMMERCE

IN THE MATTER OF THE PROPOSED)
RULE GOVERNING ~~THE~~ ISSUANCE)
MODIFIED GUARANTEED ANNUITIES)

STATEMENT OF NEED
AND REASONABLENESS

STATEMENT OF AUTHORITY

Minnesota Statutes, Section 61A.20 provides that:

Notwithstanding any other provision of law, the Commissioner shall have sole and exclusive authority to regulate the issuance and sale of contracts on a variable basis and to provide for licensing of persons selling such contracts, and to issue such reasonable rules as may be appropriate to carry out the purposes and provisions of sections 61A.13 to 61A.21.

Additional rulemaking authority provided in Minnesota Statutes Section 45.023 authorizes the Commissioner to "adopt, amend, suspend, or repeal rules... whenever necessary or proper in discharging the Commissioner's official responsibilities."

The Commissioner finds the rules to be reasonable and necessary and consistent with the purposes fairly intended

by the provisions of Chapter 45 and sections 61A.13 to 61A.21 of Chapter 61A.

FACTS ESTABLISHING NEED AND REASONABLENESS

BACKGROUND

In June, 1985, The National Association of Insurance Commissioners (NAIC) adopted a model regulation governing the issuance of modified guaranteed annuities and the insurers which issue them. Several states have either adopted the NAIC regulation or are about to adopt it.

As with traditional variable annuities, the assets of a modified guaranteed annuity are placed in a separate account. This enables the insurer to offer long term competitive rates and allows for an accurate matching of assets and liabilities. However, the product's design also incorporates a market value adjustment formula to determine nonforfeiture values. Through the use of the formula, the insurer can meet its withdrawal guarantees, without relying on reserves, even during periods of spiking interest rates. This characteristic ensures a fair withdrawal value at any time for the policyholder. However, as in the case of the fixed deferred annuity, the investor is guaranteed a fixed rate if the product is held to maturity.

Modified guaranteed annuities are currently being sold in Minnesota by foreign insurers. However, domestic companies cannot compete in this market because they must obtain home state approval to issue these contracts. Minnesota Statutes 61A.14, Subd. 7 provides that "unless otherwise approved by the Commissioner, assets allocated to a separate account shall be valued at their market value..." Minnesota Statutes 61A.21 provides that Minn. Stat. 61A.245 (The Standard Nonforfeiture Law for Individual Deferred Annuities) does not apply to contracts on a variable basis. It further provides that the contract must contain provisions for nonforfeiture "appropriate to such a contract". In order to determine and govern the appropriateness of the nonforfeiture values of a modified guaranteed annuity, it is necessary to promulgate a rule authorizing and governing the use of the market-value adjustment formula. The proposed rule will authorize the sale of modified guaranteed annuities by Minnesota companies and will strictly govern the terms under which the product is issued and marketed.

Rule Part 2751.0100

This part sets forth the purpose of the rule which is to regulate the issuance and the marketing of modified guaranteed annuities.

Rule Part 2751.0200

This part cites Minnesota Statutes 61A.20 as the statutory authority for the promulgation of these rules.

Minnesota Statutes 61A.20 gives the Commissioner sole and exclusive authority to regulate the issuance and sale of contracts on a variable basis and the licensing of persons selling such contracts. It also provides specific rulemaking authority.

Rule Part 2751.0300

This part deliniates the scope of the rule. The rule applies to the qualifications of agents authorized to sell the product, the qualifications of insurers issuing the contracts, the contract form and the system of separate account maintenance and reporting.

Rule Part 2751.0400

This part defines the technical terms used in the rule.

Subparts 1 through 3 and subpart 5 are self-explanatory. Subpart 4, which defines the modified guaranteed annuity, focuses on the two design characteristics of the product which differ from the design of traditional deferred annuities. First, the assets supporting the contract are held in a separate account. Secondly, the nonforfeiture value of the contract is computed by applying the predetermined market-value

adjustment formula to the balance of the policyholder's account.

The first feature, the separate account, allows for the segregation of the policyholder's investment from the insurer's general account and ensures a more accurate matching of assets and liabilities. The use of the market-value adjustment formula to determine nonforfeiture values enables the insurer to meet its withdrawal guarantees regardless of current interest rates. The market-value adjustment formula is relevant only when a surrender occurs since the contract value at maturity is guaranteed.

Subpart 6 defines a "separate account" as a separate account authorized by Minnesota Statutes 61A.13 to 61A.21 or pursuant to corresponding sections of the insurance laws of the state of domicile of a foreign or alien insurer. Minnesota Statute 61A.14 specifically authorizes domestic life insurance companies to operate separate accounts and issue contracts on a variable basis.

Rule Part 2751.0500

This part governs licensing, marketing and reporting issues which will apply to all insurers seeking approval of their modified guaranteed annuity contracts in Minnesota.

Paragraph 1 of Subpart 2 prohibits issuance of modified guaranteed annuities by companies not licensed or organized to do life insurance or annuity business in their state of domicile. In addition, the Commissioner may look at such factors as the history and financial condition of the company; and the laws under which a company is authorized by its state of domicile to issue these annuities in order to determine whether or not the insurer's method of operation is hazardous to the Minnesota public or policyholders. The language enables the Commissioner to deny approval of modified guaranteed annuity if the insurer's financial condition is so impaired that there would be a hazard to the Minnesota public or policyholders.

Paragraph 2 allows a company which is a subsidiary of an admitted life insurance company or affiliated with the company by common management or ownership to transact the business of issuing modified guaranteed annuities without meeting the requirements of Paragraph 1 if it or the principal company satisfies the requirements of Paragraph 1. This provision eases the Commissioner's regulatory burden and provides the same protection for the public as under the provisions of Paragraph 1. Likewise, a licensed company with a three year record of acceptable business operation in Minnesota will be deemed to have satisfied the qualification requirements.

Subpart 3 prohibits the use of any marketing materials which are false, misleading, deceptive or inaccurate. Illustrations may not use investment experience to show predictions of future experience. However, illustrations may use hypothetical interest credits. The Commissioner has the authority, under this subpart, to require the filing of any sales material or prospectuses. The sales material must disclose the possibility of upward and downward valuation of the contract upon a surrender. This subpart is consistent with the marketing requirements imposed on other investment products by the Department in the area of insurance and securities. The provision is necessary to protect investors from making uninformed decisions or decisions based on misleading information.

Subpart 4 addresses the reporting requirements for issuers issuing modified guaranteed annuities. Such issuers must submit annual statements regarding their separate accounts and any other information concerning their modified guaranteed annuity business which the Commissioner considers necessary. These reports will assure that the separate accounts are properly maintained. The provision also gives the Commissioner discretionary authority to obtain additional information from the insurer.

Subpart 5 gives the Commissioner authority to disapprove any material filed under this Part if it does not comply with the requirement of Chapter 2751.

Rule Part 2751.0600

This part extends the current filing requirements for individual and group life insurance and annuities to modified guaranteed annuity filings. In addition, such filings must verify that the nonforfeiture benefits provided for in the contract comply with part 2751.0700, subpart 1.

The section is necessary to assure consistency in filing requirements for like products.

Rule Part 2751.0700

This part sets forth the contract requirements for all modified guaranteed annuities delivered or issued for delivery in Minnesota.

Item A of Subp. 1 requires that the insurer provide a description of the method used to compute nonforfeiture benefits on pre-maturity withdrawal. This provision recognizes that the use of the market-value adjustment formula in determining nonforfeiture benefits is a unique concept. This disclosure will make the consumer aware of the formula's features and its potential to increase or decrease the amount of benefits received.

Item B contains the provisions for continuation of the contract for a 30 day or one month grace period after any payment other than the first is due, and for reinstatement of the contract within one year of default upon payment of all debts owed to the insurer, provided, however, that the annuitant is still alive and that the surrender value has not been paid. Such requirements provide the consumer with the necessary security against immediate cancellation of the contract upon the consumer's failure to make a payment.

Item C requires disclosure of the market-value adjustment formula in the contract and that such disclosure apply to both upward and downward adjustments. Further, it requires that an actuarial statement accompany the contract when filed and that the statement describe the basis for the formula and shows "reasonable equity" to both parties.

These requirements guard against the possibility of an uninformed investment commitment due to a misleading statement or omission regarding the formula. The filing of the actuarial statement serves to guarantee that the formula will not be inequitable to the consumer.

Item D insulates the policyholder's investment from claims of creditors in connection with unrelated business transacted by the insurer. The policyholder's assets are

subject only to liability arising out of business operations concerning his or her purchase of the modified guaranteed annuity contract.

The second to the last paragraph in Item C(4) allows the insurer to adjust the contract charges which are subtracted from the contract's value for the specified fixed costs according to changes in the Consumer Price Index. This provision transfers the assumption of increased costs due to inflation from the insurer to the consumer, and eliminates the risk of inability by the insurer to meet inflationary transaction costs.

Paragraph H of 2751.0700 provides the insurer with a fair and reasonable means of cancellation and settlement of the contract when the transactions costs involved in satisfying the contract are greater than the value of the contract itself. In such a case, it is unreasonable to require the insurer to absorb costs below a fair minimum benefit amount.

Item I deals with contracts containing both annuity and life insurance benefits and provides a mechanism for determining the combined paid-up annuity, cash surrender and death benefits as well as the minimum nonforfeiture amounts. However, the variable annuity regulations and the individual nonforfeiture laws may be applied if and

to the extent that the contract incorporates modified guaranteed annuity benefits and (1) variable annuity annuity benefits varying directly with the value of assets held in the separate account, and (2) traditional fixed annuity benefits, or (3) life insurance benefits.

Rule Part 2751.0800

Due to the hybrid nature of the modified guaranteed annuity contract, this section requires the establishment of reserve liabilities for this product according to actuarial procedures, and in consideration of the following factors:

(1) the market-value basis of the separate account assets; (2) the variable character of benefits; (3) mortality guarantees; (4) interest guarantees; (5) the market-value adjustment formula; and (6) the degree of matching of projected cash flow of assets and liabilities.

Rule Part 2751.0800 also requires that the minimum level of separate account liabilities equals the surrender value of the contract, and that the market-value of the assets equals, at a minimum, that of the liabilities. In addition, the valuation actuary must annually submit an opinion as to whether the separate account assets will sufficiently cover all future guaranteed benefits. The insurer must show not only that it is capable of providing for all benefits due the customer, but also that the market-value level of assets is at least balanced with the market-value level of liabilities.

Rule Part 2751.0900

This section contains the separate accounts requirements associated with modified guaranteed annuity contracts. Paragraphs 1, 2, and 3 concerning the establishment and maintenance of separate accounts, level of separate account assets, and valuation of these assets, incorporate and implement the Minnesota separate account law for contracts on a variable basis codified at Minn. Stat. 61A.14. Paragraph 4 subjects separate accounts for the product to the applicable investment laws.

Rule Part 2751.1000

2751.1000 delineates the reports, and the information required to be included therein, which insurers must annually provide to their policyholders. The proposed rule minimizes the possibility of misleading reports by requiring full disclosure of all current values and future adjustments to be made to these.

Rule Part 2751.1100

This section allows the Commissioner discretionary power to deem that foreign companies which are governed

by and are in compliance with laws or regulations of other jurisdictions which afford protections to the public comparable to those afforded by the proposed rule are in compliance with the proposed rule. This provision serves to ease the Commissioner's supervisory workload and simplify national transactions of business regarding the sales and issuance of modified guaranteed annuity contracts.

Rule Part 2751.1200

Under this section, sales or offerings of this product may only be transacted by those licensed to sell variable annuities under Minnesota law.

SMALL BUSINESS CONSIDERATIONS

The small businesses affected by this rule are insurance agencies.

The rule does not impose any additional burdens on these agencies. Rather, the rule allows Minnesota agents to sell a product which they previously could not sell and creates a new source of revenue for these agents. Therefore, since the impact on such agencies will be a positive one, there is no need to consider the methods listed in Minn. Stat. 14.15, subd. 2, a-e

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AMENDMENTS TO PROPOSED PERMANENT)
RULES GOVERNING THE ISSUANCE OF) AND REASONABLENESS
MODIFIED GUARANTEED ANNUITIES)

STATEMENT OF AUTHORITY

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Additional rulemaking authority provided in Minnesota Statutes Section 45.023 authorizes the Commissioner to "adopt, amend, suspend, or repeal rules ... whenever necessary or proper in discharging the Commissioner's official responsibilities."

The Commissioner finds the amendments to be reasonable and necessary and consistent with the purposes fairly intended

by the provisions of Chapter 45 and sections 61A.13 to 61A.21 of Chapter 61A.

BACKGROUND

On July 10, 1989 the Proposed Permanent Rules Governing the Issuance of Modified Guaranteed Annuities were published in the State Register. These rules are based on a National Association of Insurance Commissioners (NAIC) model regulation. The Commissioner questions whether the model regulation provides adequate protection for Minnesota consumers and believes that further review is warranted. Therefore, the Commissioner proposes this amendment in order to allow the Department to determine if the rule provides adequate standards in regard to the market value adjustment and the policy form requirements.

As stated in the first Statement of Need and Reasonableness, certain other states do approve modified guaranteed annuity contracts and do allow the sale of such contracts to their residents. However, 15 of these states require that the contracts must be approved in their home state before they can be sold in their states. This means that Minnesota insurers cannot sell their modified guaranteed annuity products in these states. The Commissioner finds that it is reasonable to allow Minnesota domiciled companies to sell their modified guaranteed annuity products in other states which currently approve such products for sale to their residents.

Rule Part 2751.1300

This part prohibits the sale of modified guaranteed annuity to Minnesota residents until an Order is issued by the Commissioner. This authority is consistent with Minnesota Statutes 61A.20 and provides the Commissioner with the time needed to more fully review the appropriateness of this investment product for Minnesota consumers. Minnesota Statutes 61A.20 gives the Commissioner "sole and exclusive authority to regulate the issuance and sale of contracts on a variable basis and to issue such reasonable rules as may be appropriate ..." It is clear from that language that the Commissioner's authority is not limited to promulgating rules but that he has broad discretionary authority in this area. Therefore, the Commissioner has been given the authority to determine by Order if and when modified guaranteed annuities may be sold to Minnesota residents.

The language of the proposed rule and amendment allows Minnesota to approve modified guaranteed annuity contracts as to form. With "home state approval", Minnesota domiciled companies will be able to obtain approval of their products in other states and complete in those markets.

SMALL BUSINESS CONSIDERATIONS

The small business consideration remain as stated in the first Statement of Need and Resonableness.

Although Minnesota agents will not be able to sell this product, the amendment allows the Commissioner to authorize the sale of the product to Minnesota residents by order. If and when such an order is issued, a new source of revenue will be created for Minnesota insurance agents and companies.

The amendment does not impose more stringent schedules, compliance or other requirements on small business and therefore, it is not necessary to consider the methods set forth in Minnesota Statutes 14.115, subdivision 2 for reducing the impact of the rule on small businesses.