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Circular Letter No. 5 (2011)
February 7, 2011

TO: All Authorized Life Insurers and Fraternal Benefit Societies (collectively, "Insurers")

RE: Guaranteed Minimum Withdrawal Benefits and Excess Withdrawals Under Annuity Contracts

STATUTORY REFERENCE: New York Insurance Law Sections 3201 and 4240

The purpose of this Circular Letter is to advise insurers that an insurer should provide an annuity contract owner with a disclosure notice that explains the impact of an excess withdrawal on the annuity contract's guaranteed minimum withdrawal benefit ("GMWB").

A GMWB provides for the continuation of guaranteed withdrawal amounts regardless of the amount of value remaining in an annuity contract. However, a GMWB generally provides for a reduction in future guaranteed minimum withdrawal amounts if the contract owner withdraws money in excess of the guaranteed withdrawal amount. The reduction in future amounts is typically made on a proportional basis, where the reduction equals the guaranteed withdrawal amount times the ratio of the excess withdrawal amount to the account balance (after the reduction for the withdrawal benefit, but prior to the excess withdrawal). As a result, the reduction in the guaranteed withdrawal amount may be disproportionate compared to the excess withdrawal amount.

For example, when the guaranteed minimum withdrawal amount is $100 and the contract owner withdraws $180, the excess withdrawal amount is $80 ($180-$100). Assuming the value of the annuity contract is $500, the guaranteed minimum withdrawal amount would reduce the value of the annuity contract to $400 ($500-$100). The excess withdrawal amount further reduces the value of the annuity contract to $320 ($400-$80). The excess withdrawal results in a permanent reduction of the annual guaranteed withdrawal amount by 20% (80/400) to $80 per month.

Indeed, if the value of the annuity contract before any withdrawal had been $200 instead of $500, the percentage reduction would have been 80% (80/100), permanently reducing the guaranteed withdrawal amount from $100 to $20. As a result, the contract owner would be giving up guaranteed $100 payments for life because he or she requested a one-time additional $80 withdrawal. If the contract owner chooses to surrender the annuity contract, the guaranteed withdrawal benefit would be eliminated.

The Department recognizes that insurers need to limit their exposure to possible anti-selection for annuity contracts with GMWBs and that proportional reductions are a common way of limiting this exposure. The Department also recognizes that contract owners who are terminally ill or otherwise have a reduced life expectancy may have an immediate need to access their funds, which is of greater importance than preserving their future life contingent payments. However, proportional reductions may result in reductions in the guaranteed withdrawal amount that are disproportionate to the excess withdrawal amount or the amount received for a full surrender. In order to make an informed decision as to whether to take an excess withdrawal, contract owners need disclosures that explain the impact of excess withdrawals on the guaranteed withdrawal amount.

Accordingly, the Department expects insurers to provide disclosures: (1) in the annual or other periodic statement sent to a contract owner; and (2) at the time that a contract owner requests an excess withdrawal. The disclosure should clearly explain the effect of taking an excess withdrawal. A general explanation is acceptable if it also indicates that the contract owner may request a personalized, transaction-specific calculation showing the effect of the excess withdrawal as of the close of the previous business day, and what the guaranteed withdrawal amount would have been if the contract owner had taken the excess withdrawal. The Department would find the following sample disclosure acceptable:

> *Withdrawals in excess of the guaranteed withdrawal amount, called "excess withdrawals", will result in a permanent reduction in future guaranteed withdrawal amounts. If you would like to make an excess withdrawal and are uncertain how an excess withdrawal will reduce your future guaranteed withdrawal amounts, then you may contact us prior to requesting the withdrawal to obtain a personalized, transaction-specific calculation showing the effect of the excess withdrawal.*

The Department recognizes that the manner in which an insurer provides the disclosure at the time of request will vary depending upon the way in which the contract owner requests the excess withdrawal. For example, insurers often accept withdrawal requests by administrative request form, telephone or over the internet. The Department expects that an insurer will provide the disclosure on its withdrawal request form if a contract owner uses such a form to make a request. If a contract owner makes a request through the internet, then the Department expects an insurer to provide the disclosure through the internet. If a contract owner makes a request by telephone, then the Department expects an insurer to provide disclosure to the contract owner orally over the telephone. Other methods of providing the disclosure at the time that a contract owner makes an excess withdrawal request may be appropriate depending upon the method by which a contract owner may request an excess withdrawal from an insurer. An insurer should establish protocols and maintain accurate records to verify that the notices are so provided. The Department recognizes that the time limitations imposed by federal securities law for processing withdrawal requests may hinder an insurer's ability to provide the disclosure if it receives a written letter requesting the excess withdrawal. If a contract owner requests an excess withdrawal by written letter, an insurer should make a good-faith effort to provide the disclosure.

With respect to group annuity contracts issued to employee benefit plans as defined in the Employee Retirement Income Security Act of 1974 ("ERISA"), insurers should advise employers or plans that appropriate disclosure to individual participants may be required.

Insurers should implement the disclosure discussed herein within 90 days of the date of this Circular Letter.

Please direct any questions regarding this Circular Letter to Todd Cafarelli, Senior Insurance Attorney, Life Bureau, at (518) 474-4552 or by email at tcafarel@ins.state.ny.us.

Sincerely,

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Life Bureau