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Annuity Nonforfeiture:

The Sound of Falling Rates

by Noel J. Abkemeier

Low interest rates have created current and potential future squeezes between affordable interest crediting on deferred annuities and the requirements of the Standard Nonforfeiture Law for Individual Deferred Annuities (SNFLIDA). The National Association of Insurance Commissioners (NAIC) responded quickly in early 2002 to facilitate a short-term solution and is close to implementing a revision to the SNFLIDA Model Act as a long-term solution. These steps both allow lower nonforfeiture interest rates, but there are some tradeoffs, too.



In early 2002, the NAIC membership voted to support the life insurance industry request to lower SNFLIDA interest requirements. This consisted of endorsing the concept of reducing the nonforfeiture interest

rate from 3 percent to 1.5 percent on an interim basis and charging the NAIC Life and Health Actuarial Task Force (LHATF) with finding a more permanent solution. Insofar as these solutions are embedded in state laws, they require enactment in each state legislature and thus take a long time to come to fruition. Slow implementation can occur from legislatures not being in session, submission deadlines for bills having passed, deferred effective dates for new laws or lack of support.

Interim Solution

The interim solution to reduce the nonforfeiture interest rate to 1.5 percent was brought before state legislatures in early 2002 through the efforts of the American Council of Life Insurers (ACLI). At the time this article was written, 19 states have implemented interim solutions, two states have no annuity nonforfeiture law and thus need no action, and 18 states have bills in various stages from basic introduction to nearing approval. The interim revisions to the state laws allow contracts that have been approved with the lower rate to be issued until a sunset date in the law. The sunset dates range from July 2004 to July 2005, although four states have not included a sunset provision.

Model Law Changes

Over the last year, LHATF, led by the efforts of Frank Dino and Sheldon Summers, has drafted possible revisions and has reviewed suggested changes made by the ACLI and the American Academy of Actuaries (AAA). On February 20, LHATF released for exposure a draft with revisions to the SNFLIDA Model. These must be approved in turn by LHATF, the NAIC Life Insurance and Annuities (A) Committee, and then by the NAIC membership. These approval steps had

not yet been taken at the time this article was written, although they may have been taken by the time this newsletter is published.

The most significant features of the proposed SNFLIDA model revision are:

- The minimum nonforfeiture interest rate is set at the five-year Constant Maturity Treasury Rate minus 1.25 percent, except for equity indexed annuities (EIAs).
- EIA are allowed an additional reduction of 1 percent, but the value of the guaranteed equity indexed benefits must be at least as great as the value of the additional interest reduction.
- The minimum nonforfeiture interest rate cannot exceed 3 percent nor fall below 1 percent (no exception for EIAs).
- The interest rate may be redetermined at specified dates, if any, stated in the policy.
- The interest rate can be determined as of a single date or on the basis of an average over a period within the most recent 15 months.
- The net considerations (which had been 90 percent on single premium products and 65 percent first year/87.5 percent subsequent on flexible premium products) are now 87.5 percent of gross premium on all products.

Other changes are:

- The minimum nonforfeiture amount recognizes an annual contract charge of \$50, regardless of whether premium is paid. Collection charges are eliminated.
- Premium tax paid by the insurer reduces the nonforfeiture amount.
- The reference “increased by any existing additional amounts credited to the company by the contract” is removed.

This wording had been interpreted differently in various jurisdictions.

- The right to defer payment of cash surrender benefits for up to six months is to be subject to approval by the commissioner.

The major tradeoff is the increase in recognized net considerations on flexible premium products in return for the interest reduction and the ability to periodically re-determine the guarantee rate. This affects all fixed deferred annuities but may have the greatest impact on EIAs, where the nonforfeiture floor is a component in defining long-term benefits.

Just as the interim solution is taking several years to be implemented, so will it take an extended period to enact the long-term solution. However, the specificity and comprehensiveness of the long-term solution may allow it to get more attention and more prompt responses in legislatures.

Another Temporary Remedy

It should be noted that additional relief has always existed is available in all but a few states and can relieve some pressures prior to changes in the law. The nonforfeiture law in most states requires minimum cash values equal to the specified percentage of premium less withdrawals, all accumulated at 3 percent (or, temporarily, 1.5 percent). This does not address guaranteed minimum crediting rates (as opposed to nonforfeiture rates). Consequently, there is the possibility of setting minimum guaranteed crediting rates below the nonforfeiture interest rate in the vast majority of states, provided cumulative minimum values meet the nonforfeiture requirements. This is certainly not a full solution, but can provide some limited relief. □



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