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XYZ Addresses UL Nonforfeiture Values

by James N. Van Elsen

Minimum nonforfeiture values have been difficult to define for universal life products since they first appeared in the early 1980's. The Universal Life Insurance Model Regulation used the unamortized whole life expense allowance to determine minimum values for flexible premium universal life products. A drafting note in the regulation observes: "The drafters chose a whole life initial expense allowance for several reasons. Although highly flexible, universal life insurance is generally considered a permanent life insurance plan. Most companies encourage a premium level which will provide a lifetime insurance protection. Every universal life insurance policy of which the drafters are aware has a 'net level premium' that could be computed which would guarantee permanent protection. As a result, it is expected that most universal life insurance policies will be sold as permanent plans."

Obviously the drafters of this regulation did not anticipate the current "term-like" universal life insurance products. The only consideration of secondary guarantees in the regulation was in a drafting note: "it is possible that policies will have secondary guarantees. Such guarantees should be taken into consideration when computing minimum paid-up nonforfeiture benefits." Proposed actuarial guideline XYZ attempts to address the impact of these secondary guarantees on minimum nonforfeiture values.

The current draft of XYZ was submitted by Frank Dino of the Florida Insurance Department. As written, it would apply to all policies issued on or after January 1, 2001. As an actuarial guideline, its adoption by the NAIC would be sufficient for it to become effective in most states.

The current proposal uses the secondary guarantee premium for determining nonforfeiture adjusted premiums. After the secondary guarantee period, premiums sufficient to produce a zero account value are used. For example, a product with a 30-year level secondary guarantee premium would use the level premium for 30 years followed by annually increasing premiums approximately equal to the annual cost of insurance. Adjusted premiums would be calculated using a constant percentage of this schedule of premiums. At older ages, this would generally result in significant minimum nonforfeiture values. These values would be used only if greater than the cash surrender value otherwise available from the universal life contract.

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The difficulty with this proposal is that it ignores the flexibility of premium payments available under the universal life policy. Term policies avoid nonforfeiture values in this situation by having large ultimate premiums that effectively eliminate any required cash values.

Universal life policies cannot have such high ultimate charges because of the nonforfeiture requirements of the Universal Life Insurance Model Regulation. Yet, a policyholder could choose to pay exactly the same schedule of premiums for the universal life policy as for the term policy. The universal life policy would require significant nonforfeiture values under the proposal. The term policy would not have any nonforfeiture values.

An alternative to the XYZ guideline was proposed by the Actuarial Committee of the American Council of Life Insurers (ACLI) at the September meeting of the Life & Health Actuarial Task Force (LHATF). This proposal calculates the ratio of the present value of guaranteed premiums (plus an expense allowance) to the present value of 1980 CSO mortality charges. This ratio is multiplied by the 1980 CSO mortality table to develop adjusted mortality charges. Minimum cash values are then a retrospective accumulation of actual premiums reduced by the adjusted mortality charges.

This methodology adjusts the minimum nonforfeiture values to the level of funding of the policy. All other things being equal, policies with larger premium payments will result in larger minimum nonforfeiture values. The same is not true for the current LHATF proposal.

Discussion can be expected to continue on both proposals. The difficult task will be to develop a reasonable guideline that does not require rewriting the *Standard Nonforfeiture Law* or the *Universal Life Insurance Model Regulation.*

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