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Regulatory Debate (Part 2): Changes to the Standard Nonforfeiture Law

Track: Product Development

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Summary: The NAIC has introduced many regulations over the past year and is proposing several more that may materially impact life product reserving and cash values. Some may result in narrowing the price gap between universal life and whole life plans. Industry experts and participants discuss and debate the necessity for these regulations, the issues surrounding them and their impact on product design. This session focuses on new regulatory developments, including changes to the standard nonforfeiture law for fixed products, the potential to lower the minimum guaranteed interest rate for annuity products and the need or desire to do so for traditional life products as well.

MS. ELINOR FRIEDMAN: I'm Elinor Friedman, and I will be the moderator for this session. I'm a consultant with Tillinghast in the St. Louis office. Over the last few years with Tillinghast, I've primarily worked in life project development work, as well as a variety of other assignments, including embedded value reviews and analyzing reinsurance solutions. Before joining Tillinghast, I worked at General American and at RGA, both in St. Louis.

This Part 2 session will focus on the deferred annuity nonforfeiture law. Bill Schreiner will give us a general overview of the issues surrounding the deferred annuity nonforfeiture law. Bill Cummings will follow with an industry perspective, and then David Hippen will finish with the regulator's perspective. Then we'll open it

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up for questions and comments from the audience.

Bill Schreiner is an actuary with the American Council of Life Insurers (ACLI). He has followed issues of the NAIC since the early 1980s and most recently has represented member companies on actuarial issues before the NAIC's Life and Health Actuarial Task Force (LHATF). The consideration of the new individual deferred annuity nonforfeiture law is one such issue. Before joining ACLI, Mr. Schreiner held managerial and executive positions at life insurance companies. He's a fellow of the Society of Actuaries and a member of the Academy.

MR. WILLIAM J. SCHREINER: What I propose to talk about is the work that's being done relative to a new individual deferred annuity nonforfeiture law. We'll start with a little background. The driving force behind this proposal, which was started by the industry, was the interest rate environment. In 2001 there were 11 reductions in the Federal Reserve rate. Currently it's at 1.75 percent, and there is talk that the Fed may reduce it even more when it meets again. In addition, there have been continued decreases in interest rate yields during the current year, and this all is playing out against the background of very long-term, very low interest rates in Japan. This is in conjunction with a minimum interest credit of 3 percent in the current deferred annuity nonforfeiture law.

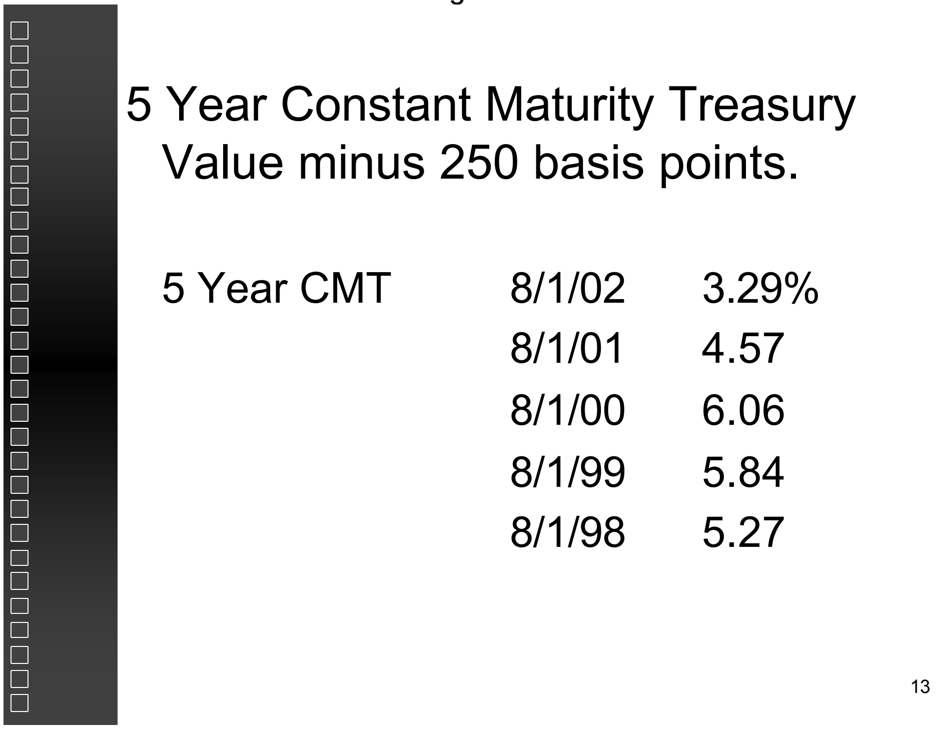
The conclusion that the ACLI's member companies reached was that an index rate over some appropriate range would protect companies in low interest rate yield periods that continued for some considerable length of time. So what did we do? We considered this as a two-pronged effort. The first was to try to obtain immediate relief. We did that by seeking reduction in the law from 3 percent required interest credit to 1.5 percent. As of September 2002, 14 states had adopted it. Two states have no such laws, which meant that companies there were free to do whatever they wished with respect to the interest rate. We anticipate that two more states may well adopt the 1.5 percent requirement before the end of the year. However, about half of the states that adopted this included sunset provisions, generally in mid-2004. When the sunset occurs, the interest rate requirement would go back to 3 percent in those states.

The second prong of our effort was to obtain a durable solution. We saw that it was most likely to be achieved through an indexed interest rate. Therefore, we proposed a new law to the NAIC's LHATF this year, and I'll talk about the key features. First, in contrast to the current 65, 87.5 percent front-end reduction in the amount that's accumulated, we proposed that be changed to 85 percent for all products. Single premium annuities now have a 90 percent factor, but many of the single premium products are written as flexible premium products, therefore subject to the 65, 87.5 percent requirement. We were focusing on the absolute minimum value for the nonforfeiture benefit.

With respect to this accumulation, the company would be free to charge whatever fees and surrender charges, including market value adjustments, to develop the policy's account value. But the important factor was that in no event, regardless of what fees or adjustments were made to the account value, could it ever be less than the statutory minimum. In other words, this percentage of considerations accumulated at the appropriate interest rate.

Let's move now to the interest rate basis. Figure 1 shows a five-year constant maturity treasury value minus 250 basis points and the progression of that value through the last five years. In addition, because there is a subtraction, we need a minimum value. That minimum value was 1 percent, and we said the range that that index should operate in is 1 percent to 4 percent, both lower and higher than the current rate. But, the fundamental function of this change would be to grant protection to insurance companies in low interest rate environments. Obviously when you can get 10 percent on your investment, having a 3 percent minimum requirement is no real burden. If that proposal had been in effect in the last 25 years, in most years it would have produced a result greater than 3 percent. On average, it was 3.79 percent.

Figure 1



5 Year Constant Maturity Treasury Value minus 250 basis points.

5 Year CMT	8/1/02	3.29%
	8/1/01	4.57
	8/1/00	6.06
	8/1/99	5.84
	8/1/98	5.27

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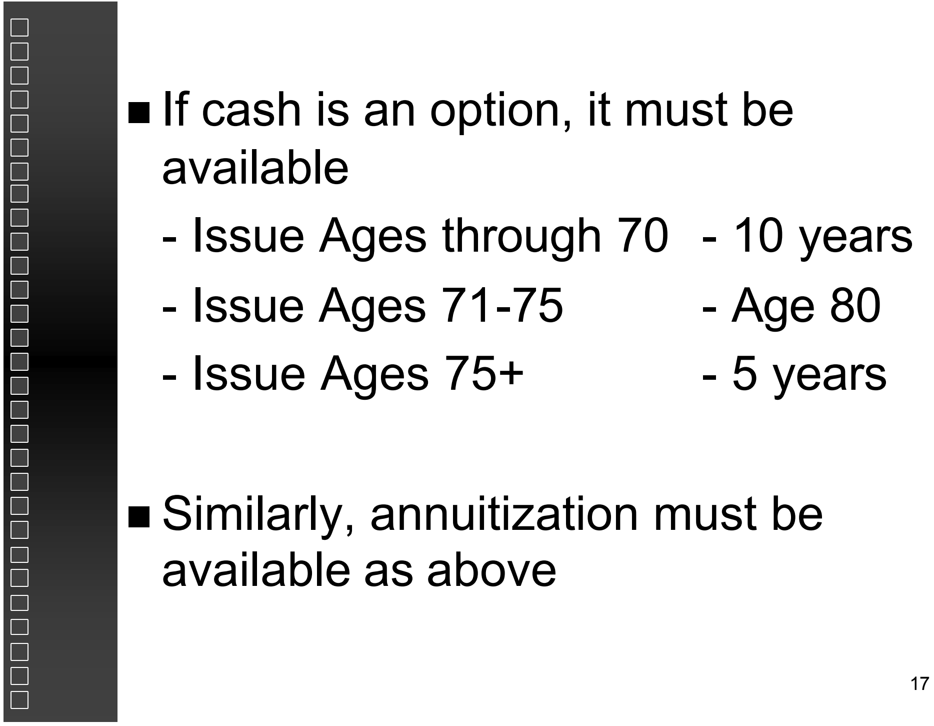
To address the regulators' concerns that if the index rate came out at 1 percent, companies would be happy to provide lifetime guarantees of that, we put in an index reset whenever the initial result was less than 2.5 percent; the company would have an option to establish other reset features. Presumably if the rate was at 4 percent, companies would be interested in shorter reset periods to protect themselves. We felt that in combination, this provides protection to the purchaser when the index is low and to the company when the index is high. A couple of other proposals were added to address the concern of regulators with respect to older people having their money in annuity contracts and being unable to get it out. You can see in Figure 2 that the cash option and the annuitization were age-sensitive in that proposal.

Figure 2



■ If cash is an option, it must be available

- Issue Ages through 70 - 10 years
- Issue Ages 71-75 - Age 80
- Issue Ages 75+ - 5 years

■ Similarly, annuitization must be available as above

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What was the regulatory reaction? Fundamentally, I suppose based on a lack of trust in marketplace factors, they were considerably concerned that the company could have, in effect, reductions in the actual account value at the time of forfeiture, essentially at their own will without any regulation apart from this minimum standard. Subsequently, the regulators came back with a proposal that said the accumulation should be at 90 percent and a two-year Constant Maturity Treasury (CMT) should be utilized as the basis for the interest rate requirement. The ACLI was pleased that they chose the CMT. We had the feeling that value will always be there as an index. However, as I mentioned earlier, we had proposed 85 percent instead of 90 percent. At the most recent conference call on the subject, the LHATF group, presumably reflecting on the biblical wisdom of Solomon, decided that, at least tentatively, they'd like to use 87.5 percent.

With respect to the interest-rate index, our view is that the two-year CMT does not give you low enough results in low interest rate periods. It would actually bring a result lower than 3 percent in only one period in the last 20 years, namely this year, when the result would be 2 percent. Our counterproposal was to use the three-year CMT minus 150 percent, recognizing that there is need to cover expenses from those products that are based solely on the interest rate spread as opposed to reductions from the contribution. Where is this going? It remains to be seen. The LHATF will have another conference call before the December meeting. We hope these differences in these proposals can be resolved by that time. Our goal at the ACLI is to have a proposal for a durable solution that we can go to the states with in their sessions in 2003, but it remains to be seen as to whether that can be accomplished.

MS. FRIEDMAN: Our next presenter is Bill Cummings. For the last three years, he has worked as an actuary for Allianz Life. Mr. Cummings works primarily with pricing, risk management and hedging of Allianz's equity-indexed annuities. For the past year, he's been working on committees, both with the Academy and the ACLI, to address changes in the nonforfeiture law.

MR. WILLIAM JOHN CUMMINGS: As Bill had mentioned, the nonforfeiture solutions and proposals have been somewhat fluid over the last couple of months, with proposals and counterproposals. I want to address a little bit more of the principles behind why we wanted to change the law and maybe what we need to consider when changing it.

Today we're talking about the debate centering on the standard nonforfeiture law for deferred annuities. There are two real issues. One is a short-term issue, which is what we're really addressing today, and the other is a long-term issue. First of all, the interest rate environment makes addressing the 3 percent interest rate a very pressing issue. As a longer-term project, both LHATF and the Academy are looking at the possibility of combining the annuity nonforfeiture law with a whole general nonforfeiture law addressing both life and annuities. Through that we may be able to create a law that's a little more flexible and that can solve some of the problems with the current laws. In addition, we're seeing more products combining elements in bundling. We have annuities that have life elements. We have life products with annuitization options and benefits. The lines between them are blurring, so it would be helpful to have one general law that would apply to all of them.

When we talk about changing the nonforfeiture law, we have a balancing act. We have three elements that everybody can agree we want to promote. We want to promote consumer protection, which is what the nonforfeiture law is primarily about. We want to promote consumer choice. And we want to promote solvency. We can't necessarily boost all three at the same time. There is some give and take here. In particular, as an example, right now interest rates are near historic lows. They're very, very low. We're approaching what could be a Japan scenario. We're not sure. If interest rates were to continue to drop and stay low for a long, long time, we could have some trouble in the works.

From a consumer protection standpoint, one can say that accumulating three percent interest relative to current interest rates is a very strong guarantee and a very high requirement that insurers can meet. So relative to five or 10 years ago, that 3 percent interest rate provides a lot more consumer protection than it used to. That affects the other two elements as interest rates drop. As far as consumer choice is concerned, there are insurers who are pulling products from the market. A couple of the markets that are hardest hit have been variable annuities with fixed accounts and very short time horizons, and also short-term annuities with low surrender charges and very short-term time horizons. They are finding it hard or impossible to meet that 3 percent guarantee. So that's an element of consumer choice. Consumers are no longer getting some of the products that otherwise would be available to them with the lower interest rates.

More important, I think, from an actuarial perspective is the solvency issue. I don't want to blow it out of proportion, but at the same time it's a real issue and must be addressed. We're currently issuing products throughout the industry with 3 percent guarantees. If we do get that Japan scenario, with extended low interest rates, solvency problems could be in the works, and that's why we really need to have this interest rate solution sooner rather than later.

Let me focus on these three elements in a little more detail. First of all, let's look at consumer protection. The current law provides us, first of all, cash values, which are a percentage of premium accumulated at 3 percent interest. The second item in consumer protection is a limit on surrender charges on products through a prospective test. Other than that, a few states have also used a nonforfeiture law to restrict certain product designs that they may feel are not beneficial to the customer. For example, there are a few states out there where equity-indexed annuities are difficult or impossible to get approval for, at least for a marketable equity-indexed annuity. Market value adjustments in some states are very difficult, and two-tier annuities and other product designs are being denied through the nonforfeiture law.

In addition, through some discussions among LHATF, the Academy and the ACLI, some regulators are seeking to pursue other forms of consumer protection through restricting loads to 10 percent, 12.5 percent, and 15 percent on product issues. Some regulators would like to put much stronger restrictions on issues to older ages, including having return-of-premium provisions for people age 65 or 70 or older, such that they would get their premium back starting on day one if they chose to lapse.

Second, let's discuss consumer choice. A more permissive nonforfeiture law allows more innovative products. Under the current law we've been able to get equity-indexed annuities, market-value-adjusted annuities and two-tier annuities. With an even more permissive law, who knows what other products are in the mix in the future. On the other hand, if we have a more restrictive law, we may find ourselves prohibited from selling these products, or at least having marketable versions of these products, and that really prohibits some of the market innovations that we might see in the future.

Finally, let's discuss solvency. Certain aspects of the law—in particular that 3 percent interest rate—can make certain products infeasible for solvency reasons and therefore unavailable to the market. Solvency considerations are the issues behind that 3 percent guarantee getting lower. If we want to protect the consumer as much as possible, sometimes we have to realize that consumer protection may come at the expense of solvency down the road.

So let's discuss why we want to change the current law. I've already talked about the interest rate. The interest rate is fixed at 3 percent, but as part of the longer-term project, there are other reasons regulators and the industry might like to change the law. New products always break the model, and when I say that, it's always hard to say where a new product fits into the mold. When the law was defined, innovative products were not allowed for, they were not conceived of and therefore, the law doesn't really always fit just right. We'd like to have a law that's a little more flexible to allow to that.

The ambiguous nature of the law both encourages innovative ways of compliance and creates a variety of state interpretations. I would argue that with the prospective test, I honestly don't know what the spirit of the law is most of the time. Therefore, if you don't know what the spirit of the law is, how do you find ways to comply with the letter of the law? Because of varying state interpretations, as a product actuary, I may file a product, say a fairly vanilla equity-indexed annuity, and manage to get approval for it in 45 or 46 states. There will be a handful that just won't approve equity-indexed policies or will make them so restrictive as to be not marketable. Now, outside of that, there will be another handful of states for which I will have to change the policy materially to gain compliance. So now we're left with a handful of different policies, depending on what states we're putting these in. If we could come up with a more straightforward law, it would eliminate some of those problems with state interpretations.

So what do we do? In the short-term solution, we would like to see the existing law used but with indexed interest rates in place of, or possibly in addition to, the current 3 percent. Bill proposed a couple of different solutions that have been put forward, and the argument going back and forth is, do we use CMT, a swap rate, or London Interbank Offered Rate (LIBOR)? Do we want to base it on a one-year CMT or one-year rate? Or, do we base it on a five-year rate? Or, do we use a blend of all of the above? Also, do we put floors and maximums on it? These are issues that are still left to be resolved, but I think the consensus is we do need to come up with some sort of indexed rate.

As a longer-term solution, we need to devise a simpler approach to eliminate some of the ambiguity in the current law. I also think we'd like to pursue one general nonforfeiture law for both life and annuities. There are working groups in both the Academy and LHATF working on this project to go forward with that.

A final thing I think we should do is encourage better disclosure. I think this is particularly important. There are many regulators now who want to put restrictions on issues to seniors. They want to restrict surrender charges that they feel are excessive and not fully understood by the customers. There are also regulators who would like to see restrictions put on small policies, or small face amount issues. There may be many people for whom these policies are good. I think, instead of legislating or mandating that we can't issue them, it's far more important to encourage clear disclosure so that the policyholders understand what they're getting. I think pursuing the disclosure requirements would go a long way toward satisfying where the regulators are seeking to go in protecting consumers without legislating restriction of products.

MS. FRIEDMAN: David Hippen is our next presenter. He has more than 25 years of experience in the industry as an actuary, with more than half of that on the industry side. He also has 10 years of experience in regulation at several state insurance departments. He has worked on several Academy and Society task forces, and he currently works for the Florida Department of Insurance in the life and health rates and forms division.

MR. DAVID J. HIPPEN: Regulators are in an interesting position. As a member of the Florida Insurance Department, I'm in a particularly interesting position with regard to this debate because the Florida legislature rejected the standard nonforfeiture law for deferred annuities some years ago. So, we don't have such a standard. However, we are faced with a growing body of folks who will retire or are retired and rely on somebody to provide some protection for them so that annuities are paid. However, they sometimes also want to have a lot of choice, a lot of flexibility and be permitted to make their own decisions with regard to what kinds of annuity should be offered and what kinds of cash values should be provided if they want to discontinue or take their money somewhere else. One of the difficulties, and a balance that the regulators have to strike, is trying to be consistent in enforcing the law and at the same time allowing the open market to serve the needs of the consumers so that there aren't complaints that people can't get what they want or need.

The standard nonforfeiture law basically is in place to provide some consumer protection. It provides a minimum level of cash value based on premiums or considerations that are paid. It provides a minimum interest rate for accumulating the net on those values or premiums that are paid, and it restricts surrender charges or loads so that not too much of the folk's money is taken away before it starts accumulating.

On the consumer choice side come the innovative products, and there are lots of them. One of the things that happens with the innovative products is that some states look at the nonforfeiture law as it stands and say, "Those aren't permitted." Other states don't see anything in your product that they dislike, so it should be fine. There may even be a third group that figures that until there is a large outcry and some damage is done, they should just leave it alone and let the market prevail.

One of the things that happens with interest rate requirements and nonforfeiture requirements is that some companies are reluctant to be innovative. Some companies are reluctant to grant higher current or nonguaranteed elements because they don't have a fallback position. I know that there are some companies that, if they didn't have a 3 percent guarantee, but rather a 0.5 percent or 1 percent guarantee, would be far more willing to declare higher rates for the short term. Consumers might like that better, but they might not like the result on the down side.

Market value adjustments, which arose at a time when regulators were very concerned about solvency, were granted some status by some states, and that has slowly grown. Market value adjustments can be very favorable to a consumer in the right circumstances, but they could be very devastating in other circumstances. Is this a choice that we should leave to the consumer? Equity-indexed products clearly fit into what was perceived as a market need, and the consumers who bought them certainly saw that they needed to have something that would more closely follow the direction of the stock market. But there are those who believe that equity-indexed products under the current standard nonforfeiture law are prohibited or at least severely restricted.

Two-tiered annuities and products with secondary guarantees are also innovations that are not very completely addressed with the nonforfeiture law, and regulators must help resolve if they should be. Death benefits have grown a great deal in annuities, and in some annuities they are the prevalent benefit. For example, if you sell to an 85-year-old a deferred annuity that has a minimum maturity date of 10 years beyond the issue date, most of the benefits are likely to be paid as death benefits. Is this really an annuity? Is this life insurance? There are some gray areas there, and it hasn't been made abundantly clear in the law which nonforfeiture law should be applied and how that law ought to be applied.

In the United States we have strong standard nonforfeiture laws both for life insurance and annuities. The international attitude, as I infer it from what goes on generally, is that if you look at your contract, you like it and you buy it, you've agreed to make some payments, and you've agreed to receive whatever cash values or guarantees. If you choose to drop out, then you get what you got. There isn't any need for the government to predetermine how much you should be getting out of that contract. If you don't care about cash values when you buy it, you can buy a life insurance contract, or you can buy an annuity that doesn't provide any cash values. Now, the annuity contract clearly would provide annuity payments, but cash values may not be required. Is this something that we want to have happen, or is it something that we continue to feel needs to be protected?

New products create some real risks with regards to an inflexible law. Even if a company thinks that the nonforfeiture law permits them, there is a growing risk—especially as folks with annuities retire and have time and money to seek counsel—that what was sought does not turn out to be what the court thinks is appropriate when those folks object and don't like what's happening with their cash values or with their annuity contracts. When the law is not flexible, that seems to be an even greater risk. An ambiguous law makes it very difficult for regulators to preserve or help preserve a level playing field. It becomes very difficult for the states to argue that they're interpreting it correctly in the face of other states that are interpreting it differently. I know that's been a great concern of the ACLI.

There's also a concern with regard to disclosure. The SEC has a great deal of disclosure requirements for variable products, and in light of that most of the state regulatory authority is nonexistent for variable products. There are those who feel that many of the annuities sold now should be, or in fact are, subject to securities laws because of the way they're sold or the emphasis on the sale. But so far the SEC has been relatively silent with regard to those issues. Someone commented to me after the last session that that's the way things are when times are good, and when times are bad, everybody starts looking to different venues to figure out how to vent their frustrations. We know, for example, that there are some proposed class action lawsuits with regard to equity indexes because a group of people is upset about the values that they're getting out of their equity-indexed contracts.

The standard nonforfeiture law to some extent makes it less important to have as extensive appropriateness or suitability or disclosure requirements—not that there are no disclosure needs for folks, but that as long as you have minimum values, you've protected people, and those things are going to be in the contracts. It won't matter that they don't get the disclosure or misunderstand it or just ignore it when it's given to them because they figure everything's going to be fine. However, it can create a false sense of security among those who don't understand it but buy it because the agent told them that they'll get at least 3 percent. People think that by putting $100,000 in, they're sure to get $103,000 next year. That's just not the case, and yet that is the perception that we find many consumers have when they come back and are upset about the loads that they say they didn't know about.

The NAIC and the Academy are both trying to review these issues and determine what the most equitable solution is. We're in a transition from good times to bad times, and in bad times it may be that much more difficult to look long-term at what actually will be best both for the consumer and for the industry. The shift in regulation, or the atmosphere of regulation, toward consumers and away from company solvency may also need to be considered, and it's something that regulators face pretty regularly. Twenty years ago when I had my first job as a regulator, the emphasis was that if you preserve the company's solvency, then you have done everything you needed to do for the consumer. But it was changing. Now there are regulators who wonder why we even fuss over company solvency and who believe that they should take care of themselves.

In the end, because nonforfeiture is a long enough word that most consumers just assume the actuaries have to take care of it and they shouldn't have to worry about it, we as actuaries will be the most important factor in determining what the nonforfeiture laws should be, what the standard should require and whether we're going to give consumers more choice or provide more fixed protection. There will always be a majority on one side and a minority on the other side. One group will want more protection, and the other group will want more flexibility. Whoever is the majority at the time that the law is being considered is likely to prevail, and I hope that this debate forces us to be sufficiently flexible in our solution that we don't regret the long-term result.

MR. SCHREINER: I'd like to make an observation. Both David and Bill mentioned disclosure issues. There is a very fine annuity disclosure regulation that was adopted by the NAIC a few years ago. The problem, of course, is that there are only two states that have adopted it as yet. The tools are there, but the regulators are not utilizing them.

MS. HEATHER MAJEWSKI: I'm with Hartford Life Insurance Company. I have a concern and a question with respect to the indexed rate. It's my understanding that it would be set as of Sept. 30 of the prior year. Is that correct?

MR. HIPPEN: It is set as of Sept. 1.

MS. MAJEWSKI: OK. Given the volatility of interest rates that we've been seeing lately, do you feel that it will be effective in accomplishing the goals of consumer protection and choice and insurance company solvency?

MR. SCHREINER: You're sort of torn there between having an up-to-date rate that might change daily or monthly or something like that. The reason our members suggested the September date, which is based on the whole results of the month of September, is because it's relatively close to the start of the year in which it would be applicable. But at the same time, it presumably gives companies enough administrative time to recognize what that rate will be when January 1 comes along. So, it's sort of an attempt to balance the two desires.

MS. MAJEWSKI: We've had to close down some of our fixed-annuity products with shorter terms, and I can see that in a down rate environment, if the index is still high in September of the prior year and interest rates continue to drop, that we still may not be able to credit the rates that we want to credit.

MR. SCHREINER: If you look at this year, there's a considerable drop just between August and September, so you're quite right. Even an index of this nature will not solve all of the issues.

MS. MAJEWSKI: I've seen one insurance company whose fixed account has a 2 percent minimum credited rate, and I believe the reason they can accomplish that is because they still have a cash value floor where they're accumulating 90 percent of premiums at 3 percent. So they're not actually using a 3 percent minimum credited rate, but rather a 2 percent rate. But they're still following the standard nonforfeiture law. Is that something that could continue under the new law?

MR. SCHREINER: Yes.

MR. CUMMINGS: Just to follow up on the last question, part of the reasoning for that comes from the way equity-indexed annuities work. For equity-indexed annuities, you in effect have to credit some years less than 3 percent and some years more than 3 percent. That has kind of come about through that market. However, that's been one solution—as long as you cumulatively credit the 3 percent, that would be okay.

MR. HIPPEN: But that approach does cause problems with respect to explanations to the consumers of what's going on, should there ever be any awareness of the fact that there's a minimum standard. It means that you have to track those policies to make sure that if there's a crossover point, then you know when it is between what your account value is and what the minimum standard is. So there are issues surrounding that. I guess it's our view that there should be a discounted accumulation to take care of front-loaded products. But there also should be an appropriate interest rate that could be used directly with respect to back-loaded products and accumulation products that start with 100 percent of account value accumulation.

MR. ROY OLSON: I'm with the state of Washington Insurance Commissioner's Office. One of the issues raised is the nonuniformity of interpretations of the standard nonforfeiture law by various state insurance departments. I'm not sure that something new will be more uniformly interpreted than what we have. Let's say that you designed a single premium or flexible premium deferred annuity that was fairly vanilla in nature, but it didn't provide cash surrender benefits at all times subject to the six-month deferral. If you develop such a product, in how many states would that product be approved, let's say within six months?

MR. CUMMINGS: First of all, it violates the nonforfeiture law is what you're saying because cash values have to be supplied at all times if they're ever supplied, correct? In that case, I'd think an actuary probably wouldn't make that available if it violates the nonforfeiture law. That would be the first answer, and that would be my opinion from how we would perceive that.

FROM THE FLOOR: In other words, you would not file such a product?

MR. CUMMINGS: That is correct. From a company perspective, if I saw that it violated the nonforfeiture law, I would not file it. I may take a more liberal interpretation of the nonforfeiture law than you would. However, if it's written in black and white that this is how you interpret the non-forfeiture law, I would not file it. The clearer it's stated, the less ambiguities and the less room for interpretation there would be.

MR. SCHREINER: Well, we've lived with the same law for several years now, and I'm speculating that we're all pretty aware of what is written there, and I don't mean to stretch the interpretation of it. I described my interpretation of it. Perhaps you do have a different interpretation. Go with your interpretation and tell me where you get those approvals.

MR. HIPPEN: I think that it behooves all of us as professional actuaries to be on our guard and to be the resource and, if necessary, the refuser for products that might violate the law. As far as I know, an approval means you can sell; it doesn't mean that the product complies with the law. It is generally considered to be the company's, and therefore the actuary's, responsibility to determine whether the product complies with the law. If the company or actuary fails, of course, the recourse is for the consumer or group of consumers to take the company to court and have a court construe the contract as if it were in compliance.

So, approval might or might not mean that your contract's in compliance, and simply the notion that something's accepted in even all 50 states does not necessarily mean that it's in compliance with the law. I think what is being alluded to is that there are a number of states that simply don't have time or don't even have the requirement for their staffs to review an annuity product when it comes into the department. Therefore, it's a virtually automatic approval. It really would be nice in a perfect world to say that was a good way to go for all annuities, but that would require that the actuaries were sufficiently consistent in their upholding of professional standards to make sure that those products were in compliance before they filed. That certainly is a concern that is reflected in the variability of reviews and approvals among the different states.

MR. DOUG SPEAR: I'm with Quasar Systems. I just wandered in here because this was the only session that seemed to be relevant to what I do. I haven't played with annuities for years, so I'm confused by the ACLI's proposal, and I'm going to ask, I hope, a very simple question. When you set the index on Sept. 1, applicable to policies in the following year, is that index applicable forever for that policy?

MR. SCHREINER: As we would propose it, that would be up to the company.

MR. SPEAR: So is there a provision that the index can then float year by year on an existing policy?

MR. SCHREINER: If the company chose to reset it every year, they could do so, but whether you'd see that in practice is hard to determine. Our proposal would give the company the privilege of determining the reset so they could make it consistent with their investment approaches and the like.

MR. SPEAR: I guess it just seems to me on nonsingle pay annuities that you have to have something that floats or else you're going to lock in a 4 percent interest rate on some contracts and they're going to be in force when you come to this 1 percent interest environment. It doesn't solve the solvency problem at all. So it seems like it has to be a floating interest rate to be of any value.

MR. SCHREINER: Yes, but we would expect the company to be wise enough to choose what that reset period is for their own purposes, their markets, their investment policy and the like.

MR. SPEAR: OK. So the proposed law provides for the company to have a reset provision of whatever it chooses?

MR. SCHREINER: That's correct.

MR. SPEAR: OK, thank you.

MR. HIPPEN: I think it's wise to throw in a comment here that there's a group that is, whether by choice or by default, not represented here. It's not the consumers that are missing, but rather the SEC. With all of these interest rate changes, we will all have to be very careful to be sure that we're doing whatever it is that's supposed to comply with the securities law. During the good times of the '90s, the SEC has not said a lot with regard to securities law. But there are some folks who rightfully should be concerned with interest rate changes that might not fit what a federal court would think was appropriate with regard to securities law. Looking at current products and reflecting those with regard to court decisions from the '80s, for which the laws haven't changed, there are a lot of general account products out there that the SEC in bad times might feel compelled to call securities and create a great disruption in the industry.

MR. SCHREINER: Let me address at least a little bit of that. We've had some concern about that, and we've asked our SEC counsel what the requirements are. His response is that they're not totally clear as to what might be required, but it would appear that the best guess is that as long as these annuities have some guarantee in them that's real—it doesn't have to be big, it just has to be reall—that it would not be deemed a security.

MR. ROD CHANDLER: I'm with MetLife. I'm not really sure how that ties with Variable Annuity Life Insurance Company (VALIC), the decision from several years back, but my comment was actually a follow-up to the following point. If you allow the index to be written right into the contract, I would suggest that causes a lot of problems with our current disclosure rules. We have illustrations that require you to project your guarantees to the potential insured. If you don't know what your future guarantee is, that kind of throws the whole question into the whole illustration.

I think the variable approach to the illustration is better. Providing full disclosure along the lines of the SEC model would work a little better in the long run. I think there's some question as to whether this index works. The vast majority of the in-force that we have now, including all of the policies sold this year, wouldn't even be protected by this law because they would have all been before Jan. 1. So you're only really protecting those few policies sold in a year where the variable rate was available.

Unless you write it into your contract and start this whole complex process of having every contract having a variable guarantee in it forever, you don't really gain much benefit from the current proposal. I think that the whole package needs to be considered and that you really are almost forced toward the disclosure approach, as opposed to a minimum nonforfeiture approach, to solving the problem.

MR. SCHREINER: I don't know that there's any way that you can address contracts that are already written based on the existing law. The contract is there. You must abide by it. But 50 years from now, the in-force presumably would be filled with contracts that had an indexed rate guarantee.

MR. CHANDLER: Yeah, that's true only if you write into every contract that your variable rate will float. The point that was brought up is, do you write it in that you have a variable floating guarantee in your contract, or does it only apply to contracts issued that year? If it only applies to the few contracts that happen to be issued in a year in which it was below 3 percent, then you haven't really benefited from it. So you're almost forced to write it in as a variable guarantee, which kind of flies in the face of all of the illustrations that we do now on the fixed annuities.

MR. SCHREINER: As I indicated before, it's our desire to have the company make the choice of when that guarantee applies and when it's reset. Presumably the company is wise enough to make appropriate decisions.