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Framework
Toward a new nonforfeiture law

Following is an excerpt from a concept document submitted to the NAIC as a possible framework for drafting the new Standard Nonforfeiture Law. The document incorporates comments from the NAIC's Life and Health Actuarial Task Force into a concept document prepared by the American Academy of Actuaries' Nonforfeiture Work Group. (See story below.)

In simplistic terms, when a contract holder initiates payment of the first premium, a "deal" is struck with the insurer. If the premiums include a significant refunding of benefit costs, the "deal" includes provision for nonforfeiture benefits as described in the insured's Nonforfeiture Plan.

Other parts of the "deal" are the basis by which surplus is distributed for participating contracts, and the basis by which policy costs and credits are determined for contracts with nonguaranteed policy elements other than dividends. These are described in separate plans or company operating policies which are contemplated in the Actuarial Standards of Practice.

At contract issue, the insurer's approach to provision of nonforfeiture benefits is described in the Non - forfeiture Plan, which may be as simple as setting forth guarantees. To the extent nonguaranteed nonforfeiture benefits are provided, the insurer's designated actuary confirms periodically to regulators that the Nonforfeiture Plan initially meets applicable regulatory requirements and is being followed.

The scope and permissible provisions of the Nonforfeiture Plan are

An acknowledgment of change

by Craig R. Raymond

The industry, the profession, and regulators have discussed various approaches to revising the standard nonforfeiture law (SNFL) since the mid '80s. These discussions have taken on greater focus and urgency in the past three years, and the profession, through the SOA and the American Academy of Actuaries, has been an active participant in the process.

In 1995, in response to a request from the NAIC, the SOA Task Force on Life Nonforfeiture prepared a report on nonforfeiture law concepts. This was followed by significant discussions between the NAIC and the Academy on a practical framework, culminating in a 1996 report by the Academy's Nonforfeiture Work Group. Through the working group, the Academy is providing ongoing input to support the NAIC's efforts.

Many proponents of change believe that enhanced flexibility in product design is essential for the continued development of the insurance industry in today's constantly changing world. A major stride toward acceptance of change was made earlier this year when the NAIC decided to move forward with the development of an SNFL revision as an alternative to the current law rather than as a replacement — that is, the two would coexist, at least initially, with the company choosing which to use on a product-by-product basis. (At least initially, regulators are accepting this coexistence without a time limit.)

The NAIC's aggressive schedule anticipates finalizing the proposed model regulation by the end of the year. The conceptual outline offered here provides an overview of the framework being used by the NAIC as the starting point for drafting a new nonforfeiture law. The outline is part of a longer concept document. Both the outline and the concept document combine views of the NAIC's Life and Health Actuarial Task Force with an earlier proposal prepared by the Academy's working group. Both the framework and the law are a work in progress. The current draft of the NAIC's proposed law is maintained on the NAIC Web site, *www.naic.org*.

A copy of the concept document is available from Doreen Evans at the Academy (phone: 202/223-8196; fax: 202/872-1948). Although the NAIC is expected to act soon on revisions to the SNFL, I welcome your comments on the concept outline at any point in time.

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defined by an NAIC model regulation. It provides a basis for insurers to define the method for determination of nonforfeiture benefits.

Requiring a nonforfeiture benefit

Every insurance contract offers a benefit(s) in return for premiums paid. If premiums are not of the pay-as-you-go type (that is, policy premiums materially prefund future benefit costs), nonforfeiture provisions are called for by the model law and NAIC model regulation.

Nonforfeiture provisions are expressed in terms of the form(s) of contracted benefits. At any contract duration, the nonforfeiture provision is determined in accordance with the contract's Nonforfeiture Plan.

The Nonforfeiture Plan

The Nonforfeiture Plan is summarized in the contract so as to adequately establish policy owner rights to a nonforfeiture benefit. If a more detailed summary is appropriate it is given to the policy owner at the time of issue.

The Nonforfeiture Plan itself and the summary are subject to compliance with NAIC model regulations. It is the insurer's responsibility to create and maintain the Nonforfeiture Plan, which is not subject to regulatory filing or prior approval. The policyowner summary is to be filed when applicable forms are filed, but the model law does not require its approval.

The plan is available to regulators on request for review. The specifics of the Nonforfeiture Plan with respect to assumption determination and other implementation practices are deemed confidential and protected by statute.

At the heart of the contract's Nonforfeiture Plan are:

1. The form of nonforfeiture benefit provided and optional forms that may be available
2. The methodology to be used to determine the nonforfeiture benefit, and any optional forms
3. The approach to be used in implementing the methodology, including selection of any assumptions in the case of nonguaranteed nonforfeiture benefits

The Nonforfeiture Plan provides the contract holder a basis for expectations with respect to continuation of benefits if planned premium payments cease. At the insurer's option, the Nonforfeiture Plan may provide guaranteed amounts of nonforfeiture benefits either at issue or commencing at a later duration.

When the Nonforfeiture Plan does not provide nonforfeiture amounts that are guaranteed at time of contract issue, annually the insurer affirms that the current nonforfeiture benefits of in-force contracts have been consistent with provisions of the NAIC model regulation and are in accordance with the Nonforfeiture Plans applicable to those in-force contracts. Specifics aspects of this confirmation will require actuarial support.

Guarantees

At any contract duration, an insurer may provide nonforfeiture guarantees with respect to current or future amounts of currently available nonforfeiture benefits or current or future amounts of any specific nonforfeiture benefits, even where those benefits arose from nonguaranteed elements of the policy. Guaranteed provisions must meet regulatory requirements and are prima facie evidence of Nonforfeiture Plan compliance once they are in effect.

A cash payment to the contract holder may be provided for surrender of the contract. Unless cash surrender value amounts are guaranteed, the calculation method is described in the Nonforfeiture Plan, including the duration at which any guarantee commences, or ceases.

Methodology

The insurer's methodology for determining nonforfeiture benefits is described in the Nonforfeiture Plan. For a specific Nonforfeiture Plan, the methodology, once set, may not change, unless change is agreed to by the domestic regulatory supervisor. The Nonforfeiture Plan must comply with the regulatory provisions that establish the framework for nonforfeiture provisions. Two possible approaches for insurers to use at their choice are the accumulation approach and the future benefits approach.

The process used to determine nonforfeiture benefits must be in accordance with the provisions of an Actuarial Standard of Practice promulgated by the Actuarial Standards Board (ASB) within the framework of the NAIC model regulation.

Implementation of the methodology

Implementation of nonforfeiture methodology follows steps established by the Nonforfeiture Plan. For guaranteed nonforfeiture benefits at issue, this requirement is satisfied by definition. For nonguaranteed nonforfeiture benefits or those guaranteed subsequent to issue, regulatory provisions provide a structure for development of standards of practice by the ASB.

Relationship to policy dividends or nonguaranteed element determination plans

For participating contracts, this proposed concept is based on the assumption that participating policyowner dividends reflect distribution of statutory surplus contributions attributable to policy classes according to an insurer's Plan for Participation with Respect to Participating Business. The Nonforfeiture Plan addresses the effect of prefunding of future benefits and related costs. The Plans are separate; both are a part of the "deal." Assumptions underlying the two, as of any duration of analysis, are consistent after adjustments for risk characteristics during the period of coverage to which the assumptions apply.

For contracts with nonguaranteed elements other than dividends, the proposed concept is based on the assumption that durational contract charges and credits are determined in accordance with an insurer's Plan for Determination of Policy Charges and Credits. The Nonforfeiture Plan addresses the effect of prefunding of future benefit and related costs. The Plans are separate; both are a part of the "deal." Assumptions underlying the two, as of any duration of analysis, are consistent after adjustments for risk characteristics during the period of coverage to which the assumptions apply.