

PROJECT HISTORY - 2020

STANDARD NONFORFEITURE LAW FOR INDIVIDUAL DEFERRED ANNUITIES (#805)

1. Description of the Project, Issues Addressed, etc.

In late 2012, the Life Insurance and Annuities (A) Committee charged the Contingent Deferred Annuity (A) Working Group with evaluating the adequacy of existing laws and regulations as applied to contingent deferred annuities (CDAs) and whether additional solvency and consumer protection standards are required. The Working Group submitted its report, findings and recommendations to the Committee at the 2013 Spring National Meeting. Among its findings, the Working Group found that: 1) CDAs do not easily fit into the category of fixed or variable annuity; 2) review of solvency and consumer protection standards are necessary; and 3) tools to assist states in reviewing CDA product filings and solvency oversight of CDAs should be established. The Working Group also identified issues that would be more appropriately addressed by other existing NAIC groups with the specific subject-matter expertise.

At the 2013 Fall National Meeting, the Life Insurance and Annuities (A) Committee gave the Life Actuarial (A) Task Force a charge to recommend a manner to specifically exempt CDAs from the *Standard Nonforfeiture Law for Individual Deferred Annuities* (#805). The Executive (EX) Committee approved the Request for NAIC Model Law Development to Model #805 at the 2016 Summer National Meeting.

At the 2016 Fall National Meeting, the Life Insurance and Annuities (A) Committee adopted amendments to Model #805 recommended by the Life Actuarial (A) Task Force to exempt CDAs from certain sections of Model #805, with which, due to their structure, they cannot comply. The revisions to Model #805 exempt CDAs from the sections of the Model #805 that prescribe computational methods and minimum nonforfeiture values for deferred annuities, but would allow the insurance commissioner to specify separate nonforfeiture standards, if needed, at a later time.

In November 2020, the Life Insurance and Annuities (A) Committee adopted an amendment to Model #805 recommended by the Life Actuarial (A) Task Force to reduce the nonforfeiture interest rate floor from 1% to 15 basis points (bps) (0.15%) in response to the historic low interest rate environment.

2. Name of Group Responsible for Drafting the Model and States Participating.

The Life Actuarial (A) Task Force. The following states participated: Doug Slape, Chair, represented by Mike Boerner and Rachel Hemphill (TX); Tynesia Dorsey, Vice Chair, represented by Peter Weber (OH); Ricardo Lara represented by Ben Bock and Perry Kupferman (CA); Michael Conway represented by Eric Unger (CO); Andrew N. Mais represented by Wanchin Chou (CT); Doug Ommen represented by Mike Yanacheak (IA); Robert H. Muriel represented by Vincent Tsang (IL); Stephen W. Robertson represented by Karl Knable (IN); Vicki Schmidt represented by Nicole Boyd (KS); Grace Arnold represented by Fred Andersen and John Robinson (MN); Chlora Lindley-Myers represented by William Leung (MO); Bruce R. Ramge represented by Rhonda Ahrens (NE); Marlene Caride represented by Kevin Clarkson (NJ); Russell Toal (NM); Linda A. Lacewell represented by Bill Carmello and Mona Bhalla (NY); Glen Mulready represented by Andrew Schallhorn (OK); Todd E. Kiser represented by Tomasz Serbinowski (UT); and Scott A. White represented by Craig Chupp (VA).

3. Project Authorized by What Charge and Date First Given to the Group.

The Life Actuarial (A) Task Force charges require the group to provide recommendations and changes, as appropriate, to other reserve and nonforfeiture requirements to address issues. The recommendation to reduce the minimum nonforfeiture interest rate floor was provide in response to the low interest rates for five-year constant maturity treasuries, which was as low as 25 bps during the period of Task Force deliberations. The

Executive (EX) Committee approved the Request for NAIC Model Law Development to Model #805 at the 2020 Summer National Meeting.

4. A General Description of the Drafting Process (e.g., drafted by a subgroup, interested parties, the full group, etc). Include any parties outside the members that participated.

The Life Actuarial (A) Task Force, chaired by Mr. Boerner, drafted the change to Model #805.

The following interested parties participated: American Council of Life Insurers (ACLI); American Academy of Actuaries (Academy); Allianz Life Insurance Company of North America (Allianz); and the Interstate Insurance Product Regulation Commission (Compact).

5. A General Description of the Due Process (e.g., exposure periods, public hearings or any other means by which widespread input from industry, consumers and legislators was solicited).

The Task Force began working on the charge during open meetings beginning in the summer of 2020. The initial Request for NAIC Model Law Development submitted to the Life Insurance and Annuities (A) Committee recommended reduction of the minimum nonforfeiture interest rate floor from 1% to 0%. When approving the request, the Committee asked the Task Force to consider rates between 0% and 50 bps, inclusive. At the Summer National Meeting, the Task Force voted to expose a revision to the model for public comment. The revision asked stakeholders to provide comments on potential rates of 0.15%, 0.25%, 0.35% and 0.50%, in addition to the originally proposed 0% with approved the request. The Task Force held public discussions on the potential revision on Oct. 8, Oct. 1 and Sept. 24. The Task Force adopted the proposed revision, which recommended reducing the Model #805 minimum nonforfeiture interest rate to 15 bps, on Oct. 8. The Life Insurance and Annuities (A) Committee adopted the revisions to the model on Nov. 10.

6. A Discussion of the Significant Issues (items of some controversy raised during the due process and the group's response).

The revision is intended to provide companies relief from a minimum nonforfeiture interest rate floor that was considered unsupportable in the environment of historically low interest rates. The feedback received from commenters was that retaining with the 1% minimum nonforfeiture interest rate floor would likely result in the limited availability of indexed annuity products or possibly an exodus of companies from the indexed annuity market. The Task Force members, with the exception of Missouri, New York and Oklahoma, agreed that a significant reduction in the minimum nonforfeiture interest rate floor was warranted.

7. Any Other Important Information (e.g., amending an accreditation standard).

None.

PROJECT HISTORY - 2017

STANDARD NONFORFEITURE LAW FOR INDIVIDUAL DEFERRED ANNUITIES (#805)

1. Description of the Project, Issues Addressed, etc.

In late 2012, the Life Insurance and Annuities (A) Committee charged the Contingent Deferred Annuity (A) Working Group with evaluating the adequacy of existing laws and regulations as applied to contingent deferred annuities (CDAs) and whether additional solvency and consumer protection standards are required. The Working Group submitted its report, findings and recommendations to the Committee at the 2013 Spring National Meeting. Among its findings, the Working Group found that: 1) CDAs do not easily fit into the category of fixed or variable annuity; 2) review of solvency and consumer protection standards are necessary; and 3) tools to assist states in reviewing CDA product filings and solvency oversight of CDAs should be established. The Working Group also identified issues that would be more appropriately addressed by other existing NAIC groups with the specific subject-matter expertise.

During the 2013 Fall National Meeting, the Life Insurance and Annuities (A) Committee gave the Life Actuarial (A) Task Force a charge to recommend a manner to specifically exempt CDAs from the *Standard Nonforfeiture Law for Individual Deferred Annuities* (#805). The Executive (EX) Committee approved the request for model law development to Model #805 at the 2016 Summer National Meeting.

At the 2016 Fall National Meeting, the Life Insurance and Annuities (A) Committee adopted amendments to Model #805 recommended by the Life Actuarial (A) Task Force to exempt CDAs from certain sections of Model #805, with which, due to their structure, they cannot comply. The revisions to Model #805 exempt CDAs from the sections of the Model #805 that prescribe computational methods and minimum nonforfeiture values for deferred annuities, but would allow the insurance commissioner to specify separate nonforfeiture standards, if needed, at a later time.

2. Name of Group Responsible for Drafting the Model and States Participating.

Contingent Deferred Annuity (A) Working Group of the Life Actuarial (A) Task Force. The following states participated: Tomasz Serbinowski (UT), Chair; Perry Kupferman (CA); Bob Chester (CT); Nicole Boyd (KS); Felix Schirripa (NJ); Mike Boerner, Jan Graeber and Phil Reyna (TX); and Craig Chupp and Ern Johnson (VA).

3. Project Authorized by What Charge and Date First Given to the Group.

The charge was given to the Life Actuarial (A) Task Force at the 2013 Fall National Meeting to recommend a manner to specifically exempt CDAs from Model 805. The Task Force appointed the Contingent Deferred Annuity (A) Working Group to complete the charge. The Executive (EX) Committee approved the request for model law development to Model #805 at the 2016 Summer National Meeting.

4. A General Description of the Drafting Process (e.g., drafted by a subgroup, interested parties, the full group, etc). Include any parties outside the members that participated.

The Contingent Deferred Annuity (A) Working Group, chaired by Mr. Serbinowski, completed the charge to exclude CDAs from the scope of Model #805.

In addition to the Working Group members, the following interested state insurance regulators participated: Mike Yanacheak (IA); Rhonda Ahrens (NE); and Pete Weber (OH).

The following interested parties participated: American Council of Life Insurers (ACLI); Center for Economic Justice (CEJ); American Academy of Actuaries (Academy); and Lewis & Ellis Inc.

5. A General Description of the Due Process (e.g., exposure periods, public hearings or any other means by which widespread input from industry, consumers and legislators was solicited).

The Working Group began working on the charge in open conference calls beginning in the spring of 2014. Draft recommendations were posted on the Working Group's web page, and comments were solicited. Draft revisions to Model #805 were adopted by the Life Insurance and Annuities (A) Committee at the 2016 Fall National Meeting.

6. A Discussion of the Significant Issues (items of some controversy raised during the due process and the group's response).

The revisions sought to achieve two objectives: 1) exempt CDAs from the current nonforfeiture requirements; and 2) preserve state insurance commissioners' authority to prescribe CDA-specific nonforfeiture requirements in the future.

The Life Actuarial (A) Task Force received multiple comments to the effect that the revisions to Model #805 would likely result in a non-uniform treatment of CDAs across the country, with individual states establishing different nonforfeiture standards for CDAs. The Task Force noted that many NAIC model laws grant state insurance commissioners' rulemaking authority and that this has never been viewed as contrary to the NAIC's stated mission of encouraging uniformity.

7. Any Other Important Information (e.g., amending an accreditation standard).

None.

PROJECT HISTORY - 2003

STANDARD NONFORFEITURE LAW FOR INDIVIDUAL DEFERRED ANNUITIES (#805)

1. What issues was the project intended to address?

At the Executive Committee and Plenary Meeting in San Antonio, Texas, on February 8, 2002, the issue of the appropriate interest rate to incorporate into Section 4 of the Model was discussed. The following excerpt from the minutes summarizes that discussion:

Commissioner Koken, vice chair of the Life Insurance and Annuities (A) Committee, stated that the A Committee has been reviewing the issue of the minimum nonforfeiture rate on annuities. It is currently 3%, which in the current economic climate means that companies may have to take some products off the market because they can't invest at that rate, or there will be real solvency concerns. The recommendation from the A Committee is to support the industry in their efforts to go to the legislatures and ask for a reduction in the nonforfeiture rate to 1.5% and to give a charge to the Life and Health Actuarial Task Force to develop a long-term solution to this issue. The group believes that ultimately an indexed rate is the best response so that as the economy changes it will not be necessary to go back to the legislatures.

The minutes of that meeting further show that the following motion was adopted: "Recommend that the states support a 1.5% nonforfeiture with a sunset of July 1, 2004 and a charge to develop an indexed rate." In a subsequent discussion of the Task Force, the project was defined to include the following general scope (as captured in the Life and Health Actuarial Task Force minutes from March 14-15, 2002):

William Schreiner (ACLI) reported that the ACLI has a committee studying this matter, and that the committee is looking for the Task Force's input on areas to study. He said "it is fair that you will want to look at more than just the interest rate." A lengthy, wide-ranging discussion ensued on how to proceed. Mr. Hartnedy summarized the discussion by saying that three potential areas of inquiry had been identified: 1) "You've got to carefully consider in the change of any minimum guarantees the surrender charge;" 2) "We're very interested in a dynamic or, if you will, index rate"; and 3) "We want pros and cons as to impact on people in different circumstances by doing this." Mr. Gorski suggested "maybe there is a need to think about disclosure at the same time." Mr. Schreiner added that "all the elements of the (nonforfeiture) 'formula' will be in play."

2. What states participated in drafting the model?

The following states are currently members of the Task Force: New Mexico (Chair), Arkansas (Vice-Chair), California, Connecticut, Florida, Illinois, Minnesota, Nebraska, New York, Oklahoma, Pennsylvania, Texas, Utah, and Vermont.

3. What general procedure was followed in drafting the model? What efforts were made to assure that all interested parties were provided an opportunity to comment during the drafting process?

The efforts of the Task Force were closely coordinated with all industry interested parties. In addition to open sessions at the quarterly meetings of the NAIC, seven conference calls were held over the last year to discuss the various submissions and drafts of the Model. Notice of those conference calls was posted on the NAIC's home page on the Internet and e-mailed to approximately 200 regulators and interested parties, including representatives of the American Council of Life Insurers, the National Alliance of Life Companies, the National Fraternal Congress of America, and the American Academy of Actuaries (AAA).

4. What significant issues were raised during the drafting process, and how were those issues resolved?

Given this complexity of this topic and the myriad of opinions, it is impossible to put together a brief description which captures a) all of the issues raised and b) all of the detail underlying those issues. Any summary will of necessity be a broad overview and will omit numerous particulars of the project. However, I believe that the items below represent the major points of discussion:

A) Is there really a need to change the Model?

Many regulators expressed doubts regarding whether there was a need to change the Model. This excerpt from Frank Dino's (Florida Department of Financial Services) summary of the October 10, 2002, conference call of the Task Force summarized the basic nature of those concerns:

Some of the previously expressed doubts regarding whether a problem actually exists in the current nonforfeiture law were repeated. It was noted that the current law allows initial expense loads of 35% and 10% for flexible premium and single premium products, respectively. Even ignoring annual expense charges, it would take fifteen years and four years, respectively, for the minimum values to match the original deposit, assuming the minimum 3% were credited each year. It was also noted almost all states interpret the existing law as imposing a cumulative standard, rather than requiring that a minimum interest credit of 3% be applied each year. This gives companies the ability to credit less than 3% some years (provided they can still meet the cumulative requirement).

Ultimately, a consensus emerged on the Task Force that changes to the Model should be made. The distinct expense loads for flexible premium and single premium products were eliminated, and replaced by a single standard of 12.5%. In its first draft Model submitted on August 22, 2002, the ACLI suggested 15%. However, subsequent discussions resulted in the compromise figure of halfway between the existing 10% standard for single premium annuities and the ACLI's proposed 15%.

B) What should be the basis of the index used in establishing the minimum nonforfeiture interest rate?

Early on in this project, it became clear that there is no economic or actuarial theory that makes any one index the obvious choice over another. The following suggestions were among the many received:

In correspondence received on May 24, 2002, the ACLI suggested the following:

Proposal: five-year constant maturity treasuries (CMT) is proposed as the basis of required minimum interest rate credits.

Rationale: the use of a CMT basis has the virtue of expected continuous availability, while the choice of a five-year basis lies between short and longer-term maturities.

The ACLI provided this commentary with the submission of their initial proposal for actual draft language on August 22, 2002: "The interest rate proposed is the Five-Year Constant Maturity Treasury rate (CMT) as of June 30 of the preceding calendar year minus two and one-half percent (2.5%), but not greater than four percent (4%) nor less than one percent (1%)."

In a submission dated November 13, 2002, the ACLI modified its proposal as follows: “Index Basis: 3 Year Constant Maturity Treasury (monthly) rate – minus 150 basis points, but not less than 1%.”

In a submission dated January 22, 2003, the ACLI made the following recommendation: “Therefore, we urge that the index basis in the proposed model Individual Deferred Annuity Nonforfeiture Law be changed to the three-year CMT reduced by 125 bps.”

In a submission labeled “Preliminary Draft” dated September 10, 2002, the AAA stated that “an index rate for the annuity non-forfeiture value can be based on either the Treasury Curve, The Swap Curve (or) somewhere on any myriad of credit curves.” The submission includes a description of how LIBOR swap rates might be used:

Under this approach we define the Non-Forfeiture Interest Rate (NIR) as equal to the Applicable Swap Rate less X. The Applicable Swap Rate is the monthly average swap rate for a swap whose term is equal to the term of the guarantee period for the premium/renewal (rounded up to the next whole year) during the month the premium is received or the renewal rate is set.

Many other comments were provided relative to the appropriate choice of an index, as well as a) what reductions to the index should be made to recognize company expenses and b) maximum and minimum limits on the interest rates.

In reaching a decision, the Life and Health Actuarial Task Force concluded that the Five-Year CMT less 125 basis points provides a reasonable balance between 1) giving companies relief in times of low interest rates and 2) providing an appropriate minimum guarantee for the consumer. Also, a consensus seemed to emerge on the Task Force in agreement with the position expressed in the January 22, 2003, submission from the ACLI: “The primary goal of the law’s revision is to provide a means to permit lower interest rate guarantees than the current law allows in low interest rate environments.” Accordingly, a cap equal to the existing 3% interest rate was established. However, in order to provide some minimum level of guarantee to the consumer, a floor of 1% was also established. Finally, flexibility was provided to the companies by allowing for the redetermination of the minimum interest guarantees on a periodic basis.

C) Should a lower minimum nonforfeiture interest rate be allowed for equity-indexed annuities?

This matter was not raised in a substantive way by any of the interested parties until the Task Force meeting in December 2002. Subsequently, a report was received from the AAA (dated January 27, 2003) that recommended the following: “The Academy of Actuaries recommends that an offset for Equity Indexed Annuities be allowed. The Academy strongly believes there is a need for an offset as long as the product provides a meaningful equity participation guarantee.”

The Task Force agreed with this recommendation, and inserted the following language into the Model:

During the period or term that a contract provides substantive participation in an equity indexed benefit, it may increase the reduction described in Subsection B(2) above by up to an additional 100 basis points to reflect the value of the equity index benefit. The present value at the contract issue date, and at each redetermination date thereafter, of the additional reduction shall not exceed the market value of the benefit. The commissioner may require a demonstration that the present value of the reduction does not exceed the market value of the benefit. Lacking such a demonstration that is

acceptable to the commissioner, the commissioner may disallow or limit the additional reduction.

The commissioner may adopt rules to implement the provisions of Section 4C and to provide for further adjustments to the calculation of minimum nonforfeiture amounts for contracts that provide substantive participation in an equity index benefit and for other contracts that the commissioner determines adjustments are justified.

Several members of the Task Force expressed a desire that a model regulation be developed to assist the states in implementing this provision.

5. What are the implications of this project for accreditation and codification?

Since this project does not deal with solvency monitoring, there is no impact for accreditation and codification.