



AMERICAN ACADEMY of ACTUARIES

**Nonforfeiture Modernization Work Group Report  
to the NAIC's Life Actuarial Task Force**

**Regulator and Consumer Information Under the Proposed Nonforfeiture Law**

**Houston – April 2013**

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## **Scope of Report**

Following the presentation of the American Academy of Actuaries' Nonforfeiture Improvement Work Group's (now renamed the Nonforfeiture Modernization Work Group, or NFMWG) August 2011 Report, the NAIC's Life Actuarial Task Force (LATF) requested the NFMWG keep it apprised of its future discussions and recommendations with respect to the specific items that need to be addressed to implement the proposed approach to reform. These decision points are set out in Section VII of the 2011 Report.

The less prescriptive nature of the recommended Gross Premium Nonforfeiture Method (GPNM) approach to nonforfeiture mandates results in the need for consumer and regulatory information appropriate to the GPNM approach. Such information is necessary for the consumer to understand the basis for determining the Required Policy Nonforfeiture Account (RPNA) and for regulators to ensure that the RPNA provided under the policy is reasonably aligned with the risks assumed. The purpose of this report is to provide LATF with the NFMWG's current thinking on its recommended approach to consumer and regulatory information systems under the proposed GPNM. The process of implementing the proposed GPNM approach to nonforfeiture reform necessarily involves a rigorous analysis of all of the elements of the proposed GPNM approach. Consequently, the content of and initial recommendations made in this report should be viewed as items for discussion and elaboration rather than final positions on the subject of consumer and regulatory information systems.

## **Background**

The current nonforfeiture law for life insurance has well defined minimum standards for guaranteed nonforfeiture values and cash values that do not vary by company, level of gross premiums relative to net (adjusted) premiums or expected experience. The cash surrender value is, for most products, the basis for determining any nonforfeiture values. Companies can provide values that are higher than these minimum standards. The policy form contains a description of the basis for calculating the policy's nonforfeiture values, including the interest rate, mortality table and a set of net adjusted premiums. Any non-guaranteed element that is retained in the policy increases the nonforfeiture value and/or cash value of the policy.

The minimum nonforfeiture value for annuities is defined in terms of a premium load allowance, fixed per-policy expense charges, and a minimum accumulation rate. In addition there are some constraints on the pattern at which surrender charges decrease from their initial level, and this can affect actual nonforfeiture values. The actual nonforfeiture value is determined on the basis of premiums, credited interest, and surrender charges, and the policy is structured so that this value is generally above the minimum value.

Current nonforfeiture mandates for life insurance were developed using a prospective methodology largely based on fixed level premium non-participating and participating whole life policies with book value benefits. Consequently, other than being somewhat non-transparent in their determination, current minimum values for these product types could still be considered a reasonable representation of the prefunded portion of the risks assumed at any time. However, an increasing number of products that characterize the market today typically have more flexible premium payment options and requirements, often with market value or equity value based designs that emphasize consumer choice in policy funding and/or investment decision making, but with additional risks retained or assumed by the company. Certain characteristics of the current

nonforfeiture mandates represent impediments to the development of appropriate nonforfeiture values for such products, and may also impose barriers to more effective asset/liability management. These are among the reasons a new approach to the establishment of nonforfeiture mandates for both life and annuities is being proposed.

The proposed GPNM approach to the determination of minimum nonforfeiture values is based on a set of Guaranteed Nonforfeiture Basis (GNFB) factors selected by the company subject to certain guidelines and guardrails. These GNFB factors are applied to the actual gross premiums paid by the policyholder and any resulting pre-funding values are used, along with any declared and credited non-guaranteed elements, in the determination of the RPNA amount in the contract. All policies with any pre-funding of the risks assumed will have an RPNA value (unless regulators determine some “de minimis” exception). A separate issue to be decided by regulators is whether or not the contracts will be required to have a cash surrender value when an RPNA is present. But, regardless of whether required, any cash surrender value that is made available must be actuarially related to the RPNA amount but not necessarily equal to it. If premiums are stopped or completed, the RPNA continues to accrue or, depending on the options in the contract, may be used to provide a paid-up in-kind benefit by applying the GNFB factors to the RPNA amount. If the policy is terminated, then any surrender value, if available, is paid. Under the proposed GPNM approach, life insurance and annuities will be treated in a similar way in terms of the approach.

The GNFB factors are based on the guaranteed benefit period of the product and a specified schedule of premiums for the guarantee period, which for a flexible premium product may or may not be paid. After the initial guarantee period, if no further guarantee is provided, the company can charge whatever premium it deems appropriate to continue the policy in force. There may be multiple sets of GNFB factors, one set for each guarantee period, and/or a set for each benefit stream.

### **Suggested Approach to Regulator and Consumer Information Systems Under the GPNM**

#### *Information Provided To State Regulators When the Policy is Filed for Approval:*

- List of all GNFB factors and an actuarial documentation of their compliance with any regulatory and actuarial guidance and/or requirements
- Disclosure of the GNFB factor guarantee period or periods and the assumed schedule of gross premiums used to validate the GNFB factors
- List of factors or adjustments used to calculate the cash surrender value, if any, from the RPNA of the contract
- If policy loans are available, the policy loan interest rate; the guaranteed crediting rate on any policy loans and how that relates to the GNFB interest rate; how a policy loan would affect the period that coverage is guaranteed by the contract
- If the policy guarantees to provide coverage after the GNFB guarantee period, a description of how the contract will operate thereafter

#### *Information Provided to a Statistical Agent On a Regular Basis (Feedback Loop):*

- Companies will be required to annually electronically submit to a chosen statistical agent information on the GNFB factors it is currently using for its life and annuity products. This data will be scrubbed to ensure company anonymity and consistency. Reports will be provided to state regulators and, on a form, to consumers via the Internet. Regulators may use the information to request further information from the statistical agent on outlier GNFB factors to ensure that RPNA values provided to consumers appropriately reflect the risks

assumed and company experience as required by any applicable GNFB factor regulatory guidelines and guardrails

*Information Provided To the Consumer Prior to Completion of Sale:*

- For all life and annuity products, an automated, personalized “point of sale” illustration would be required to be provided. This illustration is to be based on the schedule of premiums the consumer plans to pay (for flexible premium policies) or is required to pay (for other policies). This would show the GNFB factor assumptions, and, by duration, the RPNA, nonforfeiture benefits, and, if applicable, cash surrender values that would be provided under the currently applicable set of GNFB factors and, if applicable, the corresponding benefits that would be provided if current non-guaranteed elements were to be continued. The illustration would give the consumer the option of seeing the benefits available if premiums ceased at any policy duration and allow the consumer to electronically receive, if desired, an alternative proposal based on additional schedules of premiums and/or benefits.
- A statement as to whether the policy may be surrendered for a cash surrender value, and if so, a description of the calculation and factors used in the determination of the cash surrender value
- A statement as to whether or not the policy has a loan provision and if so, the loan interest rate(s) charged and the guaranteed rate(s) credited on amounts securing policy loans
- A statement as to whether or not the policy has non-guaranteed elements and an appropriate disclaimer as to their availability and amount
- A statement listing all of the GNFB factor assumptions by policy duration and the guarantee period or periods during which they apply [Drafting Note: Since these factors will vary by company, and except for guidelines and guardrails that are not prescriptive, some reference to an industry standard may be useful such as, for mortality, the percentages of the current CSO table reflected in the GNFB mortality factors.]

*Information Provided to the Consumer Via Inclusion in the Policy:*

- A statement (on the front cover) as to whether or not the policy has a cash surrender value and/or loan value
- If a cash surrender value exists, a description of its calculation and its relationship to the RPNA calculation
- If a loan value exists, a description of its calculation and the interest rate(s) used in calculation of loan value and cash surrender value as affected by policy loans
- A statement as to whether or not the policy has non-guaranteed elements
- A listing and description of the GNFB factors by policy duration and the guarantee period(s) for which they apply

*Information Provided to an In-Force Policyholder:*

Current information regarding the policy is to be available upon request, on a “real-time” basis, including at least the following:

- The amount of the RPNA, nonforfeiture benefit and, if applicable, cash surrender value (if applicable), loan value, and death benefit as of the requested date
- The amount of any guaranteed and non-guaranteed elements, as applicable, paid or credited during the current contract year
- The currently applicable GNFB factor assumptions and the guarantee period and benefit stream to which they apply

Information regarding potential future value of the policy is also to be available upon request, but not necessarily in “real-time.” Such information should include:

- The ability to project future values using both the GNFB factors currently applicable to the guarantee period(s) being shown and a current non-guaranteed factor basis, with selected assumptions for premiums and death benefits, if applicable
- The ability to determine the level gross premium that, if paid, would maintain coverage for the term of the contract, or during the guarantee period(s) being shown, as applicable, using either the GNFB factors applicable to the guarantee period(s) being shown, or current non-guaranteed factors, and a display of projected values based on payment of that premium
- Information on the effect of any existing policy loans on the RPNA, nonforfeiture benefits and any applicable cash surrender value; information on the policy loan interest rate and its determination, and the credited rate on the loaned portion of the RPNA

[Drafting Note: There should be some consideration of allowing a limitation on the number of such reports that may be requested without a charge.]

In addition to the above “on-demand” information and reports, at least once per year the company would be required to promptly provide, without charge and without specific request, corresponding information related to current policy values as described above, including amounts paid or credited during the year. Projections of potential future values should also be included in these reports, based on the level gross premium needed to maintain the policy to its latest maturity date using the GNFB factors currently applicable to the guarantee period(s) being shown. Other related projections may also be shown.

[Drafting Note: This annual report is not intended to replace any other annual reporting requirement; rather it is intended to provide supplemental information related to the proposed revised nonforfeiture mandates.]

The NFMWG appreciates the opportunity to provide this report on its ongoing activities to LATE.