



AMERICAN ACADEMY *of* ACTUARIES

Nonforfeiture Modernization Work Group

Update on Nonforfeiture Treatment of Certain Fixed Deferred Annuities Under the Proposed GPNM Nonforfeiture Approach

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Background and 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 various items that need to be addressed to implement the proposed approach to reform.

In addition, we understand that the Kansas Insurance Department (KDOI) is coordinating a "proof of concept" project with respect to a proposal to simplify PBR, with the intention to make the audit process more manageable. The KDOI effort is currently focused on fixed (non-variable) deferred annuities but, if successful, could be applied to other lines of business, such as variable annuities and life insurance. As part of this project, the NFMWG has been requested by KDOI to provide comments on the considerations involved in the determination of nonforfeiture values for certain types of fixed deferred annuities under the Gross Premium Nonforfeiture Method (GPNM) approach proposed in the NFMWG's August, 2011 Report. The initial effort would concentrate on the GPNM approach as it would apply to two products: (i) a fixed deferred annuity with a base guaranteed interest rate only and no riders, and (ii) a fixed indexed annuity (FIA) with a guaranteed lifetime income benefit (GLIB) provided either by rider or inclusion in the base policy itself.

The purpose of this update is to apprise LATF of the activities to date with respect to its activities regarding nonforfeiture values under the GPNM approach for fixed deferred annuities, both with and without GLIB benefits.

Fixed Deferred Annuity Nonforfeiture Values

At this point in its discussions, the NFMWG has concluded that the Required Policy Nonforfeiture Amount (RPNA) value for a fixed deferred annuity, with no riders or GLIB, be determined using a generalized retrospective approach similar to that used in the determination of the RPNA values for a universal life insurance product. The NFMWG plans to set forth in upcoming reports for LATF and the KDOI the specific actuarial approach to determining nonforfeiture values for this product type together with examples of RPNA values.

GLIB Nonforfeiture Values

GLIBs marketed with a fixed deferred annuity present a number of special issues with respect to nonforfeiture in general and its integration into the proposed GPNM approach in particular. The GPNM approach incorporates, as one of the criteria in the NFMWG's framework for nonforfeiture reform, the requirement that:

"Nonforfeiture values should be based on prefunding resulting from premium payments and credited or charged amounts" [See page 20 of the NFMWG's August, 2011 Report]

The anticipated risks associated with a GLIB do not easily lend themselves to a retrospective measurement of prefunding using the GPNM approach to nonforfeiture that is proposed for most other insurance and annuity products. The NFMWG is currently discussing several specific issues with respect to GLIBs marketed with fixed deferred annuities. Some of these issues and the questions they raise are:

- Should a GLIB, whether included in a fixed deferred annuity policy or added by rider, have an actuarially appropriate nonforfeiture value?
- Should any GLIB nonforfeiture value be separate from that of the underlying deferred annuity?
- How should any GLIB nonforfeiture value be determined (for example, should the value be based on accumulated charges, the current GLIB benefit level, the current account value, future charges that would not be collected, etc.)?
- Should the nonforfeiture benefit for a GLIB be a reduced paid up GLIB (RPU-GLIB)?
- Should there not be any actuarially appropriate cash surrender value attributable to the GLIB?
- Is there a need for the typical GPNM RPNA nonforfeiture value in the RPU-GLIB benefit calculation? (For other insurance and annuity products, the RPNA can be considered an intermediate calculation point on the path to fully paying up the risks assumed under the policy; does it serve any purpose in the RPU-GLIB determination?)
- Should the same nonforfeiture approach apply to separate GLIB riders as to embedded GLIBs?

The NFMWG intends to set forth in upcoming reports for LATF and the KDOI its recommendation as to whether nonforfeiture values are appropriate from an actuarial perspective for fixed deferred annuity GLIBs. If so recommended, the NFMWG plans to propose a specific actuarial approach that can be utilized in determining nonforfeiture values for GLIBs, together with examples of nonforfeiture values. In addition, in conjunction with the review of the above GLIB nonforfeiture issues, the NFMWG plans to review other benefits on the market that may raise issues similar to those presented by GLIBs with respect to nonforfeiture (e.g., GMDBs, ULSGs, CDAs).

The NFMWG appreciates the opportunity to provide this update to LATF and anticipates providing additional reports on the applicability of the proposed GPNM approach to nonforfeiture for other life insurance and annuity products and benefits.