

# **American Academy of Actuaries Nonforfeiture Improvement Work Group Report**

**Presented to the Life Actuarial Task Force**

**Washington, DC  
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**AMERICAN ACADEMY *of* ACTUARIES**

Nonforfeiture Improvement Work Group  
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# Academy NFIWG Charge From LATF (Formerly LHATF)

*“Study the feasibility of a new nonforfeiture law for life insurance and annuities to replace the existing nonforfeiture standards. Provide quarterly status reports on this project.”*



# Historical Context of Nonforfeiture (NF) Mandates

- **History of NF mandates; one of fair value to the consumer**
- **Guertin:**
  - **Persisting policyholders not unduly penalized on account of the granting of excessive NF benefits to terminating policyholders**
  - **Terminating policyholders get largest value consistent with above**
  - **Equity between persisting and terminating policyholders**
- **Guertin philosophy goes beyond prefunded benefits concept of NF**
- **Up to now NF benefits (benefits in kind) = forfeiture (cash) benefits**
- **NF benefits/values in report refer only to benefits “in kind”**



# Impetus for Life & Annuity NF Mandate Reform

- **WG's view is that the need for change is driven by:**
  - **Changed financial services business and product environment**
    - **Consumer desires**
    - **Increased competition**
    - **Technological advances**
- **Constraints of current Standard Nonforfeiture Laws**
  - **Minimum values not directly related to premiums**
  - **Prospective approach does not work well for some products**
  - **Current mandates are product-based rather than risk-based**



# Benefits of an Appropriately Designed Approach to NF Mandate Reform

## ■ To Consumers

- Increase product choices/flexibility
- Increase transparency in NF values
- Potential for reduced cost

## ■ To Regulators

- Reduce filing review time and expenses
- Increase regulators' ability to assess values provided vs. risks assumed
- Fewer consumer complaints



# Benefits of an Appropriately Designed Approach to NF Mandate Reform (Cont'd)

- **To Insurers**
  - **Uniform interpretation of NF mandates yields reduced filing costs**
  - **Facilitate more product innovation**
  - **Provide for more policy transparency**
  - **Better align risks assumed with policy values (ERM)**



# Challenges to Achieving NF Reform

- **Varying views on primary objective of reform**
- **Resistance to change from constituent sectors**
  - **Industry is divided on need for NF reform**
  - **Regulators generally recognize the need for NF reform, though not universally**



# Work Group Recommendation #1

**Current life insurance and annuity minimum nonforfeiture mandates should be replaced with a revised methodology for determining required nonforfeiture values.**



# Framework for Nonforfeiture Reform

- **Consists of a set of criteria designed to:**
  1. **Provide the benefits of reform, and**
  2. **Recognize the historical importance of NF values as a consumer protection benefit**
- **Guided WG's efforts to develop an approach to NF reform**
- **Limited for now to life and annuity products; concept can be extended**
- **Not limited to an individual product chassis**



# Framework for Nonforfeiture Reform

- **Objectives of Criteria Constituting the Framework for NF Reform**
  - **Product design flexibility/transparency**
  - **Fair and equitable NF values**
  - **Homogeneous NF value treatment for similar assumed risks**
  - **Industry nimbleness in product development activities**
  - **Remedy shortcomings in current NF mandates**



# Framework for Nonforfeiture Reform

- **Criteria constituting a framework for NF reform**
  - **Required NF values should be based on the prefunding of the risks inherent in the benefits provided resulting from premium payments and charged and/or credited amounts**
  - **NF mandates should provide specific requirements with respect to a required NF value methodology and general guidance with respect to the establishment of NF value actuarial assumptions**
  - **NF mandates should incorporate a well defined and purposeful approach to the statistical collection of NF value actuarial assumptions**
  - **Required NF values should not be representative of the economic value of the policy**



# Framework for Nonforfeiture Reform

- **Criteria constituting a framework for NF reform (cont'd)**
  - **Required NF values should not incorporate any change in the insurability status of the insured since issue, other than such changes occurring as a result of the exercise of a policy provision**
  - **NF methodology mandates should be the same for life and annuity products**
  - **NF mandates should not govern the determination of non-guaranteed element values in excess of guarantees; however, once credited or charged to a policy such amounts should be included in the determination of any required NF value for the policy**
- **WG considered various approaches to the determination of NF values Appendix B)**



## Work Group Recommendation #2

**Required nonforfeiture values for life insurance and annuity policies should be determined using a retrospective methodology meeting the criteria set out in the WG's framework for reform, utilizing actual policy gross premiums and reflecting the funded portion of the risks assumed by the company under the policy.**



# Recommended NF Reform Methodology

- **“Gross Premium Nonforfeiture Method” – GPNM**
- **GPNM assumes the nonforfeitable value in a policy is any prefunding of benefit risks measured as premiums paid and interest credited in excess of amounts required to pay benefit (risk) and expense charges**
- **Crediting or charging of NGE excess amounts contributes to this value**
- **Total value of any such prefunding amount is termed the Required Policy Nonforfeiture Account (RPNA)**
- **Note the RPNA is not a “minimum” nonforfeiture value**



# Basic Components of GPNM Approach

- **Nonforfeiture Basis (NFB)**
- **Required Policy Nonforfeiture Account (RPNA)**
- **Nonforfeiture Benefits**



# Additional GPNM Components

- **Implementation issues**
- **Policy form requirements**
- **Consumer disclosure**
- **Regulatory information**
- **Suitability issues**



# Regulatory Framework for GPNM

- **New NF law for life and annuity products**
- **New Life and Annuity Nonforfeiture Manual**
- **Potential new Actuarial Guidelines**
- **Potential new ASOPs**
- **Enhanced sales disclosure mandates**
- **Mandatory availability to regulators of information on industry NFB assumptions**
- **Enhanced consumer access to product costs/features information**



# Cash Surrender Values or Not?

(Subtitle: Cash surrender values, To Be Or Not To Be?)

- **Under current NF mandates, value of NF benefits and cash surrender value, when available, are generally equal**
- **Generally, but not always, when NF benefits are available, so is a cash surrender value**
- **WG concluded:**
  1. **Issue is essentially a public policy issue; and**
  2. **If cash surrender values are required or provided, they should be actuarially related to the policy's RPNA**
- **Report presents pros and cons of mandating cash surrender values when RPNA is present, and actuarial equivalence considerations**



# Work Group Recommendation #3

**If cash surrender values are required for or provided under a life or annuity policy, such values should be actuarially related to the RPNA.**



# Where to Now?

## Work Group's Recommendations

- 1. Current life insurance and annuity minimum nonforfeiture mandates should be replaced with a revised methodology for determining required nonforfeiture values.**
- 2. Required nonforfeiture values for life insurance and annuity policies should be determined using a retrospective methodology meeting the criteria set out in the WG's framework for reform, utilizing actual policy gross premiums and reflecting the funded portion of the risks assumed by the company under the policy.**
- 3. If cash surrender values are required for or provided under a life or annuity policy, such values should be actuarially related to the RPNA.**



# Issues to Be Discussed/Resolved if Recommendations of WG are Accepted

- **Is the GPNM an appropriate methodology for NF mandates?**
- **Should cash surrender values be mandated when RPNA is present?**
- **Should threshold levels for a RPNA values be mandated?**
- **Should minimum threshold levels of cash surrender values be established when such values are mandated and a RPNA is present?**
- **What, if any, guardrails should be placed on the NFB assumptions used in determining a policy's RPNA?**
- **How should any federal tax issues associated with the proposed GPCM approach to determining RPNA values and cash surrender values be addressed?**

