NAIC Update – New Annuity Standard Nonforfeiture Law

SEAC Spring Meeting
Amelia Island, FL
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Agenda

- SNFL for Fixed Annuities
  - Background
  - Environmental Changes
  - Issues
  - Game Plan
  - Results
- C-3 RBC Phase II
  - Proposal
  - Issues
  - Next Steps
- Other NAIC Developments

SNFL – What Is It?

- Defines Minimum Surrender Value for Policy Holder
- 2 Tests - Prospective and Retrospective
- Retrospective - Accumulates Net Premiums at Designated Rate of Interest (3% Until Recent Changes)
- Prospective - Discounts Minimum Guarantee Maturity Value to Present
- Must Provide Maximum of Two Values

SNFL – What Is It?

Retrospective

- Single Premium Accumulates 90% of Premium at 3% Per Year
- Flexible Premium Accumulates 65% of First Premium Plus 87.5% of Additional Premiums at 3% Per Year
- Excess Interest Credited in a Year Is Added to Minimum Required Value
  - Example: Can’t credit 6% in 1 year and zero the next

SNFL – What Is It?

Prospective

- Calculates Guaranteed Maturity Value at Guaranteed Interest Rate (Currently 3% Per Year) Using Current Value Only
- Uses Later of Age 70 1/2 or 10 Years From Issue As Maturity Date (If Flexible; Otherwise Use Fixed)
- Maturity Value Is Discounted Back at Guaranteed Interest Rate Plus 1% (Currently 4% Per Year)
- Impact Is Cash Value 1% Less Than Annuity Value for Each Year Until Maturity

Pros and Cons

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- Eliminates “Trust Me” Nature of Annuity	- Reduces Choices by Consumer
- Competitive Selling Feature	- Risky Product Feature
- Level Playing Field?	- No Level Playing Field
	- Increased Cost to All Annuity Purchasers

Law Provides Balance; Where is the Tipping

What Changed?

- Interest Rates
- Move to Back-end Loads
- Interest Rates

Interest Rate History

	5 Year CMT	10 Year CMT
1975	7.51	7.86
1980	9.21	9.78
1985	9.60	10.16
1990	8.43	8.48
1995	5.93	6.17
2000	6.30	6.10
2003	2.08	3.20

Rates at Lowest Level in Almost 50 Years

Industry Response

- Short Term
  - Reflected Lengthening Duration in Investments
  - Changed Investment Strategy
  - Refiled Contracts to Allow Minimum Crediting Rate of 2% for First Ten Years
- Intermediate Term
  - Pursued Regulatory Changes – Lower Minimum to 1.5%
  - Some Success But….Sunset Provisions
- Long Term
  - Pursued Regulatory Changes – Index Minimum Crediting Rate to External Benchmark

Survive Near Term and Build for Long Term

Results

- GE – 2% for 10 Years Approved in 40 States
- 33 States Passed the 1.5% Minimum
- Handful of States Have Already Passed the Indexed Rate

Industry, Regulators Worked Together to Find Solution

C-3 RBC – Phase II

- Phase I - Interest Rate Risk for Annuities, Single Premium Life
- Phase II - Equity Risk for Variable Products with Guarantees (GMDB, GMIB, GMAB, etc.)

C-3 RBC – Recommendation

- Stochastic Modeling
  - Factor Approach Optional for GMDB
- Metric - Lowest Yearly Value of Accumulated Statutory Surplus for Each Scenario
- Scenarios Ranked by Above Metric
- Modified CTE90 Requirement for RBC Level
  - Arithmetic Average of Worst 10%
  - Positive Surplus Values Set Equal to Zero

MCTE90 Intended to Capture Low Freq, High Severity

C-3 RBC – Recommendation

- Company Gets to Choose Scenario Generator
  - Calibrate Generator to Prescribed Distribution
  - Must Have “Fat” Tails
- Calibration Based on Historical S&P 500
  - Experience From January 1945 – October 2002
  - Regime Switching Lognormal Model
- Reinsurance, Hedging Can Reduce RBC
- Aiming for 2004 Adoption – Delayed from March 2003

C-3 RBC – Implications

- Preliminary Analysis – Higher RBC Needed
- Projections to Date Based on Single Cells
- Path Dependency Introduces Volatility Into RBC Calculation
- Projections of Total Capital Required – Definition of Reserves Still Needed

Projected Levels Could Lead to Removal of Product Features

C-3 RBC – Next Steps

- Industry Still Analyzing and Improving Models
- Industry Organizations (ACLI, NAVA) Continue to Push for More Measured Move to Implementation
- Determine Impact on Your Company If Not Already Completed
- Get and Stay Involved with Industry Groups