

BY E-MAIL

June 17, 2020

Mike Boerner  
Chair, NAIC Life Actuarial (A) Task Force

Attention: Reggie Mazyck ([rmazyck@naic.org](mailto:rmazyck@naic.org))

Re: APF 2020-07 on Life Nonforfeiture

Dear Chair Boerner,

Our companies appreciate the opportunity to comment on APF 2020-07. We strongly support the proposal to replace the 4.0% interest rate floor in life nonforfeiture requirements with a reference to the tax code as it best protects policyholders in a low interest rate environment. Moreover, this proposal is consistent with the fundamental purpose and intent of the nonforfeiture requirements – to provide fair value to policyholders who surrender their policies after years of paying premiums. In a low interest rate environment, a minimum nonforfeiture standard that includes an artificial 4% interest rate floor permits the development and sale of products that deprive policyholders from receiving equitable value upon surrender after years of policy contributions, at a time when they no longer need or are able to afford coverage.

**Nonforfeiture Objective is to Provide Equitable Value to Consumers**

The intent of the nonforfeiture law is to provide equitable policyholder value between those who surrender versus those who persist. This is done by passing a value linked to the reserve to consumers through cash surrender value and other nonforfeiture options. If the 4.0% interest rate floor remains, products can be designed where consumers will not receive equitable value upon surrender in the current low interest rate environment. If the nonforfeiture interest rate is floored at an artificially high level, minimum guaranteed cash values will be smaller relative to the size of the reserve, making whole life a lapse-supported product.

When a policyholder surrenders a whole life contract, the company releases reserves that are larger than surrender benefits, receiving a surrender gain. The nonforfeiture interest rate is 125% of the valuation interest rate, allowing 25% of the investment income to be retained by the company.

In the likely scenario that the valuation rate drops to 3.0% for policies issued in 2021, but the 4.0% floor remains, the discount rate cushion would increase from 25% to 33% ( $4.0\%/3.0\% - 1$ ), allowing increased surrender gains to be retained by the company. If the current low rate environment persists and the valuation rate drops to 2.5%, and if the 4.0% floor remains, the discount rate cushion would increase to 60% ( $4.0\%/2.5\% - 1$ ), allowing for even more surrender gains to be retained by the company. In such a scenario, consumers who pay into policies for years and surrender the policy in a time of need would not receive value commensurate with their policy. In contrast, the company would realize a gain that may or may not be passed back to

the consumer via reduced premiums.<sup>1</sup> If the 4.0% floor is kept, then the lower the interest rate environment, the greater the amount that can be withheld from the policyholder upon surrender.

The following chart shows examples of an insurance company’s “surrender gains”, which are the excess of the minimum reserves over the minimum nonforfeiture values (cash values). This is shown for a sample policy under two different reserve valuation rate scenarios (3.0% and 2.5%), with and without the current 4.0% nonforfeiture interest rate floor.

<b>“Surrender Gains” – Difference between Reserves and Minimum Cash Values</b> <i>\$100,000 Coverage for an Issue Age 45, Male, Non-Smoker</i>						
	<b>Valuation Rate = 3.0%</b>			<b>Valuation Rate = 2.5%</b>		
<b>Nonforfeiture Rate</b>	<b>4.0% (NF Floor)</b>	<b>3.75% (No NF Floor)</b>	<b>Additional Value Withheld</b>	<b>4.0% (NF Floor)</b>	<b>3.25% (No NF Floor)</b>	<b>Additional Value Withheld</b>
<b>Duration 10</b>	\$ 3,371	\$ 2,896	<b>16.4%</b>	\$ 4,493	\$ 3,014	<b>49.1%</b>
<b>Duration 20</b>	\$ 4,506	\$ 3,672	<b>22.7%</b>	\$ 6,346	\$ 3,783	<b>67.8%</b>
<b>Duration 30</b>	\$ 4,386	\$ 3,483	<b>25.9%</b>	\$ 6,269	\$ 3,527	<b>77.7%</b>

As shown in the chart above, maintaining the current 4.0% interest rate floor in a low interest rate allows the insurer to realize a higher surrender gain in all durations. As illustrated, the more years the policyholder pays into the policy, the more the company is able to withhold additional value from the consumer upon surrender if the 4.0% floor remains.

### **Leaving in the 4.0% Floor Harms Consumers**

Claims that removing the 4.0% floor would harm consumers by increasing premiums is a misdirected argument. In fact, if the floor remains, companies would be permitted to withhold value from consumers, resulting in greater gains for the company. These gains could either be passed through as lower premiums (creating a lapse-supported product) or pocketed by the company in a low interest rate environment. There is no requirement to lower premiums. To frame lower minimum benefits to the consumer as helping the consumer is fundamentally misguided.

The nonforfeiture requirements are designed to protect policyholders who do not stay in force, either because they no longer want or need coverage or are unable to afford coverage. Requiring a higher exit value maintains parity with persisting policyholders and protects all customers, not just those who persist.

<sup>1</sup> If the company passes the surrender gain back to policyholders in the form of lower premiums it is potentially (1) creating inequities between persisting and surrendering policyholders and (2) creating a lapse-supported policy, where the company is financially incented to have a greater percentage of policyholders surrender.

### **Holding Archaic Remnants of the Tax Code Hostage**

The change to the nonforfeiture law in 2014 to include the 4.0% interest rate floor was not made to lower nonforfeiture benefits, but instead solely to avoid conflict between the minimum nonforfeiture values and the maximum funding values permitted under Section 7702 of the Internal Revenue Code (“Section 7702”). However, if Section 7702 is amended so that it no longer includes a hard-coded 4% minimum rate, the 4% floor in the nonforfeiture interest rate would no longer be appropriate. APF 2020-07 proposes to eliminate this floor in the interest of providing greater equity to policyholders who surrender. We support returning to the level of fairness that was always intended by the Standard Nonforfeiture Law.

### **Conclusion**

We strongly urge LATF to adopt APF 2020-07 to maintain equity between persisting and surrendering policyholders consistent with the purpose of the Standard Nonforfeiture Law. Leaving the current 4.0% floor in VM-02 is not only arbitrary, but deprives surrendering policyholders of value in a low interest rate environment. Consumers are not helped by lower premiums that may or may not come to fruition. In contrast, they are helped by ensuring that minimum nonforfeiture values are fair and equitable relative to the value they have already paid into their policy.

Sincerely,



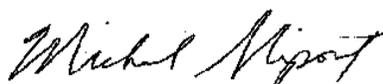
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