

UL Nonforfeiture

- Compact is seeking clarification on the application of the nonforfeiture requirements in Models 585 and 808 to UL products
 1. How should Model 585 nonforfeiture requirements apply to contracts with multiple or alternative guaranteed contract account values?
 2. What is the applicable nonforfeiture interest rate for determining the expense allowance?

Focus

- Item 1 is the most immediate issue for which we are seeking guidance
How should Model 585 nonforfeiture requirements apply to contracts with multiple or alternative guaranteed contract account values?
- Item 2 is fundamentally related to Item 1
What is the applicable nonforfeiture interest rate for determining the expense allowance?

Multiple or alternative guaranteed contract account values

- Recently became aware that some companies have designed their index linked UL products to provide multiple guaranteed account values.
- The cash value in these products is the greater of the contract account value and this separate guaranteed account value, less a surrender charge. The same premium and COIs are applied to both accounts.
- One account value has specified guaranteed minimum interest rate/s and maximum administrative expense charges, and the other account value has different guaranteed minimum interest/s and or different guaranteed administrative expense charges.

Section 6A of Model 585

Surrender charges are limited to unamortized unused initial expense allowances.

Unamortized unused initial expense allowances are determined as follows:

1. **Initial Expense Allowance**=Whole life initial expense allowance per **Section 5cA of Model 808**: $EA = (.01 * ELA) + 1.25 \text{ Min}(PNL, .04 * ELA)$

- ELA = Average death benefit over the first 10 policy years
- PNL = Net level whole life premium.

2. **Initial Acquisition Expense Charges**= actual 1st year expense charge less the average administrative expense charge.

- the average administrative expense charge is the average of administrative expense charges for policy years 2 through 20.
- using guaranteed maximum charges (premium, per 1000, per policy)-required under the Compact standard

3. **Unused Initial Expense Allowance**=1. – 2.

4. **Unamortized Unused Initial Expense Allowances** = 3. * a_{x+t}/a_x

- using mortality and interest guaranteed in the policy

Section 5cA of Model 808

Subsection H: *All adjusted premiums and present values referred to in this Act shall...for all policies issued in a particular calendar year be calculated on the basis of a rate of interest **not exceeding** the nonforfeiture interest rate as defined in this section for policies issued in that calendar year.*

- *“not exceeding” the nonforfeiture interest is conservative for WL and Term since using a rate lower than the nonforfeiture rate results in higher cash values*
- *For UL the lower the rate used in determining the allowance, the larger the surrender charges and the lower the cash values*

Compact UL Nonforfeiture Reviews

- The historical and current practice by a significant majority of companies is to use the guaranteed interest rate (GIR) in the contract to determine the expense allowance, if lower than and instead of the nonforfeiture rate.
- This is consistent with what states have allowed.
- We suspect that this was allowed by states because of the provision in Model 808 which permits use of an interest rate that does not exceed the nonforfeiture rate for WL contracts.

Observations from Compact Reviews

- Over the years the guaranteed interest rates have lowered. It used to be common for the guaranteed interest rate to be about 3+% (2007) and now we see guaranteed interest rates as low as .05%.
- For indexed linked UL, the guaranteed interest rate is 0%, however, companies in general use their fixed account guaranteed interest rate for nonforfeiture compliance.
- Many companies set initial surrender charges close the initial maximum surrender charges, and some stay close to the max allowed in the first several durations, but in all cases surrender charges eventually grade off much more quickly (20 yrs or less) than would be permitted.
- Some companies do set initial surrender charges significantly lower than the maximum surrender charges.

Multiple Account Values Company Example # 1

Cash Value Basis = greater of:

- Account Value 1: guaranteed minimum interest=0.5% on fixed account and 0% on indexed account
- Account Value 2: guaranteed minimum interest=5% for years 1-2 and 2.5% for years 3+.
- Impact on Initial Maximum Surrender Charge (\$100,000 Face, 2017 M ANB Composite):

GIR = 0.5%		
Account Value 1		
Age	Initial Max SC	
35	\$	3,409
60	\$	5,979

GIR = 5% for 2 yrs then 2.5%		
Account Value 2		
Age	Initial Max SC	
35	\$	2,532
60	\$	5,031

Multiple Account Values Company Example # 2

Cash Value Basis = greater of:

- Account Value 1: guaranteed minimum interest=.15%, level maximum administrative charges
- Account Value 2: guaranteed minimum interest=.15%, maximum monthly charges: \$5/1000 and 8% premium for 1, 2, 3, ...up to 15 yrs
- Impact on Initial Maximum Surrender Charge (\$100,000 Face, 2017 CSO M ALB Composite):

AV 1 Expenses (level)		
Account Value 1		
Age	Initial Max SC	
35	\$	3,604
60	\$	6,000

AV 2 Expenses for 1 yr			
Account Value 2			
Age	Initial Max SC		
35	\$	2,864	
60	\$	5,260	

AV 2 Expenses for 10 yrs			
Account Value 2			
Age	Initial Max SC		
35	\$	3,215	
60	\$	5,611	

- Note: AV 2 differs due to duration of guaranteed charges.

Question for LATF: What interest rate(s) and expenses should be used in determining the maximum surrender charges?

- Most companies today use guaranteed minimum interest rate and guaranteed maximum expenses.
 - For multiple guaranteed accounts, companies have been demonstrating compliance based on one account's guarantees.
- A handful of companies use the nonforfeiture rate or a rate higher than the guaranteed interest rate for the expense allowance.
- **For multiple guaranteed account values, should each set of guarantees be tested for compliance? (Test each account's guarantees for the expense allowance interest rate, acquisition expenses, amortization interest rate)**