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SFA BILL ANALYSIS

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House Bill 5999 (as reported without amendment)
Sponsor: Representative Andrew Richner
House Committee: Insurance and Financial Services
Senate Committee: Financial Services

Date Completed: 10-28-02

RATIONALE

A fixed annuity contract is a type of investment, commonly issued by an insurance company, that repays the capital invested (premiums paid) plus a fixed rate of return over a set period of time. Under the Insurance Code, the "minimum nonforfeiture rate" is the minimum interest rate guarantee that an insurer may use to determine the cash value of an individual fixed annuity contract. The rate is designed to represent the level below which interest rates are not expected to fall.

Currently, the minimum nonforfeiture rate for an individual fixed annuity contract is 3%, which was set over 20 years ago when interest rates were higher. Due to the recent economic downturn and stock market fluctuations, it has been difficult for insurers to maintain an accurate prediction of interest rates on individual fixed annuity contracts. In some instances, market rates actually have fallen below or near the 3% minimum rate, according to the Office of Financial and Insurance Services. To protect the financial stability of insurers, it has been suggested that they should have the ability to adjust interest rate levels to a lower minimum rate, if necessary.

CONTENT

The bill would amend Section 4072 of the Insurance Code to lower the minimum nonforfeiture rate for individual deferred annuity contracts from 3% to 1.5% per year until 2005. The bill also would redefine the term "maturity value" to refer to an annual interest rate of 1.5%, instead of 3%, until 2005. (Section 4072 is known as the "standard nonforfeiture law for individual deferred annuities".)

Presently, for contracts providing for flexible considerations, the minimum nonforfeiture amount at any time until annuity payments begin must be equal to an accumulation up to that time at an interest rate of 3% per annum of percentages of the net considerations paid before that time, increased by any existing additional amounts credited by the company to the contract, and decreased by the sum of the following:

-- Prior withdrawals from or partial surrenders of the contract accumulated at an annual interest rate of 3%.
-- The amount of any indebtedness to the company on the contract, including interest due and accrued.

Under the bill, beginning on its effective date and continuing until January 1, 2005, the minimum nonforfeiture amount for these contracts would be determined in the same manner, except that the interest rate would be 1.5%.

Under Section 4072, the "maturity value" of paid-up annuity benefits is used to determine the amount of a contract's cash surrender benefits. The Code states that the benefits available before maturity may not be less than the present value as of the date of surrender of that portion of the maturity value of the paid-up annuity benefit arising from considerations paid before the time of cash surrender. "Maturity value" means an accumulation up to the maturity date at the rate of interest guaranteed in the contract for accumulating the net considerations to determine the maturity value, but not less than 3% per annum, of the percentages of the net considerations paid before that time, decreased by the sum of prior withdrawals from or partial surrenders of the contract accumulated at the rate of interest guaranteed in the contract for accumulating net considerations to determine the maturity value but not less than 3% per annum and the amount of any indebtedness to the company on the contract, and increased by excess interest previously credited by the company on the contract.

Under the bill, beginning on its effective date and continuing until January 1, 2005, "maturity value" would be defined in the same manner, except that the bill would refer to an interest rate of 1.5% per annum.

MCL 500.4072

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

By allowing life and annuity insurance companies to lower their minimum interest rate for individual fixed annuities, the bill would help alleviate concerns that the minimum interest rate might exceed the actual market rate. Although most insurers offer the highest rates possible in order to remain competitive, insurers need the ability to reduce rates below the present minimum. Otherwise, if forced to pay rates that are higher than actual market rates for a long period of time, the insurance industry might experience a significant financial decline.

Also, rate guarantees that exceed market rates can reduce consumer choice in the annuity marketplace of certain (usually shorter-duration) contract designs and options. Reportedly, many companies have stopped offering short-term annuities, such as one- to three-year contracts, because the statutory minimum rate is higher than the market rate. The bill would help keep these choices available.

The proposed reduction in the minimum guaranteed interest rate would be available only until January 1, 2005. The guaranteed minimum then would revert to 3%. According to the American Council of Life Insurers, this temporary solution would apply while the National Association of Insurance Commissioners develops a more permanent rate index, which will provide for a moveable "floor" and eliminate the need for statutory changes whenever market conditions change.

Since the minimum nonforfeiture rate is a floor only, the actual rate used in any particular contract varies by company and product design. Should the market rebound, it is likely that annuity insurers would increase their guaranteed rates.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: Maria Tyszkiewicz

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