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ANNUITIES: NONFORFEITURE RATE

House Bill 5050 (Substitute H-1)
First Analysis (10-2-03)

Sponsor: Rep. David Robertson
Committee: Insurance

THE APPARENT PROBLEM:

Generally speaking, the Standard Nonforfeiture Law (within the Insurance Code) requires that an individual deferred annuity contract provide the contract holder with a paid-up annuity or cash surrender benefits of a minimum amount if the contract holder surrenders the policy (e.g. stops making payments) during the accumulation period. The nonforfeiture amount is the deferred annuity's accumulated value, minus certain charges (such as prior withdrawals and loans), based on interest rate minimums regulated by statute. In recent years, market interest rates have fallen so low as to render unrealistic the old statutory rates that insurance companies were required to use in determining the amount to return to contract holders. This, industry specialists say, threatened financial harm to companies selling annuities and/or made companies less likely to offer annuity products.

In response, the legislature enacted Public Act 635 of 2002 (House Bill 5999). This act amended the code to establish temporary regulations of the minimum nonforfeiture amount for individual deferred annuity contracts, with the regulations to apply to contracts issued between December 23, 2002 and January 1, 2005. Among other things, Public Act 635 reduced from 3 percent to 1.5 percent the minimum interest rate used to determine nonforfeiture calculations. At the time knowledgeable industry observers said that the National Association of Insurance Commissioners (NAIC) was working on updating its model act on nonforfeiture in order to provide a long-term solution. That work has been completed, and legislation has been introduced to incorporate that model into Michigan's Insurance Code.

THE CONTENT OF THE BILL:

The bill would amend the section of the Insurance Code known as the Standard Nonforfeiture Law to put in place a new set of provisions to regulate the minimum nonforfeiture amount for individual deferred annuity contracts as of January 1, 2005. The bill would permit insurance companies to use the existing regulations or these new regulations until January 1, 2005, at which time the new provisions would automatically govern.

Under House Bill 5050, the interest rate used in determining minimum nonforfeiture amounts would be an annual rate of the lesser of three percent per annum and the following, as specified in the contract if the interest rate is to be reset: 1) the five-year constant maturity treasury rate reported by the Federal Reserve as of a date, or average over a period, rounded to the nearest one-twentieth of one percent, specified in the contract no longer than 15 months before the contract issue date or redetermination date; 2) reduced by 125 basis points (or more for equity indexed benefits, as described later); and 3) with a resulting interest rate not less than one percent. The interest rate would apply for an initial period and could be redetermined for additional periods. The redetermination date, basis, and period, if any, would have to be stated in the contract.

The bill would provide that during the period or term that a contract provided substantive participation in an equity-indexed benefit, the contract could provide for an increase in the reduction in basis points of up to an additional 100 basis points to reflect the value of the equity index benefit. The present value at the contract issue date, and at each redetermination date after the issue date, of the additional reduction could not exceed the market value of the benefit. The commissioner of the Office of Financial and Insurance Services could require a demonstration that the present value of the additional reduction did not exceed the market value of the benefit and could disallow or limit the additional reduction if the demonstration was unacceptable. The commissioner could adopt rules to implement these provisions and to provide for further adjustments to the calculation of minimum nonforfeiture amounts for contracts that provide substantive participation in an equity index benefit and for other contracts where the commissioner determined adjustments were justified.

The bill contains several other new provisions. 1) Currently, the law says that an insurance company must provide a paid-up annuity benefit upon the cessation of payments by the contract holder. The bill would also require a paid-up annuity benefit to be provided "upon the written request of the contract owner". 2) The company is currently allowed to defer the payment of a cash surrender benefit for six months after the demand for payment has been made with the surrender of the contract. The bill would only allow the six-month delay "if the company makes a written request to the commissioner showing the necessity and equitability to all policyholders of the deferral and the commissioner gives written approval". 3) The law currently allows certain deductions from the amount that must be paid when a contract is surrendered to account for prior withdrawals and for any loans to the customer. The bill would also allow deductions for an annual contract charge of $50 (up from the current $30) and for any premium tax paid by the company for the contract.

MCL 500.4072

FISCAL IMPLICATIONS:

The bill would have no fiscal implications, according to the Office of Financial and Insurance Services. (OFIS analysis dated 10-1-03)

ARGUMENTS:

For:

The bill would put into the Insurance Code language from the newly developed model act on annuity nonforfeiture from the National Association of Insurance Commissioners. According to information from state regulators, "through the process of developing the model act, the NAIC sought input from consumers, industry, and all interested parties. They also used actuaries to analyze the implications of the new index rating methodologies. As a result of this process, the NAIC and many state feel the new model protects both consumers and the industry from being disadvantaged in an ever changing market". Essentially, the bill provides a floating rate, based on up-to-date market interest rates, for use in determining nonforfeiture values. The bill allows the interest rate to float between one percent and three percent. The old model act required insurance companies to base their nonforfeiture amounts on an interest rate of three percent. Those regulations became problematic when market interest rates fell below three percent. The legislature enacted a temporary stop gap measure to address this issue last year. The new formula in this bill is intended as a long-term solution.

POSITIONS:

The Office of Financial and Insurance Services supports the bill. (10-1-03)

Representatives from the Life Insurance Association of Michigan and the American Council of Life Insurers testified in support of the bill. (10-1-03)

Representatives from Jackson National Life and MetLife indicated support for the bill to the House Committee on Insurance. (10-1-03)

Analyst: C. Couch