Re: Nonforfeiture Benefits for Contingent Deferred Annuities (CDAs)

Dear Commissioner Nickel:

The American Council of Life Insurers (ACLI) appreciates the opportunity to comment on the questions raised at the August meeting about whether there should be required nonforfeiture values for CDA contracts.

**Public Policy Question: should CDA's have required minimum nonforfeiture benefits?**

The suggested requirement of minimum nonforfeiture requirements on CDAs raises several important public policy issues and concerns, including:

1. **Compromise of risk pooling.** CDAs provide longevity risk protection. The pooling of longevity risk provides clear public benefit, as individuals with shorter lifespans effectively fund the incomes of those with longer lifespans. Minimum nonforfeiture requirements, however, would encourage anti-selection: a customer who receives a health diagnosis with negative mortality implications would have a much greater incentive to surrender in order to minimize the funding of those with longer lifespans. This would fundamentally compromise the pooling mechanism that is fundamental to insurance.

2. **Increase in cost to consumers.** The decline of defined benefit pension plans and increased longevity have created a clear public policy need for affordable vehicles that allow a pool of assets to be

---

1The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. ACLI advocates in federal, state and international forums. Its members represent more than 90 percent of the assets and premiums of the U.S. life insurance and annuity industry. In addition to life insurance, annuities and other workplace and individual retirement plans, ACLI members offer long-term care and disability income insurance, and reinsurance. Its public website can be accessed at www.acli.com.
converted into reliable lifetime income. Every benefit, however, has a cost. The existence of a nonforfeiture benefit on CDAs would increase the cost of longevity risk protection which would, in turn, provide a disincentive for consumers to purchase the product.

3. **Potential arbitrage opportunities against the insurer.** Traditional nonforfeiture requirements are based on providing a minimum book value. If a minimum book value concept were applied to nonforfeiture requirements on CDAs, however, insurer solvency could be compromised. In particular, in situations when guarantees are not deeply “in the money” (i.e. the benefit base is near the value of the covered investments), a “book value” nonforfeiture benefit could create situations where a consumer could achieve economic arbitrage—at the expense of the insurer—by surrendering the CDA and using the proceeds to fund an alternative investment. This would be counter to the interests of both insurers and insurance regulators.

4. **Potential "run on the bank" scenarios.** While the use of market-based nonforfeiture benefits could address some of the challenges with book value-based requirements, they would create other concerns. In particular, they could lead to a “run on the bank” scenario when markets are down. Consider if variable annuity customers with guaranteed income benefits had market based cash values available during the market crash of 2008 – there could have been large surrender activity and a resulting increase in solvency concerns for insurers and potentially systemic risk implications for the broader economy. The 2008 crisis demonstrated that the absence of nonforfeiture benefits on guaranteed income benefits provides a stabilizing influence on insurers and the broader economy.

5. **Applicability.** The Model law exempts other annuities which emphasize payout streams over lifetime similar to those offered through CDAs, such as variable annuities (including those offering GLWBs), immediate annuities and deferred annuities after annuity payments have commenced. It would seem inappropriate to inconsistently apply nonforfeiture requirements across products that are providing similar longevity risk protection to consumers.

Based on the aforementioned concerns, we suggest that it would be counter to sound public policy and to the interests of consumers, regulators, and insurers to require minimum nonforfeiture benefits on CDAs. Nor is it clear that such benefits are actually desired by consumers, based on the industry’s experience with variable annuities that have lifetime withdrawal benefit riders. If market preferences shift to demand such benefits, competitive and creative forces will create an incentive for companies to provide them within their risk tolerances, even in the absence of a required regulatory minimum.

In February 2014, pursuant to its charges from the NAIC Life and Annuities Committee to specifically exclude CDAs from the scope of the Standard Nonforfeiture Law, the Life Actuarial Task Force exposed revisions to the Model to clarify the exemption of CDAs from the minimum requirements of the current law. We encourage the Working Group to support this revision and its formal adoption by the NAIC.

Sincerely,

John Bruins
Vice President & Senior Actuary

Kelly Ireland
Senior Counsel, Insurance Regulation

Cc: Richard Wicka, Deputy Chief Legal Counsel, Wisconsin Office of the Commissioner of Insurance
Tomasz Serbinowski, Actuary, Utah Insurance Department
Jennifer Cook, Health & Life Policy Counsel, NAIC