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**Additional Comments on the NAIC CDA (A) Working Group Draft
Contingent Deferred Annuity (CDA) Cancellation of Benefits Document by the
American Academy of Actuaries' Nonforfeiture Modernization Work Group**

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Background

The NAIC CDA (A) Working Group (CDAWG) recently exposed for comment a proposal for certain “cancellation” benefit(s) to become required under Contingent Deferred Annuities (CDAs). The Nonforfeiture Modernization Work Group (NFMWG) of the American Academy of Actuaries provided comments on the *Draft Contingent Deferred Annuity (CDA) Cancellation of Benefits Document* during the exposure period, and now offers these additional comments.

Additional Comments

The proposal by the CDAWG for cancellation benefits under CDAs provides for such benefits to be available when the CDA arrangement is ended by the action of either the insurer or a third party, but not if ended by action of the insured (or contract holder as the case may be). Under the proposal, cancellation benefits may take three forms, a replacement annuity, a paid up benefit, or cash.

The NFMWG has the following specific concerns with respect to the CDA cancellation benefit proposal:

1. No nonforfeiture benefits are proposed when the insured cancels the CDA. Yet, the exposure draft states, in the last paragraph on page 1, “Thus, the cancellation of a CDA contract could result in the insured losing a significant amount of equity without any corresponding benefit.” This statement and the exposure draft language immediately preceding it are consistent with the concept of nonforfeiture benefits, but the proposed cancellation benefit approach is contrary to the concept of nonforfeiture benefits.
2. Nonforfeiture benefits are primarily a *consumer protection* issue, as noted in the August 2011 Report of the NFMWG (at the time the “Nonforfeiture Improvement Work Group”), even though there may be some public policy considerations associated with the provision of these benefits. The concept of nonforfeiture benefits implies that cancellation of the CDA by the insured should result in a continuation of benefits in some in-kind form when there is value. By proposing to require a cancellation benefit when the insurer terminates the CDA, the NAIC has recognized there may be value, so consistency suggests value in the case when the insured initiates the termination.
3. Two of the proposed cancellation benefits provide for cash payments of either a return of a portion of the CDA fees or the present value of the then guaranteed withdrawal amount. One of the options could alternatively be payable in the form of a lifetime income. This apparent equivalent treatment between cash and in-kind benefits does not reflect the conceptual distinction between nonforfeiture and cash surrender benefits. The NFMWG believes an in-kind benefit should be available when there is value. The August 2011 Report, mentioned earlier, proposes that the provision of cash surrender values is primarily a *public policy* issue, including when and if such benefits are to be payable. The issue of whether cash surrender values should be made available under CDAs merits further discussion among all stakeholders involved, as it may not be appropriate from a public policy perspective to permit or require cash surrender payments at termination of a CDA.
4. As mentioned above, the exposure draft suggests “a return of a portion of the fees incurred by the insured” as a possible cancellation benefit. A cancellation benefit equal to a return of a portion of the CDA fees may not be an appropriate measure of the

actuarial value of either the in-kind nonforfeiture benefit or the cash benefit under the CDA. Consistency between a nonforfeiture benefit and a cancellation benefit is best achieved if such benefits reflect the funded portion of the risk benefit covered under the CDA contract. Using some portion of the CDA fees for this purpose may overstate (e.g., if the CDA is substantially out of the money) or understate (e.g., if the CDA is substantially in the money) the true actuarial measure of the risks funded to date under the CDA.

5. It is not clear that the sample approaches proposed for the cancellation benefits fully reflect the complexities involved in determining the appropriate benefit value upon CDA termination. When the cancellation benefit is the result of a unilateral action by the insurer or a third party, equity demands that fair value be provided in order for appropriate consumer protections to be achieved. Such values should reflect methodologies and risk factors underlying the CDA contractual arrangement. Existing nonforfeiture mandates do not address either these methodologies or risk factors, so more detailed guidance than that made available in the Draft CDA Cancellation of Benefits Document is necessary.
6. As further justification for a required cancellation benefit when the CDA is terminated by the insured, consider that a CDA is essentially a standalone Guaranteed Living Withdrawal Benefit (GLWB). Various insurers have at times offered buyout programs for GLWBs included in their variable annuities. This is evidence that some insurers acknowledge that certain GLWBs have value, and they are willing to share some or all of it if the insured agrees to terminate their GLWB. This offer has the characteristics of an insured-initiated termination (even though the insurer made the suggestion) for which the insurer pays a value upon termination of the GLWB. Therefore, it appears that insurers already recognize the value of guaranteed benefits of this type in what is effectively a nonforfeiture situation.

Conclusion

The NFMWG appreciates the opportunity to provide input on the issue of CDA cancellation benefits.