VERMONT

DEPARTMENT OF FINANCIAL REGULATION

Act No. 25 (2021) Report: Statutory Minimum Nonforfeiture Interest Rate Applicable to Individual Deferred Annuities

Section 33 of Act No. 25 of 2021,
Report; Minimum Nonforfeiture Interest Rate

REPORT

Report to the General Assembly

January 15, 2022

Submitted by
Michael S. Pieciak, Commissioner of Financial Regulation

In accordance with the Legislature's directive in section 33 of Act No. 25 of 2021, the Commissioner of Financial Regulation hereby submits to the House Committee on Commerce and Economic Development and the Senate Committee on Finance this report, which contains the Department's findings and recommendations on whether to decrease the floor to the statutory minimum nonforfeiture interest rate applicable to individual deferred annuities under 8 V.S.A. § 3750(d)(1)(C)(iii) from one percent to 0.15 percent.

I. What is an annuity? What are the common types of annuities?

An *annuity* is:

- a contract sold by an insurance company;
- under which the person purchasing the contract pays a single premium (contribution) or multiple contributions;
- in exchange for the insurer's promise to pay a single income payment or a series of income payments at regular intervals over time.

There are many different types of annuities. An *individual annuity* is a contract between an insurer and an individual, whereas a *group annuity* is a contract between an insurer and a group—usually an employer or retirement plan—to provide retirement benefits to group members. An annuity may be *immediate* or *deferred*. An *immediate annuity* allows a contract holder to convert contributions into an immediate income stream. With a *deferred annuity*, contributions accumulate value over time before being converted to a payment or payments at a future date. Annuities may also be *fixed*, *variable*, or *indexed* (or a hybrid of these). With a *fixed annuity*, an insurer agrees to credit the contract a fixed interest rate (credited rate) on contributions, for at least a certain period. Although a fixed annuity's credited rate may fluctuate (e.g., be reset periodically) according to terms set in the contract, the relative stability of the credited rate is its defining feature. This contrasts with a *variable annuity*, in which the contract value fluctuates based on the actual returns of investments selected within the contract, and an indexed annuity, in which the rate of return is linked to a market index.

The period during which the contract holder makes contributions to the annuity is called the *accumulation period*. A contract holder may make a single lump sum contribution or a series of contributions over time. Contributions earn interest or otherwise accumulate value during the accumulation period and any gains are tax-deferred. If a contract holder stops making contributions during the accumulation period and triggers or requests the termination of the annuity contract, an insurer must refund to the contract holder a benefit value of the annuity, which is generally based on the present value of the annuity minus any applicable charges. For individual fixed and fixed indexed deferred annuities, this value must not be less than the statutory minimum nonforfeiture amount set by § 3750.

During the *annuitization phase*, the insurance company distributes accumulated principal, earnings, and interest to the beneficiary (annuitant) in a single payment or series of payments, which are taxable to the extent they constitute earnings. The annuity payment period may be a set term or the lifetime of an annuitant (or beyond if a death benefit or survivor benefit rider is included). In simple terms, payments made on a term fixed deferred annuity are calculated as the total contributions plus credited interest, divided by the number of payments in the term. If an annuitant

dies during the term, payments will typically be made to the annuitant's estate or designated beneficiary. A lifetime deferred annuity guarantees payments to an annuitant for as long as they live. If the annuitant dies, however, payments typically cease (even if the entire balance hasn't been paid).

II. Individual deferred annuities

The type of annuities impacted by the proposed statutory change to the minimum nonforfeiture interest rate are individual deferred annuities, both fixed and fixed indexed. In short, these are annuities to which an annuitant makes one or more tax-deferred contributions that earn interest or index-linked returns during accumulation. At some point in time, the insurer pays one or a series of fixed income payments to the annuitant, which consist of a return of accumulated principal and any growth in value, the latter of which is taxable.

Fixed annuities are popular because they are viewed as safe and predictable savings vehicles—they provide a guaranteed income stream unaffected by market fluctuations. A drawback of fixed annuities is that they tend to provide a relatively low credited rate, as they are generally based on market rates for bonds and other fixed income investments. Fixed indexed annuities operate similarly to fixed annuities, except they tie the amount of value earned to the performance of an underlying equity index, such as the S&P 500. These products provide more growth potential than fixed annuities, but less risk (as well as less potential return) than variable annuities. Although fixed indexed annuities generally offer principal protection in case the index performs negatively, most also include caps and participation rates that serve to limit gains. In most cases, like fixed annuities, fixed indexed annuities also offer a minimum guaranteed rate of return. Both fixed and fixed indexed annuities are relatively conservative products that protect an individual's principal for long period of time. For this reason, fixed and fixed indexed annuities are often used in retirement planning.

Although it may be available for a cost, fixed and fixed indexed annuities typically do not include the protection of a cost-of-living adjustment, so the real value of the principal contributed to the annuity may decrease over time. The annuitant depends on the rate of return to keep up with inflation. In addition, fixed and fixed indexed annuities are also relatively illiquid. There are significant tax and fee implications associated with early withdrawals. If a contract provides a cash surrender benefit, an annuitant may withdraw (surrender) all or a portion of paid-up benefits prior to the end of the statutory surrender period, which may be three to ten years, or longer. However, the amount withdrawn will be subject to a considerable surrender charge (although many annuity contracts do provide that an annuitant may withdraw up to a certain percentage of the paid-up value prior to the end of the surrender period without incurring a charge). If an annuitant surrenders an annuity before they have reached age 59 ½, in most cases they will also be required to pay a 10 percent early withdrawal penalty plus regular income tax. In addition, unless the annuitant has chosen to pay for survivor or death benefits, an insurer may not be obligated to continue payments or refund any part of the contributions to the annuitant's estate after their death.

A fixed annuity may have a market value adjustment (MVA) built in, which provides an annuitant with the flexibility to withdraw money before the end of the surrender period, while at the same

time, protecting insurers against market risk. The MVA adjusts any withdrawal subject to a surrender charge up or down based on market conditions at the time the withdrawal is made. The adjustment may be positive or negative, depending on whether interest rates have gone up or down since the initial contract date. If interest rates have gone up, the MVA will be negative, and the annuitant will be charged an additional fee on the withdrawal amount. This serves to discourage annuitants from liquidating their annuity in the short term to take advantage of higher rates available elsewhere. If interest rates have gone down, the MVA will be positive and may partially offset the surrender charge.

III. How do insurers make money on annuities?

An insurer makes money on an annuity in two ways: the spread between the yield on its investments and the credited interest rate; and the fees it charges in connection with the annuity contract. In case of a fixed annuity, an insurer invests 100 percent of an annuitant's contributions in bonds and other long term, fixed investments. The yield on these investments is used to credit interest, cover the insurer's expenses, and provide a return on the insurer's capital. In case of a fixed indexed annuity, an insurer invests a small amount in equity call options, in addition to bonds and other long-term investments. The insurer pays itself the difference between its investment yield and the cost of the call options.

Investment yield also provides a profit for the insurer in exchange for the risks it undertakes. Although fixed and fixed indexed annuities are relatively straightforward contracts, insurers do take certain risks in providing them. For example, the total amount paid out by an annuity could exceed the total amount of contributions made, particularly in the case of a lifetime deferred annuity. In addition, investments could yield a return for the insurer that is lower than the annuity's guaranteed credited and/or nonforfeiture interest rate (discussed in the next section).

In addition to earning a yield on investment, insurers also charge various fees in connection with annuity contracts. These may include administrative fees, mortality expenses, investment management fees, rider charges, and surrender charges. Fees for fixed annuities are generally lower than fees for fixed indexed annuities and, in each case, fees may increase as optional riders and guarantees are added to the contract.

Because annuities are intended to be long-term investments, surrender charges serve to discourage early withdrawals, thereby allowing insurers to utilize longer term investments with higher returns. Surrender charges also allow an insurer to recoup its initial costs of setting up and administering the annuity. Surrender charges generally decline over the time period agreed by the contract holder at purchase. For example, a contract with a seven-year surrender period may have a surrender charge schedule of 7%, 7%, 6%, 5%, 4%, 3%, 2% for the seven years prior to maturity. Surrender charges for fixed annuities are lower than those for fixed indexed annuities, with the latter averaging around 10% but as high as 15% at the beginning of the contract.

IV. Vermont's nonforfeiture law

Vermont's standard nonforfeiture law for individual deferred annuities is set forth in 8 V.S.A. § 3750. It is based on the National Association of Insurance Commissioners (NAIC) model

nonforfeiture law. Among other requirements for individual deferred annuities, this law sets the minimum amount that an individual deferred annuity contract must pay a contract holder as paid-up annuity, cash surrender, or death benefits if the contract holder surrenders the policy or stops making contributions during the annuity's accumulation period.

It is important to distinguish the minimum nonforfeiture rate from a minimum credited rate. The credited rate is used to credit interest to an annuity's principal, whereas the nonforfeiture rate is used to determine an annuity's cash value at the time of surrender. In some instances, annuity contracts offer the same credited and nonforfeiture rates. However, credited rates are not subject to a statutory floor, so an annuity's minimum credited rate may be higher or lower than its minimum nonforfeiture rate.

The minimum nonforfeiture value of an individual deferred annuity is equal to 87.5 percent of the accumulated gross value of contributions; minus any prior withdrawals, partial surrenders, and loans taken against the contract; minus an annual contract charge; plus, interest at a rate determined as follows:

> The lesser of three percent per annum and the following, which shall be specified in the contract if the interest will be reset:
>
> (i) 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 prior to the contract issue date or redetermination date under subdivision (iv) of this subdivision (C).
> (ii) Reduced by 125 basis points.[1]
> (iii) Where the resulting interest rate is not less than one percent.
> (iv) The interest rate shall apply for an initial period and may be redetermined for additional periods. The redetermination date, basis, and period, if any, shall be stated in the contract. The basis is the date or average over a specified period that produces the value of the five-year Constant Maturity Treasury Rate to be used at the redetermination date.[2]

Vermont's statutory nonforfeiture rate has not always been variable with a 3.00 percent ceiling and a 1.00 percent floor. Section 3750 was enacted in 1981, when the NAIC first adopted its model nonforfeiture law. At that time, the nonforfeiture rate was set at 3.00 percent. This static rate reflected the economic environment of the time. In 1980, inflation was high and the average yield on ten-year Treasury notes, which is often used as the benchmark that guides other interest rates, was 11.43 percent.[3]

[1] For an indexed annuity, the 125 basis point reduction may be increased by up to an additional 100 basis points, not to exceed the market value of the indexed benefit.
[2] 8 V.S.A. § 3750(d)(1)(C)
[3] https://www.macrotrends.net/2016/10-year-treasury-bond-rate-yield-chart

Throughout the 1980s and 1990s, ten-year Treasury yields decreased slightly but remained relatively high, even as inflation cooled. The average ten-year Treasury yield was 8.55 percent in 1990 and 6.03 percent in 2000.[4] By 2003, however, the average yield had dropped to 4.01 percent, only one percent more than the guaranteed nonforfeiture rate. According to life insurers, low interest rates had created squeezes between the yields insurers could earn on long-term investments and the rates they could afford to pay on annuities. In response to the low interest rate environment and insurer requests, the NAIC temporarily reduced the nonforfeiture rate to 1.5 percent in 2002, before voting to adopt a permanent amendment to the model law in 2003. Vermont followed suit that same year. The 2003 amendment implemented the current dynamic nonforfeiture rate, which is based on the average five-year Constant Maturity Treasury Rate less 125 basis points, subject to a 1.00 percent floor and a 3.00 percent ceiling.

Since the 2003 amendment, ten-year Treasury yields have continued to decrease steadily. The COVID-19 pandemic has been particularly challenging for bond investors—in 2020, the average ten-year Treasury yield dropped to 0.89 percent and reached an all-time low of 0.54 percent in March 2020.[5] The average ten-year Treasury yield for 2021 was 1.45 percent and for January 2022 stands at 1.65 percent.[6]

On December 9, 2020, the NAIC voted to amend its model nonforfeiture law to reduce the minimum nonforfeiture rate from 1.00 to 0.15 percent. This new rate would apply to new contracts only. The formula and 3.00 percent ceiling would remain unchanged.

V. Impact of the proposed statutory change

An individual deferred annuity's nonforfeiture rate is the rate that results from the statutory formula, based on the average five-year Constant Maturity Treasury Rate at the time of surrender, subject to a floor and a ceiling. The statutory minimum nonforfeiture rate is applicable only when the resulting rate falls below the floor—when five-year Treasuries are performing well, the floor will not be applicable. The proposed statutory change would reduce the floor from 1.00 to 0.15 percent. The following chart demonstrates the points at which the rate would be triggered, both for the current and the proposed rate, at a range of average five-year Treasury Rates:

Average five-year Treasury Rate	Rate with current 1.00% minimum	Rate with 0.15% minimum
0.00%	1.00%	0.15%
0.50%	1.00%	0.15%
1.00%	1.00%	0.15%
1.50%	1.00%	0.25%
1.75%	1.00%	0.50%
2.00%	1.00%	0.75%
2.25%	1.00%	1.00%
2.50%	1.25%	1.25%
3.00%	1.75%	1.75%
4.00%	3.00%	3.00%

[4] Id.

[5] https://www.forbes.com/advisor/investing/10-year-treasury-yield/

[6] https://www.macrotrends.net/2016/10-year-treasury-bond-rate-yield-chart

As the chart demonstrates, a reduction in the floor from 1.00 to 0.15 percent would serve to reduce a contract's nonforfeiture rate only when the average five-year Treasury Rate at the time of forfeiture is below 2.25 percent. The average five-year Treasury Rate has not been above 2.25 percent since April 2019. In January 2022 the rate stands at 1.65 percent.[7]

In addition, the minimum nonforfeiture rate floor tends to have relatively limited impact on most annuities' surrender values. Exhibit A illustrates how minimum nonforfeiture values—based on both the current 1.00 percent rate floor and the proposed 0.15 rate floor—interact with an annuity's surrender value. The exhibit tracks a hypothetical ten-year annuity product with a credited rate of 0.75 percent and a surrender charge schedule that begins at 15 percent and grades to zero after five years. In this scenario, even with an above-average surrender charge schedule the calculated minimum nonforfeiture value only constitutes the surrender value during the first two years of the contract when surrender is relatively unlikely. After that time, the surrender value, calculated based on the 0.75 percent credited interest rate, exceeds the minimum nonforfeiture value.

There was broad support for the NAIC model law amendment by the life insurance industry and most NAIC member states. States supporting the amendment cited the potential decrease in the availability of individual deferred annuity products absent the amendment, as well as concerns about insurer solvency should insurers continue offering products with a 1.00 percent minimum nonforfeiture rate while interest rates remain historically low.[8] During deliberations about the amendment, the American Council of Life Insurers (ACLI) reported to the NAIC life actuarial task force that some annuity products were already being withdrawn by member insurers due to the financial strain caused by the minimum nonforfeiture rate in the very low interest rate environment.

On the other hand, a small number of member states opposed the amendment. The New York Department of Financial Services (NYDFS) was most vocal in its opposition because it did not believe the nonforfeiture rate floor reduction struck "the correct balance between solvency concerns and consumer interests."[9] In light of potentially high surrender charges associated with individual deferred annuities, the NYDFS favored retaining a higher minimum nonforfeiture rate.

To date, 17 states have enacted the NAIC model law amendment and 8 states have legislation pending. Both ACLI and AIG, a leading global insurance organization with operations in Vermont, have encouraged states, including Vermont, to adopt the 2020 NAIC model law amendment. When AIG proposed the change to the Vermont Legislature in 2020, the Department neither supported nor opposed the proposal. However, the Department did cite concerns to the Legislature that, if

[7] https://fred.stlouisfed.org/series/GS5

[8] https://content.naic.org/sites/default/files/national_meeting/Life%20Insurance%20Cmte%20Fall%20Mtg%20Minutes.pdf; https://insurancenewsnet.com/innarticle/regulators-settle-on-0-15-nonforfeiture-floor-on-deferred-annuities

[9] https://content.naic.org/sites/default/files/national_meeting/LATF%20Fall%202020%20Minutes_Packet_wProperties.pdf

the minimum nonforfeiture rate were not lowered, some insurers might cease offering individual deferred annuity products, which would reduce the availability of important retirement savings vehicles for Vermonters.

A. Interstate Insurance Product Regulation Commission

The Interstate Insurance Product Regulation Commission (the Commission or IIPRC) reviews and approves annuity and other insurance product filings on behalf of 47 states, including Vermont. The Commission is composed of members representing each state which has enacted the Interstate Insurance Product Regulation Compact legislation (the Compact). The Compact is a state-based agreement designed to modernize the regulatory approval of asset-based insurance products, including annuities, and improve speed to market. The Compact is intended to facilitate uniformity in the regulation of designated insurance products through the development and adoption of Uniform Standards that are applicable to the content, approval, and certification of products submitted to the Commission. The Uniform Standards serve as the sole standards for review of products filed with the Commission regardless of any other laws that may be in effect in any state.

Several of the Compact's uniform standards reference the NAIC model nonforfeiture law and require compliance with its terms. However, following the NAIC's amendment to the model nonforfeiture law, the IIPRC reviewed the changes to determine if its Uniform Standards for new individual deferred annuity contracts should be amended to adopt the 0.15 percent statutory minimum nonforfeiture rate. The issue was discussed at length and a decision was made to modify the relevant Uniform Standards to require insurers to defer to state law on what statutory minimum nonforfeiture rate should be applied at the time a product is filed and approved in that particular state. This decision was made due to questions raised by a 2020 Colorado Supreme Court decision related to the Compact's effectiveness with respect to an unrelated but conflicting Colorado state law. The Uniform Standard will be reassessed after additional analysis of whether the Colorado decision has broader impacts on conflicts between Uniform Standards and state law.

B. Impact on insurers

A statutory minimum nonforfeiture rate similar to or higher than prevailing interest rates may pose risks to insurer solvency and liquidity. As discussed above, in 2003 in light of falling interest rates, the NAIC voted to address these risks by reducing the then minimum nonforfeiture rate of 3.00 percent to 1.00 percent. Vermont adopted the amendment the same year. Although interest rates have continued to decrease steadily since 2003, the decline in rates resulting from the COVID pandemic has accelerated these concerns (See Exhibit B – Monthly Average CMT Rates from 2000 to Present).

Life insurers are particularly susceptible to liquidity and solvency issues in low interest rate environments due to the concentration of long-term fixed-income securities such as bonds in their investment portfolios. Life insurers' liabilities are also affected by interest rate fluctuations

since products such as whole life insurance and annuities provide interest income to consumers. Deferred fixed annuities with guaranteed minimum interest rates and future income payments are particularly impacted. Persistent low interest rates create additional stress since the spread between investment income earned by insurers and credited interest due to contract holders narrows. Combined with the increasing cost to hedge portfolios, insurer income is reduced and the risk that an insurer may not be able to meet its guarantee obligations increases.

Consumer demand for the return of assets held by life insurers is also influenced by the interest rate environment and may further impact both solvency and liquidity. Persistent low interest rates may result in consumers holding higher-paying products longer than forecasted at contract inception, forcing insurers to continue to support guaranteed high interest rates with lower returning investment portfolios. Shorter duration products may also be surrendered more frequently by consumers seeking higher yields, thereby increasing insurer liquidity needs to levels that may not have been anticipated.[10]

The concerns identified above may be exacerbated when insurers' ability to manage their obligations is limited due to requirements to pay a statutory minimum nonforfeiture rate that is close to or higher than the actual market interest rate. Subject to these unusual conditions, insurers are forced to alter their normal management mechanisms in order to limit exposure.

One management tool to address this convergence of credited interest rates and guaranteed minimum rates for fixed deferred annuities is for insurers to take a two-pronged approach to setting rates. Traditionally, many fixed deferred annuity contracts have offered a guaranteed credited rate in line with or higher than the guaranteed minimum nonforfeiture rate. However, the current low interest rate environment has caused some insurers to reduce or eliminate guaranteed credited rates and use a two-value structure to lower the guaranteed interest rate risk as much as possible. Under this approach, a contract states both an account value, with a very low minimum credited rate, and a separate nonforfeiture value, which is subject to the statutorily required minimum nonforfeiture rate. Account value is calculated as 100 percent of accumulated premium, less withdrawals, plus interest at the low minimum credited rate. Nonforfeiture value is 87.5 percent of the premium, less withdrawals, plus interest at the higher 1.00 percent minimum nonforfeiture rate. Historically, account value was used to determine cash surrender value; however, due to extremely low credited rates, the account value, minus any surrender charge and market value adjustment, may now be less than the nonforfeiture value, and the nonforfeiture value will be used as the cash surrender value.

Actuarial consulting firm Miller Newberg recommends its insurer clients use this two-pronged approach because "using a secondary guarantee of an underlying nonforfeiture value gives [an insurer] the weakest interest rate guarantee allowable under current law. It allows [an insurer] to have credited rates below one percent from time to time, even potentially for many years, before the nonforfeiture value starts to exceed the account value less surrender charge." Miller

[10] https://content.naic.org/cipr_topics/topic_low_interest_rates.htm

Newberg reports that if the 0.15% standard nonforfeiture rate was universal this two-pronged approach would likely no longer be necessary.[11]

In addition to this two-pronged approach, insurers may also choose to remove products from the market, further limit or reduce product features (e.g., reduce annual income payments) or continue the sale of more generous products by increasing their portfolio investment risk in order to meet their guarantee obligations. An insurer's choice to increase investment risk by investing in lower quality, less liquid and more complex securities has clear implications for solvency given the higher potential for investment losses and illiquidity to directly affect insurer cash reserves, stability, and capital. Although decisions to limit or remove products from the market also have solvency implications due to the potential impact to sales, these decisions also may pose a risk to the deferred fixed annuity marketplace by limiting consumer access to important retirement vehicles. Reducing the standard minimum nonforfeiture rate is intended to reduce, if not eliminate, the risks created by the convergence of the current and statutory rates.

C. Impact on consumers

The annuity market normally provides consumers with a variety of options to consider when choosing a retirement product to fit their needs. These choices include multiple insurers, product features, guarantees, interest rates, durations, and fee and surrender charge schedules. Unlike the variable annuity market where investment options are an important feature for consumers, the fixed annuity market is focused on returns and guarantees. Because costs to the insurer are highest at the initiation of a contract and recouped over time, fees and surrender charges that decline over time are used to deter consumers from chasing return through frequent product surrenders. Competition drives insurers to provide consumers desirable product features and returns that are high enough to incentivize them to give up liquidity for the period without concerns that they may be able to find a better return elsewhere. As a result, the statutory minimum nonforfeiture rate is not generally the focus for an annuity purchaser. It was designed to serve as a floor, but only a floor, with competitive market features acting as the true consumer motivators.

A persistent low interest rate environment squeezes insurer margins, making competition more difficult. A statutory minimum nonforfeiture rate that is equal to or higher than the market rate adds additional stress since it artificially imposes a rate that may not be achievable without increased risk, potentially narrowing consumer choice as some insurers eliminate products or decrease product benefits (e.g., lower lifetime income benefits) to limit their exposure.

An example of the potential for decreased product benefits was provided by Allianz, an insurer doing business in Vermont, in their comment letter to the NAIC during discussion of the potential model rule change. It illustrates the relationship between higher minimum nonforfeiture interest rates and consumer benefits, such as annual income payments, with lower rates allowing insurers the ability to provide consumers with a higher income stream.

[11] http://www.miller-newberg.com/index.php/naic-annuity-minimum-interest -rate-change/

"In the current interest rate environment as of 7/31/2020, the difference between a 1% floor and a 0% floor equates to a difference of approximately 25% to 35% of annual guaranteed income in our fixed indexed annuity policies, assuming the same investment risk and profitability targets. In a $100,000 policy, that difference is approximately $750 to $1,250 every year during income payout.

	Annual Income	
Nonforfeiture Interest Rate	**Low**	**High**
1.00%	$3,900	$4,600
0.25%	$4,400	$5,000
0.15%	$4,500	$5,050
0.00%	$4,650	$5,150

Assumes $100,000 premium, 1.20% rider charge, issue age 55, income start age 65. Source: Allianz full pricing model. Annual income rounded to the nearest $50.

– Allianz comment letter to NAIC Life Actuarial Task Force August 25, 2020[12]

Two examples of the potential impact to consumer surrender values in a low interest rate market can be found in Exhibit A, Sample Calculation of Annuity Surrender Values. As the chart illustrates, the standard minimum nonforfeiture rate will generally only impact a consumer's surrender value during the first two years when surrender charges are high and the probability of surrender is lower. These higher charges in the early years are designed to balance insurers' high upfront costs against the needs of consumers and as such this time frame is unaltered by lowering the standard minimum nonforfeiture rate, although there is a small impact on calculated surrender value.

Even with the increasing pressure from low interest rates, a review of product offerings and annuity sales shows that insurers continue to work to adjust and offer consumers new annuities, although with some shifts in products.

- 39 new fixed indexed and 16 new fixed products were introduced in 2020, compared to 23 new fixed indexed and 12 new fixed products in 2019. There were 46 and 25, respectively in 2018. Of the fixed deferred products, however, 14 were MVA (market-value adjusted) versus two non-MVA. The increase in MVA products is expected

12 https://content.naic.org/sites/default/files/call_materials/Allianz%20Annuity%20Nonforfeiture%20Comment%20Letter%209.30.2020.pdf

considering the 2020 interest rate environment since it provides additional protection for insurers from early withdrawals by consumers. [13]

- In 2021, fixed annuity issuance continues to rise but at a slower rate than variable annuities. According to the Secure Retirement Institute, fixed deferred annuity sales totaled $31.7 billion for the third quarter of 2021, level with the third quarter of 2020, and $98.1 billion for the first nine months of 2021, up 10% over the same period last year. Total variable annuity sales were $30.6 billion for the third quarter 2021, up 28% from the same quarter in 2020, and $93.3 billion for the first nine months of 2021, up 31% from the prior year.[14]

This activity is consistent with assertions from industry groups such as the American Council of Life Insurers that:

"Companies will continue to use non-guaranteed crediting rates, bonuses, and other features to maintain market competitiveness and product differentiation. When market conditions improve, companies will be pressured to increase both their current and guaranteed crediting rates regardless of the regulatory floor."[15]

If operating effectively, these competitive market forces can potentially balance the impact of the reduction in the standard minimum nonforfeiture interest rate by limiting the duration of any period during which the minimum might be triggered.

IV. Recommendations

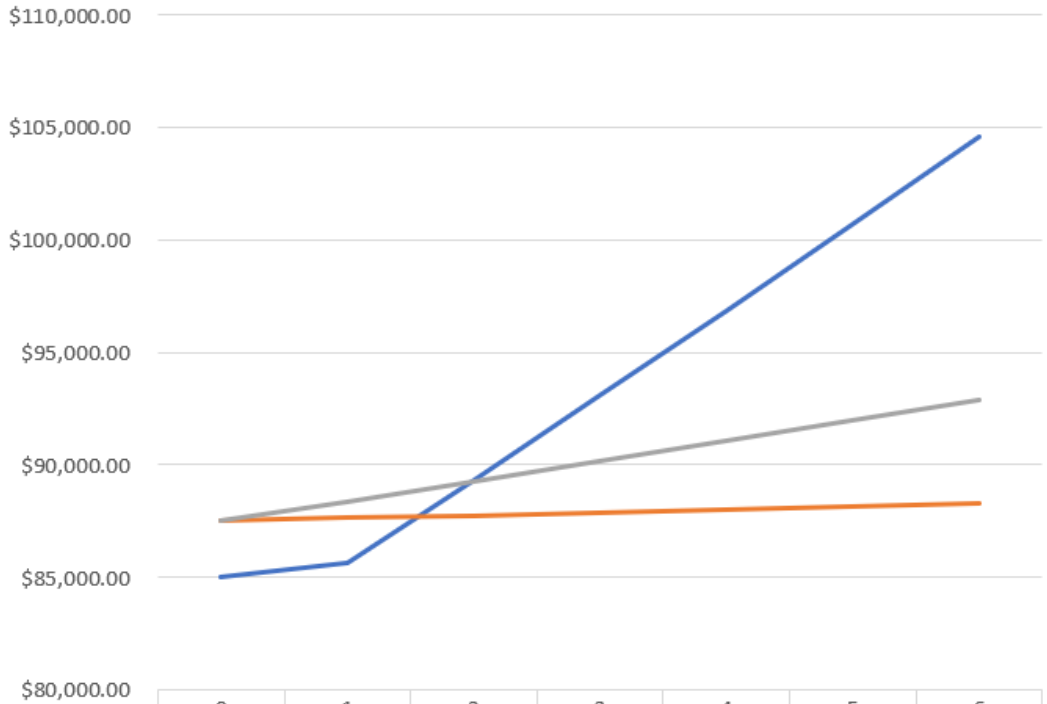
Based upon the preceding information and findings, the Department believes that a change to the statutory minimum nonforfeiture rate for deferred annuities will support the continued health of a strong deferred fixed annuities marketplace while striking an appropriate balance between the needs of consumers and the needs of insurers in a sustained low interest rate environment. This change will only affect consumers purchasing new deferred fixed annuity contracts after the effective date of the statutory change during a sustained low-interest rate environment. If interest rates increase, the statutory minimum will cease to be relevant. As such, it is the Department's recommendation that the statutory minimum nonforfeiture interest rate applicable to individual deferred annuities under 8 V.S.A. § 3750(d)(1)(C)(iii) be decreased from one percent to 0.15 percent.

[13] https://www.myirionline.org/docs/default-source/default-document-library/2020-soti-report.pdf; https://www.myirionline.org/docs/default-source/press-release/soti_2019report_final.pdf; https://www.myirionline.org/docs/default-source/research/soti-report_final_2018.pdf

[14] https://www.limra.com/en/newsroom/news-releases/2021/secure-retirement-institute-total-annuity-sales-rise-12-in-third-quarter/

[15] https://legislature.vermont.gov/Documents/2022/WorkGroups/House%20Commerce/Bills/S.88/Witness%20Documents/S.88~Chuck%20Storrow~American%20Council%20of%20Life%20Insurers%20Talking%20Points%20Regarding%20Annuities-Minumum%20Insurance%20Rate~4-7-2021.pdf

Exhibit A
Sample Calculation of Annuity Values



	0	1	2	3	4	5	6
Credited Rate 0.75%	$85,000.00	$85,637.50	$89,324.95	$93,062.89	$96,851.88	$100,692.47	$104,585.2
NF Rate 0.15%	$87,500.00	$87,631.25	$87,762.70	$87,894.34	$88,026.18	$88,158.22	$88,290.46
NF Rate 1%	$87,500.00	$88,375.00	$89,258.75	$90,151.34	$91,052.85	$91,963.38	$92,883.01

Exhibit B
Monthly Average CMT Rates from 2000 to Present