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To: All insurers with Annuity Authority

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Director

Subject: Interpretative Bulletin
Individual Fixed Deferred Annuities

South Carolina Standard Nonforfeiture Law for Individual Deferred Annuities (the Law), South Carolina Code § 38-69-240, specifies minimum nonforfeiture values to be provided by an annuity product. There has been some confusion as to the applicability of the Law to some product designs. The purpose of this Bulletin is to clarify the provisions of the Law related to the allowable surrender charge schedules. It does not supersede or replace the existing law. Insurers must comply with the disclosure provisions and other requirements of existing law.

Scope.

The Law applies to non-registered, general account contracts including traditional fixed annuities, equity-indexed annuities, deposit type annuities, and market value adjusted annuities.

Maturity Date.

The Law defines maturity for the purpose of the nonforfeiture calculation. It does not require that a contract terminates or that a contract holder annuitizes by that date. For the purpose of the nonforfeiture calculation, the maturity date is the latest date permitted by the contract, but not later than age 70 or the tenth anniversary of the contract, whichever is later. For contracts that provide cash value benefits, the cash value must meet or exceed the minimum required by the Law. An increased amount may be used to determine annuity payments. The reviewing analyst should not confuse the maturity date with what is allowable for the income date in the contract itself.

Retrospective Test.

For contracts that provide cash surrender value benefits, the Law requires that cash values available under the contract be not less than a specified percentage of net considerations, less withdrawals, loans, rider charges, and partial surrenders, accumulated at 1.5% per year. Please note that the 1.5% per year rate is scheduled to sunset on **June 30, 2005**. The Department intends to adopt recent NAIC revisions to the Standard Nonforfeiture Law for Individual annuities prior to the sunset date.

Smoothness Test.

For contracts that provide cash value benefits, cash values available prior to maturity shall be not less than the amount that would have been available at maturity, arising from the considerations paid prior to surrender, discounted at an interest rate 1% higher than the interest rate specified in the contract for accumulating the net consideration.

Variable Annuities with Fixed Sub-Accounts.

Variable annuities, including registered modified guaranteed annuities, are exempt from the Law, except that the fixed sub-accounts within variable annuities, which are supported by the general account assets, are subject to the Law. The nonforfeiture values associated with the amounts held in the fixed sub-accounts shall be at least as great as those required for a fixed annuity contract.

Products with Rolling Surrender Charges.

Flexible premium contracts may have separate surrender charge schedules associated with each premium payment, provided that the nonforfeiture values are at least as great as they would be had each premium payment been a separate single premium contract (retrospective test shall be based on 90% of net considerations). The contract shall contain a partial withdrawal provision that allows for withdrawal of monies subject to the smallest surrender penalty first (commonly referred to as first-in first-out). For the purpose of determining the maturity date, the tenth anniversary of the contract shall be determined separately for each premium payment.

Products with Renewing Surrender Charges.

Contracts that periodically renew interest rate guarantees and surrender charges are in compliance with the Law provided that the nonforfeiture values available under the contract following each renewal are at least as great as they would be had the contract been surrendered at renewal and a new contract issued. The contract shall provide for a reasonable time period and adequate disclosure at renewal, during which the contract can be surrendered free of additional surrender charges or any other penalties. For the purpose of determining the maturity date, the tenth anniversary of the contract shall be the tenth anniversary of the most recent renewal date.

Market Value Adjustments.

Fixed annuities, supported by the general account, that offer periods of fixed rate guarantees may have nonforfeiture values that incorporate market value adjustments (MVAs). To be fair to contractholders, the MVAs shall equitably reflect gains and losses, providing for up as well as down adjustments. Application of the MVAs cannot result in cash surrender value lower than the one resulting from the applicable retrospective test. MVAs can be used in addition to the surrender charge schedule that would have satisfied the smoothness test in the absence of the MVA. The MVA can apply during the entire surrender charge schedule, even if the interest rate is not guaranteed for multi-year periods. While the need for an MVA product might not be as apparent on a product that is not designed with distinct guaranteed periods (usually multi-year periods), there are benefits of including an MVA in the contract even if the products have the same surrender charge patterns and interest rate crediting periods.

Bonuses.

Persistency and other bonuses are allowed. For the purpose of the nonforfeiture calculation, the bonus shall be treated as an annual rate enhancement over the period during which the bonus is earned. For the purpose of the retrospective test, net considerations need not include the bonus amount. For the purpose of the smoothness test, the bonus amount shall be considered a part of the maturity value, and the interest rate specified in the contract for accumulating the net consideration shall reflect the rate enhancement attributable to the bonus. Simple annuitization bonuses recognize that if the contract value (which is the same whether the contract is annuitized or surrendered) is applied to certain life income options, the company can increase the factors because of the degree of control the company will retain over the funds.

DATED this 23rd day of July, 2003

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