

## IRS Interest Rate Change Impacts Life Insurance

### How many filings will YOU need to make?

Life insurance companies got a potential win when Congress passed the “Consolidated Appropriations Act, 2021” in the final days of 2020. Although this law was largely a spending and stimulus relief bill, it also contained a provision that lowered the minimum interest rate used in determining whether permanent life insurance meets the requirements under Section 7702 of the Internal Revenue Code and qualifies for tax advantaged treatment.

#### What is Section 7702?

Section 7702 contains actuarial tests that a life insurance policy must pass to be considered life insurance and not an investment contract. If considered to be life insurance, the death benefit and increases in cash value within a life insurance policy generally are not subject to ordinary income taxation.

#### What are the Changes?

- Section 7702 had a pair of interest rates, 4% and 6% set forth in the law, that had not been changed since 1984. Because of today’s low interest rate environment, there was concern that life insurance carriers would no longer be able to profitably offer certain whole life products such as universal life under these interest rates, and still meet the testing requirements of Section 7702.
  - The law reduces the required guarantee from 4% to 2% for level premium policies and from 6% to 4% for single premium policies, issued on and after January 1, 2021.
  - For policies issued in 2022 and thereafter the interest rate guarantee is tied to indexed market rates.
- Indirectly, the change in Section 7702 impacted the Standard Nonforfeiture Law for Life Insurance so that cash values on most traditional life products will need to change by January 1, 2022.
  - Under the Standard Nonforfeiture Law, the maximum interest rate that can be used in the calculation of traditional life product cash values is 125% of the maximum valuation interest rate, but no less than the interest rate specified in Section 7702 for the CVAT test.
  - When the maximum valuation interest rate changes, as it did from 3.5% for 2020 to 3% for 2021, there is a one-year grace period before the change to the nonforfeiture rate is mandatory. The maximum valuation interest rate for 2021 is 3%, and 125% of this rate is 3.75%.
  - Because of the change in the CVAT interest rate and its resulting impact on the Standard Nonforfeiture Law, policies issued in 2022 must use a nonforfeiture interest rate of at least 2% but no higher than 3.75%.

### What do Carriers Need to Do?

- Actuaries will need to evaluate the impact of the 7702 interest rate changes under the testing calculations used to determine whether policies continue to meet the definition of life insurance.
- Every whole life type product that currently uses a nonforfeiture rate higher than 3.75% must have their cash values recalculated at an interest rate of 3.75% or lower. Carriers will be required to refile nonforfeiture tables and/or actuarial memorandums for whole life type products and have them approved prior to January 1, 2022.

There is an overwhelming amount of compliance and actuarial work to complete in a short period of time. First Consulting is an industry leader in state filings. We are current with the special requirements of the Interstate Compact and specific state requirements regarding the 7702 filings. Let us help lighten your load and assist you in obtaining approval prior to the looming January 1, 2022 deadline. Contact us today to put your drafting and filing plan into action.



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