Are Nonforfeiture Rate Changes to Life and Annuity Products Making YOU anxious?

Beat the End-of-Year Perfect Storm Filing Rush!

A last-minute perfect storm may be brewing for carriers who write life and annuity business impacted by nonforfeiture interest rate changes. If you have not yet reviewed your policy forms and actuarial memorandums, you have only until December 31, 2021 to obtain life regulatory approvals. You may want to act now to avoid a potential problem with new business sold in 2022.

What are the Changes?

There are changes to Life Insurance policies and changes to Deferred Annuity contracts that are driving carriers to determine if their cash values for new business must be revised.

- **For life insurance**,
  - IRS Section 7702 was revised in 2021.
  - The NAIC Standard Valuation Law changed the valuation interest rate (impacts reserving) from 3.5% to 3% for new business effective January 1, 2021, and
  - The Standard Nonforfeiture Law for Life Insurance (cash values) requires the use of a nonforfeiture interest rate of at least 2% but not higher than 3.75% for new business effective January 1, 2022.
- **For annuity contracts**,
  - States have begun amending the minimum interest rate guarantee on new business from 1% to 0.15% under the Deferred Annuity Nonforfeiture law to assist carriers in this low interest rate environment.
- **The bottom line** is that each of these changes may require a filing with state insurance departments, whether it be revisions to an actuarial memorandum, policy schedule, or cash value table in the policy forms. The extent of the required filings is determined by how the policy forms and actuarial memorandum were originally filed.

What are the Specific Details?

Specific details of the changes are set forth below:

Life Insurance

- IRS 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 vale within a life insurance policy generally are not subject to

- Ordinary Income Taxation - The Consolidated Appropriations Act of 2021 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.
- 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 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 policies issued on and after January 1, 2022, and the rate will adjust to market conditions over time. The reduced interest rates allow more premium to be paid into a policy before disqualifying it as life insurance.

In addition, the Standard Nonforfeiture Law for Life Insurance references an interest rate from Section 7702. The maximum valuation interest rate for 2021 is 3% and 125% of this rate is 3.75%. As a result, insurers must use a nonforfeiture interest rate of at least 2% but not higher than 3.75%. Therefore, every life product containing cash values must be reviewed for compliance with the new interest rates and recalculated as appropriate.

Deferred Annuities

- Generally, the standard nonforfeiture law requires that an individual deferred annuity contract provide the contract holder with a paid-up annuity or a minimum amount of cash surrender benefits if the contract holder surrenders the policy or stops making payments during the accumulation period.
- The nonforfeiture amount is the deferred annuity's accumulated value minus certain charges such as prior withdrawals and loans based on interest rate minimums regulated by statute. Recent market interest rates have fallen so low it is challenging for companies to sell annuities with guarantees.
- In December 2020, the NAIC revised the Deferred Annuity Nonforfeiture Model Law to reduce the floor interest rate from 1% to 0.15% bringing the model law in line with the current, historically low interest rate environment. The 1% nonforfeiture floor was established in 2003 when interest rates were far higher. The 0.15% floor is used to set minimum guarantees at the time of purchase and is triggered only in low interest rate environments. The .15% floor will apply to newly issued contracts only. A carrier is not required to reduce the interest rate floor below 1%, and if the change is not made, then no filing is required. States have been amending their annuity nonforfeiture laws during 2021 to assist carriers during this low interest rate period.

What do Carriers Need to Do?

- Carriers need to determine if the cash value factors for new business must be changed on their products. Generally, a drop in a nonforfeiture interest rate means an increase in cash values. If the cash values are set forth in the individual life or annuity policy forms, they will require filing of the forms and possibly policy schedules. Actuarial memorandums may also require revision and filing.
- However, if a carrier decides to continue using 1% as the minimum nonforfeiture interest rate for deferred annuities, an annuity filing may not be required.
- Under Interstate Compact Standards the nonforfeiture interest rate must be shown and cannot be changed without a filing. Compact is encouraging filers to budget 30 to 60 review days for approval of a Supporting Documentation update filing. At least one state recommends a limiting refiling through SERFF submitted at least 60 days before the annuity minimum interest rate will be used. Early submission is encouraged to ensure there is adequate time to review the filing and resolve any compliance issues.

Given the volume of policy forms that need to be evaluated for changes, carriers have a short period of time for their actuarial and compliance resources to spring into action to implement the new changes. First Consulting stands ready to assist your company with filings of actuarial memorandums and policy forms that may be required because of these new requirements. Contact us today to put your drafting and filing plan into action and beat the end-of-year rush.

Kathy OFarrell, Regulatory Affairs Manager
First Consulting & Administration
816-391-2735
kathy.ofarrell@firstconsulting.com

Kathy has over 30 years of insurance compliance experience in product development, filings, legal research, advertising review, and compliance monitoring of state and federal laws. She has worked with all types of life and health products, including individual and group.