

## **Life and Health Actuarial Task Force Amendment Proposal Form\***

1. Identify yourself, your affiliation and a very brief description (title) of the issue.  
Barbara R. Gold, chairperson, American Academy of Actuaries Tax Work Group  
John MacBain, chairperson, American Academy of Actuaries Nonforfeiture Improvement Work Group

Floor on maximum nonforfeiture interest rate

2. Identify the document, including the date if the document is “released for comment,” and the location in the document where the amendment is proposed:

Standard Nonforfeiture Law for Life Insurance  
Draft: 8/2/11  
Section 5.c.I.

On its October 5, 2011 call, the PBR Process and Coordination Subgroup decided the provision for nonforfeiture interest rates should be handled in the Standard Nonforfeiture Law. Thus, we have not provided a recommendation for changes to VM-02 to implement the floor on the maximum nonforfeiture interest rate. If this position changes, we will provide additional recommendations for changes to VM-02.

3. Show what changes are needed by providing a red-line version of the original verbiage with deletions and identify the verbiage to be deleted, inserted or changed by providing a red-line (turn on “track changes” in Word®) version of the verbiage. (You may do this through an attachment.)

Section 5.c.I.

(3) The nonforfeiture interest rate as determined under (1) and (2) will not be less than 4%.

Guidance Note: For flexible premium universal life insurance policies as defined in Section 3.D. of the Universal Life Insurance Model Regulation (NAIC Model 585), this is not intended to prevent an interest rate guarantee less than the nonforfeiture interest rate.

4. State the reason for the proposed amendment? (You may do this through an attachment.)

The reason for this recommendation is to assure that traditional life insurance can continue to be issued in compliance with both state minimum nonforfeiture requirements and the maximum cash value requirements in Internal Revenue Code (IRC) Section 7702. Life insurance contracts that fail to comply with the requirements of IRC Section 7702 are generally not viable for sale, since they would be currently taxed on the inside buildup within the contract.

A life insurance contract can use one of two tests to meet the requirements of IRC Section 7702 and qualify as life insurance for tax purposes. However, as far we know, all traditional products use the cash value accumulation test or CVAT and it is questionable whether they could use the other test (the guideline premium test) to comply with the statute. Under CVAT, the maximum cash value is the Net Single Premium (NSP) at the greater of 4% and the rate or rates guaranteed upon issuance of the contract. In addition, the contract must comply with CVAT by its terms.

This means that if the maximum state nonforfeiture interest rate were below 4%, a traditional life insurance contract would not be able, in most cases, to comply with both state minimum nonforfeiture requirements and the maximum cash value requirements in Section 7702.

For example, assume the maximum state nonforfeiture interest rate was 3 ½%. Anytime a traditional life insurance contract maturing at age 100 could become paid up, the minimum state cash value would be the NSP at 3 ½%, while

the maximum Section 7702 limit would be the NSP at 4%. So the state minimum would be greater than the maximum Section 7702 limit.

Thus, we recommend a 4% floor for the maximum nonforfeiture interest rate in the Standard Nonforfeiture Law.

This recommendation is not intended to prevent an interest rate guarantee less than the nonforfeiture interest rate for flexible premium universal life insurance policies.

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\* This form is not intended for minor corrections, such as formatting, grammar, cross-references or spelling. Those types of changes do not require action by the entire group and may be submitted via letter or email to the NAIC staff support person for the NAIC group where the document originated.

**NAIC Staff Comments:**

<b>Dates:</b> Received	Reviewed by Staff	Distributed	Considered
<b>Notes:</b>			

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