



AMERICAN ACADEMY *of* ACTUARIES

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Mr. Michael W. Boerner, ASA, MAAA
Chair, Life Actuarial Task Force
PBR Process and Coordination Subgroup

Chairman Boerner:

The American Academy of Actuaries¹ Life Practice Council Tax Work Group and Nonforfeiture Improvement Work Group (NFIWG) (together the LPC WGs) are providing this commentary to the VM PBR Process and Coordination Subgroup (Subgroup) of the Life Actuarial Task Force (LATF) to consider as part of the discussion of that Subgroup's recommended language to Section VM-02 of the Principle-Based Reserve (PBR) Valuation Manual. Section VM-02 of the PBR Valuation Manual, titled Minimum Nonforfeiture Mortality and Interest, describes the post-PBR-implementation mortality and interest rate assumptions to be utilized in the determination of life insurance minimum nonforfeiture values.

The LPC WGs would like to bring to the Subgroup's attention certain issues associated with the proposed language of VM-02:

Issue #1:

When a new commissioner's standard mortality table has been adopted by at least 26 States, it becomes a "prevailing" table and Internal Revenue Code (IRC) Section 807(d) specifies a full three calendar year transition rule for determining tax deductible reserves. IRC Sections 7702 and 7702A, which govern the policyholder tax implications of life insurance products, provides for tests and limitations that are based on a standard of reasonable mortality that cannot exceed the federal prevailing mortality assumption as defined in IRC Section 807(d). It is not clear that the specific three year transition rule for tax reserves carries over to Sections 7702 and 7702A, and further guidance will be needed from the US Treasury Department and Internal Revenue Service.

Issue #2:

Under the new process of adopting mortality tables through the Valuation Manual, it is likely that for tax purposes the table will be considered to have been adopted by 26 states when it is approved for inclusion in the Valuation Manual. This means that by adopting a new commissioner's standard mortality table through the Valuation Manual, it will become prevailing by the end of the calendar year in which the NAIC adopts these tables as part of the Valuation Manual. This will likely not allow adequate time to have the necessary revisions to the Nonforfeiture Laws adopted in each state

¹ The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

to recognize these new tables. The LPC WGs recommend that any changes to valuation mortality mandates provide for a reasonable transition period prior to their becoming effective.

Issue #3:

Any mortality standard for minimum nonforfeiture values defined in VM 02 should be referred to as the “Commissioners Standard Mortality Table.” This language is in keeping with the language regarding tax reserve mortality tables contained in the Internal Revenue Code.

Issue #4:

For the IRC Section 7702 cash value accumulation test, the interest rate used cannot be less than 4%. However, since the Standard Nonforfeiture Law defines the maximum nonforfeiture interest rate any time that law is revised, a 4% floor on the maximum nonforfeiture interest rate needs to be added to the language of VM-02 if compliance with the cash value accumulation test is to be assured for all products.

Issue #5:

The NFIWG has recently completed work on its charge from LATF to study the feasibility of a new nonforfeiture law for life insurance and annuities. Their report is intended to be presented to LATF at the NAIC meeting in November. The LPC WGs recommend that LATF wait to finalize any language governing nonforfeiture mortality and interest assumptions in the Valuation Manual until LATF considers how to proceed with the recommendations of the NFIWG, thereby avoiding the potential creation of inconsistencies with the NFIWG’s recommendations.

The LPC WGs also wish to note that as changes are made in the future to minimum nonforfeiture mortality and/or interest mandates, such changes may raise additional tax issues that would need resolution.

The LPC WGs appreciate the opportunity to submit these comments on the proposed inclusion of language in VM-02 covering minimum nonforfeiture value mortality and interest rate assumptions.

Sincerely,

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