



AMERICAN ACADEMY *of* ACTUARIES

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Mr. Michael W. Boerner
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) provided commentary to the Principle-Based Reserve (PBR) Process and Coordination Subgroup (Subgroup) of the Life Actuarial Task Force (LATF) on their October 5, 2011 call

As a result of that call, the LPC WGs were asked to submit specific recommendations for how to address Issues 1 – 4 discussed in our October 5 commentary to the Subgroup. On behalf of the LPC WGs, we offer the following comments and recommendations:

Issue #1:

When a new commissioners 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 commissioners 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 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 fully effective.

Recommendations to address Issue #1 and Issue #2:

1. Revise the VM-20 drafting note on page 10 (immediately after subsection 3.C.1.b.)

Proposed revisions to the current drafting note (All proposed changes are tracked)

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.

The Valuation Manual can be updated by the NAIC to define a new valuation table. Because of the various implications to systems, form filings, and related issues, lead time is needed to implement new requirements without market disruption. It is recommended that this transition be for a period of about 4 years – that is, that the table be adopted by July 1 of a given year, that it be permitted to be used starting January 1 of the second following calendar year, that it be optionally permitted until January 1 of the ~~4th~~5th following calendar year, and that it be mandatory thereafter. It is further intended that the adoption of such tables would apply to all business issued since the adoption of this Valuation Manual. The details regarding implementing any unlocking of mortality tables needs to be addressed in the future.

2. Revise the VM-02 drafting note at the beginning of Section 5. Mortality

Proposed drafting note

As any new Commissioners Standard Mortality table is adopted in the future, language or paragraphs will need to be added here to define the business with which the table are to be used. This will need to be coordinated with the valuation requirements contained in other sections of the Valuation Manual. It is recommended that the transition period referenced in the drafting note in Section 3.C.1.b. of VM-20 be adopted; that is that there be a transition for a period of about 4 years – i.e. the table be adopted by July 1 of a given year, that it be permitted to be used starting January 1 of the second following calendar year, that it be optionally permitted until January 1 of the 5th following calendar year, and that it be mandatory thereafter.

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.

As suggested on the call, we are recommending that the words “Commissioners Standard Mortality Table” be inserted, where appropriate in VM-02 and the Standard Nonforfeiture Law for Life Insurance: Note that we have also recommended inserting the words “Commissioners Standard Mortality Table” in the revision to the VM-02 drafting note at the beginning of Section 5. Mortality.

VM-02

Section 1. Purpose

- A. The purpose of this VM-02 is to assign the appropriate Commissioners Standard Mortality Table and interest rate for use in determining the minimum nonforfeiture standard for life insurance policies issued on and after the operative date of this valuation manual as authorized by applicable state requirements.

Standard Nonforfeiture Law for Life Insurance – 8/2/11 draft

Section 5.c.H.(6) – last paragraph

Proposed changes

For policies issued on or after the operative date of the valuation manual the valuation manual shall provide the Commissioners Standard mortality table for use in determining the minimum nonforfeiture standard that may be substituted for the Commissioners 1980 Standard Ordinary Mortality Table with or without Ten-Year Select Mortality Factors or for the Commissioners 1980 Extended Term Insurance Table. If the commissioner approves by regulation any Commissioners

Standard ordinary mortality table adopted by the National Association of Insurance Commissioners for use in determining the minimum ...

Section 5.c.H.(7) – last paragraph

Proposed changes

For policies issued on or after the operative date of the valuation manual the valuation manual shall provide the Commissioners Standard mortality table for use in determining the minimum nonforfeiture standard that may be substituted for the Commissioners 1961 Standard Industrial Mortality Table or the Commissioners 1961 Industrial Extended Term Insurance Table. If the commissioner approves by regulation any Commissioners Standard industrial mortality table adopted by the National Association of Insurance Commissioners for use in determining the minimum nonforfeiture standard for policies issued on or after the operative date of the valuation manual then that minimum nonforfeiture standard supersedes the minimum nonforfeiture standard provided by the valuation manual.

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.

As the Subgroup decided the provision for nonforfeiture interest rates is to be handled in the Standard Nonforfeiture Law, our recommendation is only for changes to the Standard Nonforfeiture Law. If this position changes, then we will provide recommendations for additional changes to VM-02.

Standard Nonforfeiture Law for Life Insurance – 12/5/08 draft
Section 5c.I

Additional sentence and drafting note

The nonforfeiture interest rate will not be less than 4%.

Drafting 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.

We thank you for the opportunity to comment. Please let us know if you have any questions.

Sincerely,

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