Product & Service Notice

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Date: Jan. 29, 2021
To: Ameritas Field Associates
RE: IRC Section 7702 Revision

Memo Number: PS4286 REV 01-29-21
Product Area: Life

Summary: The Consolidated Appropriations Act, which was passed in late December and went into effect on Jan. 1, 2021, allows a new minimum interest rate assumption for the life insurance cash value accumulation test (CVAT) and guideline premium test (GPT). These rates have long been set at 4% and 6%. These new rates allow significantly more premiums to be placed in permanent life insurance without violating these tests or creating a modified endowment contract (MEC).

Ameritas continues to evaluate the full impact of the new provision. Please refer to the attached questions and answers for more information. Continue to watch for more updates in the coming weeks as we provide more information on these changes, one of the most significant life insurance changes in decades.

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IRC Section 7702 Revision Questions and Answers

Updated 01/27/21

Section 7702 Revision Background

How did it get introduced?
The IRC Section 7702 revision was included in the *Consolidated Appropriations Act* that was passed in late December 2020.

What does the revision mean?
This revision changed the minimum interest rate assumption that life insurance companies use in the calculation for the life insurance cash value test (CVAT) and guideline premium test (GPT) for the purpose of determining whether a contract is a life insurance contract for tax purposes. The contract would be considered a modified endowment contract (MEC) if the premium violated these tests. These rates have long been set at 4% and 6%.

Why was it proposed?
The life insurance industry advocated for a rule change to allow reduced guaranteed rates due to current interest rate levels in the United States. The old minimum guaranteed rate was established in the 80s when rates were significantly higher than today. The industry led by Finseca and ACLI successfully argued that it was unfair to build product guarantees on a model established in a time when rates were reaching the double-digits.

Potential Opportunities

What is the advantage of the change?
In a sustained low interest rate environment, the prior rates stymied the amount of premium and flexibility in permanent life insurance. The insurance industry was required to match its own guaranteed rate to these relatively high 7702 rates. The revision with the new lower minimum interest rate assumption will allow for significantly more premium to be placed in permanent life insurance. This will allow for higher CVAT and GPT limits to help avoid modified endowment contracts (MEC). The maximum non-MEC premiums will increase dramatically.

Are there specific opportunities that will impact potential life insurance design?
The availability of shorter pay guarantee whole life products may be one potential design opportunity. Products with 7-pays may again be profitable for life insurers and 10-pay whole life insurance could be more secure. The introduction of new products with shorter guaranteed premium payment periods could also be an opportunity.

Impact on Life Insurance Products

When does 7702 Revision go into effect?
This revision went into effect for new permanent life insurance policies sold on or after Jan. 1, 2021.

Will all the life products be updated at the same time?
The timeline and if products will be updated at the same time is still being evaluated.

Does it require state approval for the life insurance products?
The revision is governed by the federal government, so there should be no state approvals required for the changes.

What will the impact be on universal life, indexed universal life and variable universal life insurance products?
It helps grow cash values more efficiently for accumulation focused situations where clients are funding their policies up to the MEC limits.

How will it impact whole life products?
It allows for increased premiums without violating limits. In over-funded situations, it will allow higher premium amounts to go towards the Flexible Paid-Up Rider, allowing for more cash value growth. The change will also allow whole life to appropriately balance guaranteed benefits and non-guaranteed benefits, especially on short-pay products.

Will it affect term products?
No, impact is only on permanent life insurance products.

Impact on New Policies

How will it impact new sales?
The new limits will apply to all permanent life policies with issue dates of 01/01/21 and later.

What happens for policies issued between 01/01/21 and the date Ameritas implements the change?
Ameritas is planning to update the contribution limits for policies issued on or after 01/01/21. We will notify the field immediately when the illustration software and administrative systems are updated.

Impact on Compensation

Could allowing more efficient funding have a potentially negative impact on compensation?
An increased level of funding without a corresponding change to our systems will have a downward impact on target compensation. As Ameritas implements the changes, a special focus will be given to ensure our product compensation remains competitive.

Impact on In-force Business

What will the impact be on in-force policies?
Only policies issued 01/01/21 or later will have the new higher funding limits.

What happens if an in-force policy issued prior to 01/01/21 is modified in the future? Will the policy be impacted?
It is possible a material change made to an older product could constitute a “new issue” for purposes of these rules and be subject to the new interest rate calculations. The definition of material change is unclear at this time, however there are discussions on the impact of a change in the contract that would require the new CSO table. The IRS may view that as a type of change that would cause a policy to be newly issued. Ameritas is still analyzing this impact.

Will a communication go out to clients for policies that are affected by the changes?
No communication is planned at this time.

Impact on Illustration Software

How soon will the illustration software be updated?
Ameritas is working to update the illustration software to implement the new limits with the goal of ensuring our new policyowners have access to these changes as soon as possible. We will update the field as we work through the changes and develop a transition plan.

Next Steps

What is Ameritas currently doing to implement?
Ameritas is still evaluating the full impact of the new provision and we are working to implement the new limits in our illustration software and administrative systems. Watch for more communication and updates about these changes.

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