

*APF 2020-07*  
*Impact of Discount Rates on Cash Values*

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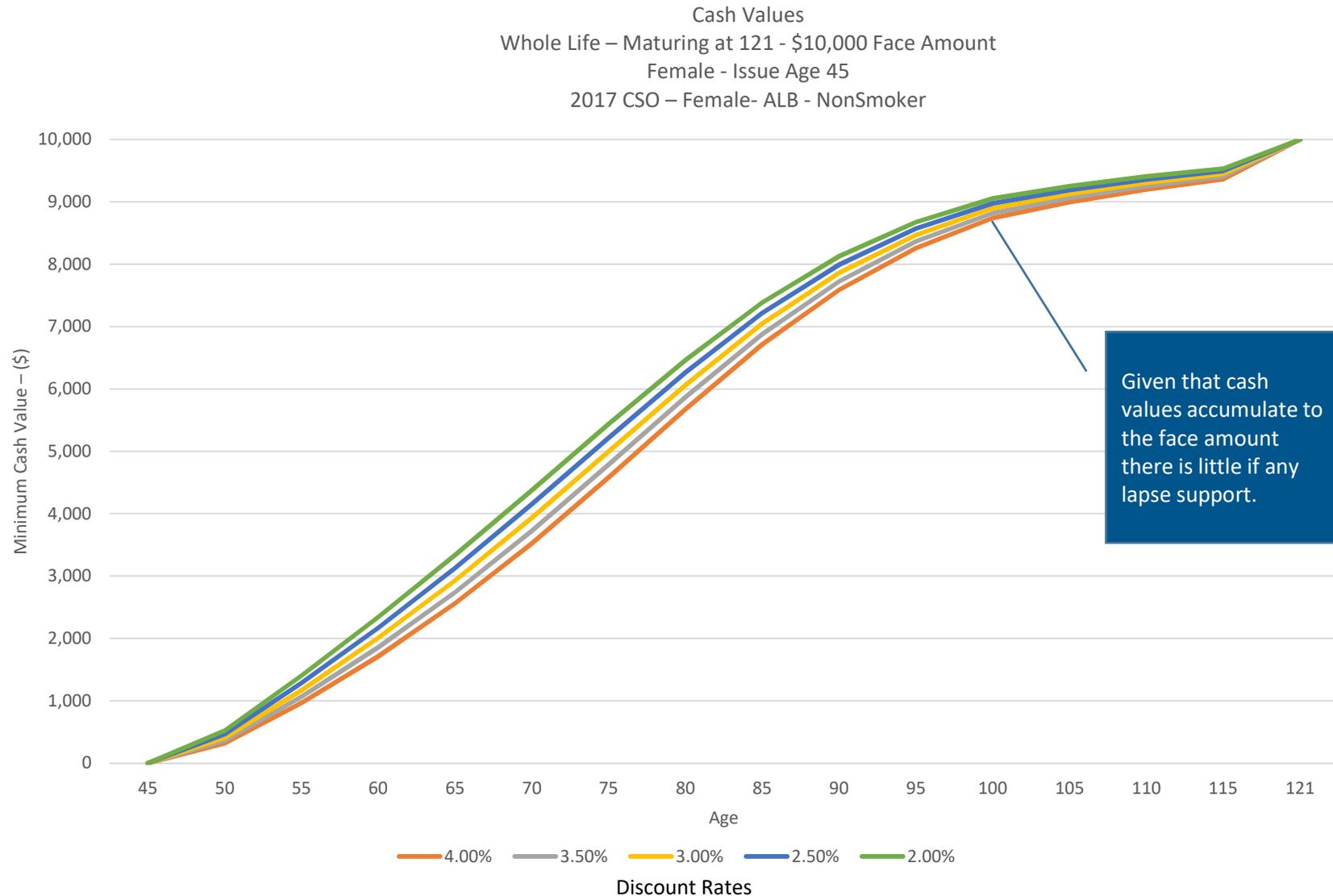
**Removing the 4% floor on minimum non-forfeiture rates has the potential to increase cash values on traditional whole life coverage, thus limiting the affordability and/or the amount of insurance protection for many Americans at a time when getting life insurance is more important than ever!**

## **Overview of Whole Life Coverage – Two Approaches Used to Determine Policy Premiums**

1. For traditional whole life coverage, many companies determine policy premiums based on anticipated costs which include:
  - The cost of providing Death Benefits
  - **The cost of providing Cash Values or Surrender Benefits including In-Kind Benefits**
  - The cost of underwriting and other acquisition expenses
  - The cost of administration
  - The cost of holding statutory reserves in excess of economic reserves
  - The cost of capital given the risks taken.
2. For mutual companies, it is common to determine premiums based on the Statutory Reserve Valuation Net Premium which is generally conservative and may provide the opportunity to pay policyholder dividends after reflecting the company's costs in #1 above. So the policy premium may be independent of the cash values provided.

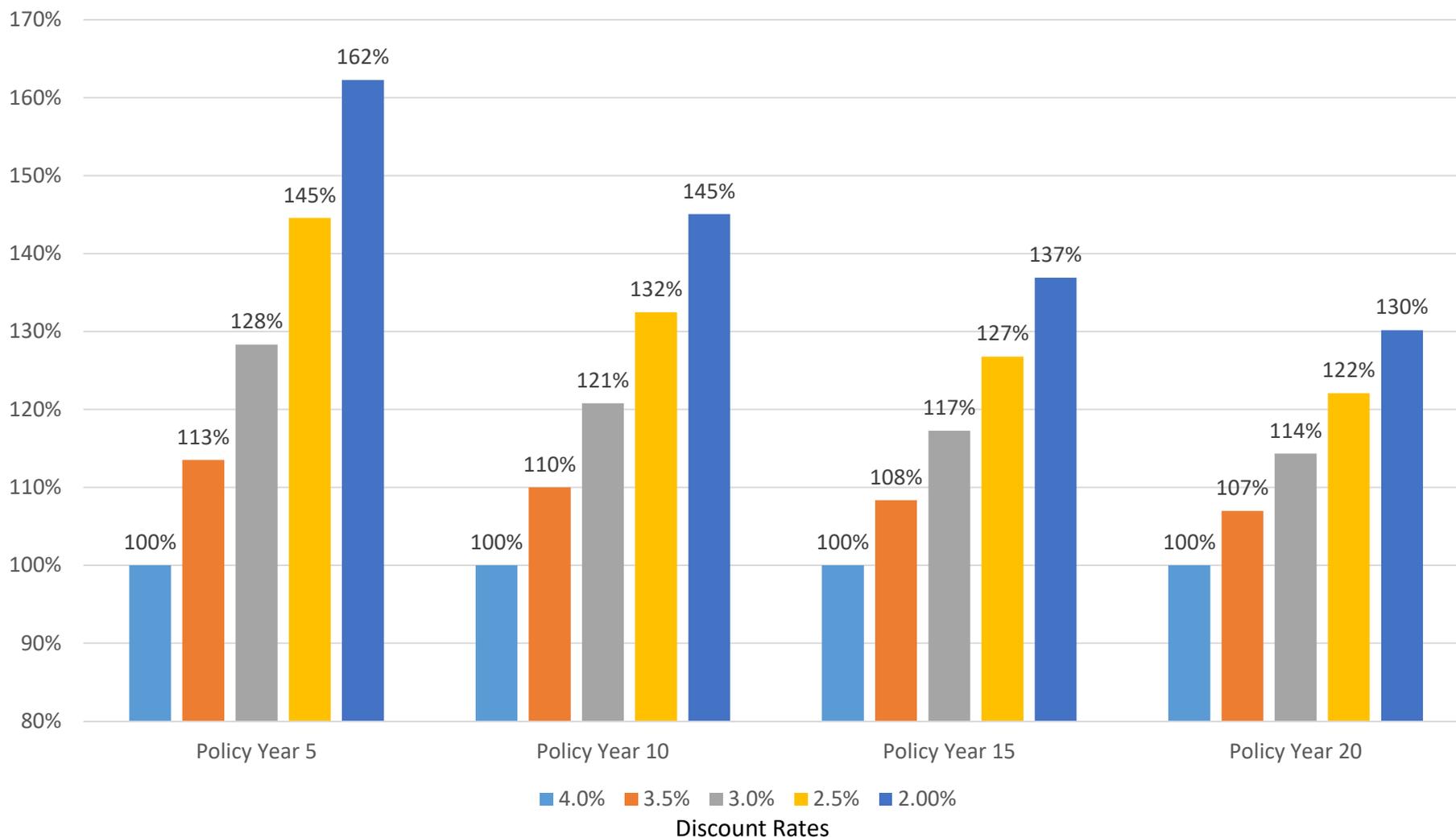
**Companies have the option to provide cash values that are greater than the minimum required. So a 4% floor on discount rates used to determine minimum cash values does not preclude companies from this option and offering higher cash values.**

The Nonforfeiture Interest Rate is a Discount Rate which is used to determine cash values – this discount rate determines how cash values emerge through maturity at which time they converge to equal the face amount for traditional whole life policies regardless of the discount rate.

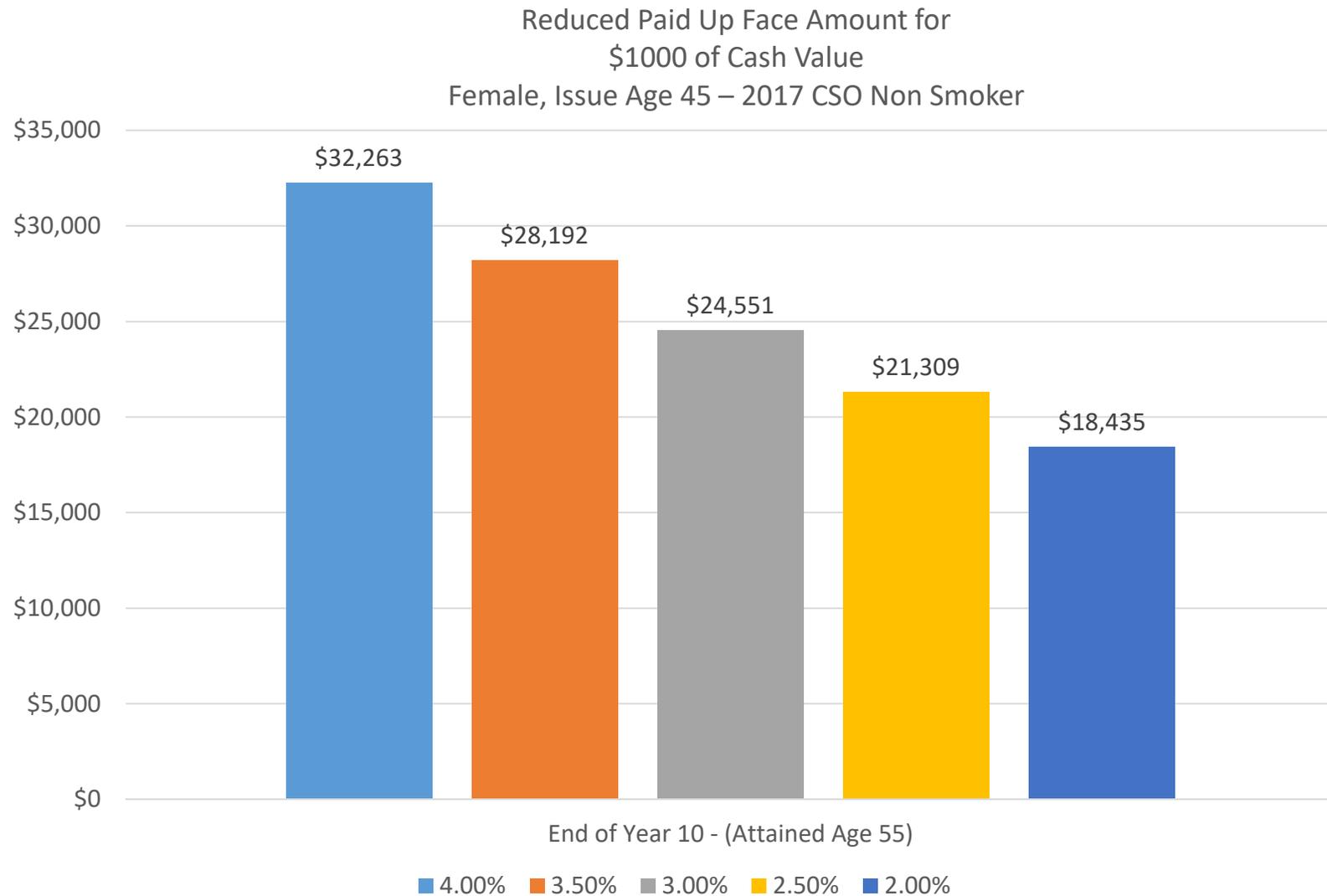


**At a 2% discount rate cash values are 30% higher than at a 4% discount rate in the 20<sup>th</sup> policy Year. Minimum Cash Value increase with lower discount rates resulting in higher surrender benefits. The cost of providing these higher benefits is reflected in the costs used to determine premiums; higher benefits lead toward higher premiums.**

Cash Values as determined at 2%, 2.5%, 3%, and 3.5% as a % of Minimum Cash Values determined using 4%



Upon Surrender, life Insurance policies provide one or more in-kind benefits (Paid Up coverage or Extended Term Insurance) in lieu of cash surrender. The Cash Surrender value is used to determine the amount of these in-kind benefits; ideally, they should be economically equivalent. A lower interest rate used to determine Paid Up (or other in-kind) benefit amounts that is more aligned with the current market rate environment has the potential to reduce overall policy costs and supports lower policy premiums.



**We urge LATF to consider an amendment to APF 2020-07, which would keep costs low for basic protection life insurance thus helping the affordability and accessibility of life insurance protection for many Americans at a time when getting life insurance protection is more important than ever.**

*Proposed Amendment:*

*The nonforfeiture interest rate for any life insurance policy issued in a particular calendar year beginning on and after the operative date of the Valuation Manual shall be equal to 125% of the calendar year statutory valuation interest rate defined for the NPR in the Valuation Manual for a life insurance policy with nonforfeiture values, whether or not such sections apply to such policy for valuation purposes, rounded to the nearer one-quarter of 1%, provided, however, that the nonforfeiture interest rate shall not be less than 4%, but the nonforfeiture interest rate to determine paid-up benefits and other in-kind nonforfeiture benefits shall not be less than the applicable interest rate used to meet the definition of life insurance in the Cash Value Accumulation Test under Section 7702 (Life Insurance Contract Defined) of the U.S. Internal Revenue Code.*

**Amendment Benefits:**

- **Maintains the current 4% floor established in the valuation manual for the discount rate used to determine minimum cash values.**
- **Mitigates the impact of lower interest rates on the cost of providing minimum cash values and therefore on premiums or dividends.**
- **Allows for a lower interest rate to determine the amount of paid up and in-kind benefits aligned with the rates permissible under 7702 and proposed amendments aligning better with current interest rates.**