Changes to IRC §7702

Frequently Asked Questions (FAQ)

Prudential has been working diligently on updating our systems to reflect changed tax limits to comply with the recent changes to IRC §7702 under the Consolidated Appropriations Act (CAA). Our illustration systems will be updated on 4/19/21. This FAQ includes important information on the CAA, what the changes mean to clients, and what opportunities these changes present.

Contents

1046596-00001-00

Prudential

What is the Consolidated Appropriations Act of 2021 (CAA)?

The Consolidated Appropriations Act of 2021 (CAA) is legislation that was signed into law on December 27, 2020. The CAA affects the interest rates used for Definition of Life Insurance testing under §7702 of the Internal Revenue Code of 1986, as amended (Code), and Modified Endowment Contract (MEC) testing under §7702A of the Code. These industry-wide changes affect all life insurance carriers and went into effect on newly issued policies beginning January 1, 2021.

Why was this change made?

The interest rate assumptions were outdated and do not reflect today's interest rate environment. The change right-sizes the interest rates established in 1984 and allows premium payments and cash value needed to fully fund life insurance policies over the insured's lifetime. The CAA also instituted a "floating rate," which will adjust the tax testing interest rate assumptions in the future based on a higher or lower interest rate environment.

What is affected?

All newly issued policies are affected beginning January 1, 2021. The impact of the interest rate changes are:

1. **The 7-Pay Premiums used in MEC testing will be higher.**
2. **For policies that use the Guideline Premium Test, guideline premiums will be higher.**
3. **For policies that use the Cash Value Accumulation Test (CVAT), Attained Age Factors (used to determine corridor death benefits) will be lower.**

What do these changes mean to clients?

Overall, the §7702 and §7702A changes in place as of 1/1/2021 will allow policyowners to maximize their cash value. Given the undue limits under prior law, the reduction in tax testing interest rates will allow for more premium payments and cash value.

CLIENTS CAN PUT MORE MONEY IN THEIR POLICIES

The new limits will allow more premiums to be paid in a policy while the policy still qualifies as life insurance and will allow more rapid funding of a policy before it becomes a MEC.

CLIENTS HAVE GREATER ACCUMULATION POTENTIAL

By being able to pay more into the policy, a client can have a policy's cash value accumulate more quickly, reducing the insurance company's net amount at risk. A lower net amount at risk reduces the overall cost of insurance, which should make the cost of carrying the policy lower when compared with the old rules. Updated Attained Age Factors for CVAT mean that policies will not corridor as quickly. With a lower net amount at risk (and COI charges), cash value accumulation can be higher, and the death benefit can possibly be higher in later policy years.

Impacts to Business Based on Sign Date

Our illustration systems will be updated on April 19, 2021 to reflect the new tax limits. For policies that were placed before then, the policy effective date will determine the impact:

Effective date prior to January 1, 2021: No impact

Effective date between January 1, 2021, and April 19, 2021: These policies will receive the new tax limits. However, since the "as sold" illustration did not reflect the new limits, we recommend that you run an updated illustration to review with the client to determine if a change needs to be requested. Once our administrative system is updated in the summer, we will send a communication to these clients with updated information on their policies.

For cases in process that have not been placed by April 19: Our case management team will require a signed, revised illustration reflecting the new tax limits.

Note that for the next couple of months until we can update our new business system, there may be situations where the illustration is not showing a MEC but we will inadvertently ask for the MEC Authorization form (ORD 86958). Please return a signed form only if the illustration shows the policy becoming a MEC in Year 1 or if a policy being replaced by 1035 exchange was already a MEC.

Making a Policy Change

If it's determined that making a change to the policy is in the customer's best interest, please follow these steps.

If the change is still within 90 days of policy issue: The change would be handled through the standard 90-day new business placed change process.

Changes beyond the 90-day placed change period: We will allow the following changes until 45 days after we send letters to clients with information on their new tax limits:

- Death Benefit Option Changes
- Face Amount Decreases

Note that face amount decreases dated back to policy issue may require commission chargebacks due to the lower face amount and resulting target premium.

Send these requests to: Change.Service.Team@prudential.com. For questions or assistance with this process, please call 800-778-5611.

Communicating the Tax Limit Changes with Customers

As a part of our reconciliation process, all customers with a policy effective date in 2021 will receive a letter explaining the new tax limits. Clients with policies issued with the cash value accumulation test (CVAT) will also receive updated contract data pages. The writing producer on the policy will be notified of all customer communications.

Please note that the process mentioned above, and the consumer letter, do not apply to Private Placement Life Insurance business.
For questions specific to PPLI, please contact your wholesaling team.

What types of policies will this affect?

The new higher limits are positive changes for accumulation-focused policies whose intent is cash value growth. However, for many policies where the focus is low-cost death benefit protection, there will be no impact.

Accumulation sales (LIRP Design, Contracts Funded at Max Non-MEC/Guideline): Higher DOLI and MEC limits mean more premiums and more rapid funding of policies, helping drive more efficient cash value growth while still maintaining the tax advantages of life insurance. The additional premiums will be most dramatic for younger age clients.

Mirrored Loan sales: Clients may be able to repay the loan sooner without causing a taxable event (recapture), and we may be able to accept premiums in the first seven years for cases where they previously would have created a MEC.

Protection-Focused sales funded well below DOLI/MEC limits: These clients will not be impacted aside from receiving new contract data pages (CVAT policies only) and revised illustrations with corrected tax limits. The higher DOLI and MEC limits are not relevant because the intent is to pay the lowest amount of premium for the desired death benefit.

How will premiums and policy values change?

Policy charges are not changing. The only change is that CVAT Attained Age Factors are decreasing. Therefore, if a CVAT policy goes into the CVAT corridor, the resulting corridor death benefit will be lower, and the cash value will be able to accumulate more quickly due to the lower net amount at risk and COI charges. With these changes, lower min non-MEC death benefits will also keep the policy's COIs lower.

What opportunities should I keep in mind?

These changes reinforce the strength and flexibility of life insurance. The updated limits benefit clients who need life insurance and want to take advantage of its accumulation potential and tax benefits. This presents a few opportunities, especially with these sales strategies:

- LIFE INSURANCE IN RETIREMENT PLANNING
- MIRRORED LOANS

How Can I Get Personalized Help?

Talk with your Prudential Wholesaler today about how these changes affect your business! If you have questions or would like to discuss an opportunity, please call 1-800-800-2738, Option 1.

Prudential

ISG_FL_ILI180

1046596

1046596-00001-00