Industry Trends

SMALL CHANGES TO IRC SECTION 7702 SHINE A BRIGHT LIGHT FOR CONSUMERS AND THE INDUSTRY

The insurance industry has been facing strong headwinds for quite some time. No one needs to be reminded of the decreasing interest rates, which caused a domino effect in almost every area of our business — product pricing, product removals, cap rate decreases, in-force product projections issues and workforce reductions at almost every insurance company. When there is less product availability and increased pricing on the existing products, it's the consumer who ends up being negatively impacted by having less choice and higher cost. All of which makes it harder for the consumer to take the steps needed to ensure their future financial security.

Contraction in the market isn't a new trend. We've been slowly going down this path for years. What's new is that we've hit such a pain point where a number of decisions seem to be happening simultaneously. Grabbing the headlines recently was TransAmerica's announcement to cease writing guaranteed variable annuities, fixed annuities and long-term care insurance. Just recently, Symetra announced the discontinuation of their Guaranteed UL. In 2020, Prudential pulled their Guaranteed UL. These actions tend to have a domino effect on the other GUL products still available. With Prudential, Symetra and now Principal pulling their GUL products, there will be more premium headed towards the remaining products and that will put pressure on reserving and investing for those insurance companies. Similarly, those companies with products facing the most reserve pressure are limiting the amount of premium they'll accept or instituting a maximum face amount well below their normal offering. These decisions all come back to the spread compression that the insurance companies are under from the combination of fallen interest rates combined and low yields on the general account portfolio.

According to ALIRT Insurance Research, Transamerica is another in "a long list of U.S. life insurers changing their product strategy and/or selling part or all of their U.S. individual life insurance or annuity businesses."* These groups include but are not limited to the following:

AIG/American General Life	**Hartford Fin'l Services Group**	**Prudential Inc. (U.S.)**
Allstate	**ING USA**	**Prudential Plc (U.K.)**
Aviva	**Jackson National**	**Sun Life of Canada**
AXA	**Liberty Mutual**	**Symetra**
Equitable	**MetLife**	**TransAmerica (prior actions)**
Great American	**Ohio National Life**	**Voya**
Great-West	**Phoenix**	

*Over the last two months, ALIRT published releases on substantial transactions by AIG/American General, Equitable Financial, Great American, and Prudential (U.S.). Please visit the ALIRT web portal site to access our thoughts on these.

With so many carriers reducing their product offerings, we're left wondering "what about that silver lining?" You might be thinking that it would be that the COVID-19 pandemic has more people purchasing life insurance or planning to do so. Or that the current environment has improved the automation of underwriting and new business processing. Indeed, a record number of life insurance sales have been sold and placed, all electronically, from end to end.

While those statements are all true, the silver lining came to pass with the federal spending package called the Consolidated Appropriations Act, 2021 (CCA 2021). Included in the package, which President Donald Trump signed into law on December 27, 2020, was a section that addresses the interest rate required by IRC Section 7702, which was written in 1984 when interest rates were 10% and higher. With the changes to Section 7702, life insurance will become more affordable as the interest rates used to determine whether the insurance contract is a modified endowment contract (MEC) will be set at 2% this year and then indexed to a reference rate that adjusts as market interest rates move thereafter. The current mandated rate of 10% is impractical given today's interest rate environment and is a contributing factor to the results we've been seeing: products with higher premiums or products becoming entirely unavailable, both of which result in consumers having less access to life insurance protection.

In addition to more availability of life insurance products, accumulation-oriented sales may see a boost in lower initial minimum non-MEC death benefits or, if the death benefit is known, then a higher 7-pay premium will be available. Given the recency of this change, many insurance companies are just now studying this change and will need to "open the hood" on product development, which includes potential changes to mortality charges, expenses and premium loads. In other words, the life insurance products will need to be recalibrated. It isn't as simple as just changing the interest rates, so the amount and timing of the impact remains to be seen.

In addition, the normal effort into launching a new product needs to take place, which will mean that new products adjusted for 7702 will not be available for months. An additional factor is that the investment environment for insurance companies is still difficult and taking in large amounts of premium upfront is problematic. Look for some product designs to reflect this environment.

Still this change to Section 7702 brings some breathing room to insurance companies, allowing them to offer more product options to consumers, which gives consumers more ready access to those products that are likely to ensure their financial stability in the future. Now that's a silver lining worth looking forward to in 2021!