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Impact of the Tax Cuts and Jobs Act on Life Insurance Product Pricing

The Tax Cuts and Jobs Act ("Tax Law"), which became effective on January 1, 2018, includes several provisions that impact life insurance companies and the products they offer.

The Joint Committee on Taxation estimates the 10-year cost for the industry to be $23 billion. While a lower corporate tax rate (21% under the Tax Law, down from 35%) will offset some of the impact, there are a number of implications to consider.

The good news is that for products with strong cash values—including current assumption Variable Universal Life (VUL), Universal Life (UL), and Private Placement Life Insurance (PPLI)—the impact for many product structures is neutral or better as the reduction in the corporate rate offsets the insurance-related tax increases.

In addition to the reduction in the corporate rate (a positive for the industry), the primary provisions of the Tax Law that impact life insurance products include:

- The DAC tax amortization rate has been increased to 9.20% from 7.70% and the amortization period has increased to 15 years from 10 (Negative)
  - The changes in the DAC tax parameters increase the cost of the DAC tax, which essentially operates as a no interest loan to the federal government. Therefore, the change in the parameters essentially increases the amount and duration of this loan.
  - In many products, the cost of the DAC tax is charged to the policy as a percentage of premium charge, approximating the present value of the cost to the company for essentially loaning the government money at 0% interest for 15 years (corporate hurdle rate on DAC balance over the amortization period).
  - While the cost to insurers will increase, this cost appears to be offset by the lower corporate tax rate. Therefore, it is not anticipated that insurers will raise the DAC tax charge for in-force policies.
  - For new products, insurers may choose to reflect a higher DAC tax cost, while applying the benefits of the lower corporate tax rate in other elements.

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- Computation of life insurance tax reserves (sec. 13517 of the Senate amendment and sec. 807 of the Code) (Negative)
  - For insurance companies, increases in reserves are tax deductible expenses and, conversely, decreases in reserves are taxable income.
  - This provision, which limits the deductibility of reserves to 92.81% of the change in reserves that are in excess of cash surrender values, could have a substantial negative impact on many insurance products.
  - While the actual impact will vary based on how the product and reserves are structured within a product, the products most likely to be impacted are those with no or low cash surrender values (such as Term, NLG, or products with NLG-like features) and products with large surrender charges.
  - In some Term and NLG products, which have a certain amount of capital leveraging, small changes in the reserving can have a potentially substantial impact on premium (estimated at 10% to 20%).
  - High cash value products like VUL and PPLI may not incur any adverse impact.
  - There is additional uncertainty as insurers are still evaluating the 2017 CSO transition and Principles Based Reserve (PBR) changes, which are especially difficult since the IRS has not ruled on the tax deductibility of the components that comprise the new PBR reserve.
- The Dividend Received Deduction sets the proration for Company Share to 70% and Policyholder Share to 30% (Positive or Negative depending on an insurer's past practices).
  - Proration is the amount of dividend income which a corporation is allowed to use for the Dividend Received Deduction.
  - This provision primarily impacts separate account business. Insurers that have been reflecting 100% company share proration in their pricing may see a negative impact.
  - However, companies that have not recognized proration in their pricing may now be willing to include this in their pricing. The impact can be a 10 to 30 basis point change in long-term policy IRRs.

In general, the Tax Bill will make products more capital intensive, a result of the DAC Tax change and the limit on the deductibility of life insurance tax reserves. Since tax deductible reserves are still able to use a cash value floor, products where the reserves equal cash values (PPLI and VUL) will feel less of an impact.

Products without cash values (Term and NLG) will feel more of an impact. There may be insurer specific situations where the interplay with other sections of the Tax Law (e.g., limits on deducting interest expense, foreign reinsurance transactions, etc.) will come into play.

At this time, M Carriers have not indicated that any provisions of the Tax Act will directly affect the pricing of their products. Going forward, it is likely the industry will identify product designs that take advantage of the lower corporate rate and minimize the negative impact of these other changes. These products would be introduced over the next couple of years as insurers continue revising product portfolios for the transition to 2017 CSO and PBR.

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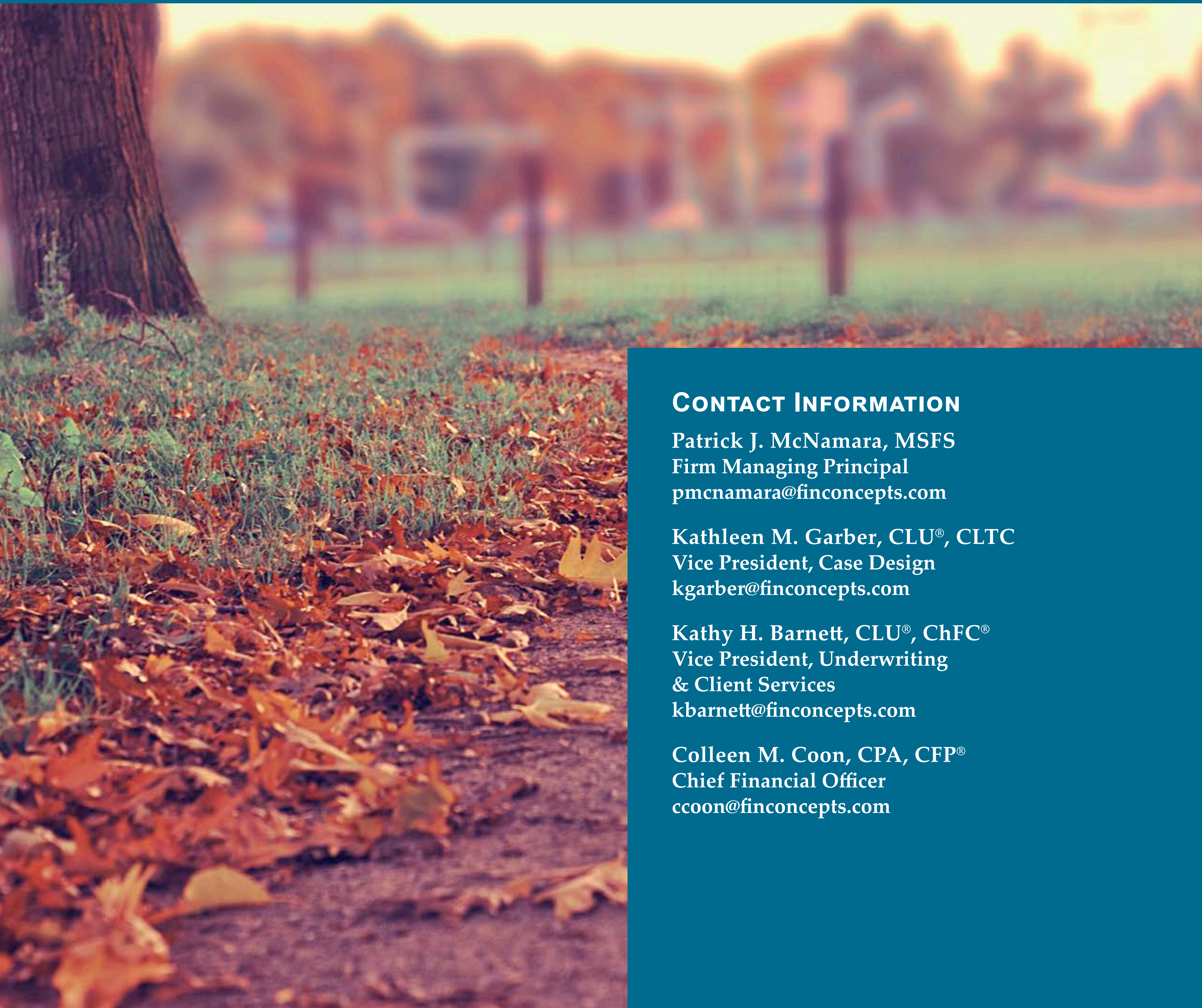

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