NAIFA® | Advocacy

Life Insurance & COVID-19

The Issue: Practical solutions are needed for consumers' financial protection, and to safeguard life insurers as a major source of capital for COVID-19 economic recovery.

Background: Life insurance has always been and is now an important source of economic stability in times of economic crisis. Life insurance provides safety to millions of Americans amid tremendous turbulence. The life insurance industry pays out $2.1 billion every day. By comparison, Social Security pays $2.7 billion every day.

Permanent life insurance is a long-term product—its payouts can and usually do come 20, 30, 40 or more years after a policy is purchased. A policy's price and value reflect the decades during which the policies accumulate earnings from the investments made by the premiums paid for the policy. Both the tax definition of life insurance (Internal Revenue Code (IRC) section 7702) as it is currently written and the rule that characterizes bonds held by life insurance companies as capital assets must be updated in order for life insurance and life insurers to continue to provide economic stability to millions of American individual and business policyholders.

- **Index outdated rates in IRC Section 7702 to match today's interest rate environment and make financial protection available to more families -** Section 7702 defines what qualifies as a life insurance policy. It deals with long duration life insurance policies, including permanent life insurance, which represents more than 60 percent of policies. In order to qualify as life insurance for federal tax purposes, these policies must meet one of two interest rate tests, either the cash value accumulation or the guideline premium test. Both tests are designed to limit the proportion of the cash value to the total face amount of the policy. Section 7702 was written in 1984, when interest rates were 10 percent and higher. The hard-wired specific rates of four and six percent are unworkable in the current interest rate environment, raising the cost of insurance and resulting in less financial protection to consumers. Rates should be indexed to a reference rate in a very low interest rate environment that will adjust as market interest rates move.

- **Classify bond investment holdings as ordinary instead of capital because they support ordinary liabilities of insurance companies -** Insurers lend to all sectors in the economy, including those most impacted by the COVID-19 virus. COVID-19 is putting American business under stress. Losses resulting from COVID-19 will cause some borrowers to default on their obligations. When insurers have credit losses on bonds and the insurer is required to sell at a loss (when a company defaults, or if the bond falls below investment grade) the tax losses cannot be offset against ordinary income because they are classified as capital assets for tax purposes. The ability to deduct capital losses is extremely constrained in the tax code and the period in which they can be deducted is very short. This tax misclassification will result in deferral of realizing the tax deduction and acts as a disruptor to prudent investment portfolio management. Providing ordinary tax treatment for bonds will allow insurance companies to operate their business, make investment decisions, and issue policies without making non-economic, tax-driven decisions related to the character of a tax deduction.

2901 Telestar Court • Falls Church, VA 22042-1205 • 703/770-8100 • www.NAIFA.org 4/2020

NAIFA Position: NAIFA supports these narrowly targeted tax law changes proposed by the American Council of Life Insurers (ACLI) to safeguard consumers' continued access to financial protection and buttress a major source of capital for U.S. economic recovery.

For More Information:

Diane Boyle
Senior Vice President
Government Relations
(703) 770-8252
Dboyle@naifa.org

Judi Carsrud
Assistant Vice President
Government Relations
(703) 770-8155
Jcarsrud@naifa.org

Michael Hedge
Director
Government Relations
(703) 770-8158
mhedge@naifa.org