CASE
CENTER FOR ADVANCED SALES EXCELLENCE

FAQs

CVAT & GPT – What's It All About?

Question: What are "CVAT' and "GPT" and why are they important?

Answer: We'll address the 'why are they important' in the Q&A's to follow. Here's what they are: CVAT means Cash Value Accumulation Test, and GPT means Guideline Premium Test. These terms refer to the two basic alternatives for determining whether a product meets the requirements to qualify as a life insurance contract. Both tests define the relationship between cash value and death benefit that is required at all times for a contract to qualify as life insurance.

Question: What happens if a product fails to meet one of these two tests?

Answer: If a product fails to meet either the CVAT or GPT tests, it is no longer taxed as a life insurance contract – instead it is taxed as an investment. Most life insurance contracts enjoy tax- deferred growth of policy values, and income tax free death benefits. Annual growth in most investment contracts is taxed currently as ordinary income, and any profit at death (ie. gain over basis) is also taxed as ordinary income.

Most life insurance contracts are designed such that they will ALWAYS meet either the CVAT or GPT tests, and will qualify as a life insurance contract.

Question: So….if most life insurance policies will always meet one of these two tests, does it really matter which test is chosen?

Answer: Yes. The test selected can have a significant impact on premiums, cash values and death benefits. In addition, the choice of which test should be used must be made by the issue date. **Once the policy is issued, the choice cannot be changed – so the initial choice is important.**

Question: OK….so the choice is important. What are the basic differences between CVAT and GPT?

Answer: The basic differences: CVAT limits cash value relative to the death benefit. GPT limits premiums paid relative to the death benefit.

The CVAT test will maintain a 'net single premium' relationship between the cash value and death benefit. In other words, for every dollar of cash value, the death benefit must be at least the amount that could be purchased on a guaranteed basis using the cash value as a net single premium. If you are familiar with 'traditional' par whole life products that use dividends to purchase

paid-up-additions (PUAs) – the PUA purchase basis is a net single premium transaction that uses the cash dividend to buy a piece of paid-up life insurance. The amount of paid-up insurance varies based on the attained age of the insured. This is the same relationship that is required by the CVAT test – the cash value determines the minimum death benefit, based on the attained age.

The GPT test defines limits on premiums paid based on the death benefit. For a given death benefit, GPT defines a 'Guideline Single Premium' and a 'Guideline Level Premium.' Payment of premiums in excess of these amounts is not permitted. The GPT test also defines the relationship between cash value and death benefit. Unlike CVAT where the cash value determines the minimum death benefit, with GPT, the death benefit limits the permissible cash value based on a 'corridor' percentage test. Put another way, with GPT, the death benefit limits the premiums that can be paid, or the cash value that can exist at any attained age.

Question: Whew…. I'm not an actuary and I never will be. Can you just tell me when to choose CVAT, and when to use GPT?

Answer: Here are some general guidelines for choosing CVAT or GPT:

Use CVAT when:

- Your client doesn't want any limitations on the amount of premium that can be paid into a life insurance policy.
- Note: there are still premium limitations if your client does not want the policy to become a modified endowment contract (MEC).
- Your client prefers to maximize policy death benefit at life expectancy.
- Your client chooses a level death benefit and wants to pay the maximum '7-pay' premium in years 1-7.
- Your client wants to make substantial first year drop-ins or has a large 1035 Exchange rollover and prefers to minimize initial death benefit.

Use GPT when:

- Your client wants to use a variable death benefit and 'stuff' the policy full of cash. In other words, your client wants to pay maximum level ongoing annual premiums for more than 10 years.
- Your client is more interested in lifetime cash accumulation and maximum policy distributions, rather than maximizing the policy's death benefit.
- Your client wants to pay the initial '7-pay' premium for much longer than the initial 7 years.
- Your client wants to maximize cash value and death benefit at age 100.

Consider the following two examples. This first example compares illustrated DEATH BENEFIT in three different scenarios. Bold numbers identify the 'leader':

PruLife UL Plus Male 45, PNS – Pay $25,000/yr for 15 yrs – Minimum Non-MEC Death Benefit

Illustrated Death Benefit	CVAT - Level Death Benefit	GPT - Level Death Benefit	GPT - B>A Death Benefit*
Yr 10 / Age55	669,769	**1,226,730**	753,618
Yr 20 / Age65	1,170,157	**1,226,730**	983,695
Yr 30 / Age75	**1,554,868**	1,226,730	1,276,498
Yr 40 / Age85	2,141,493	1,882,523	**2,177,487**
Yr 50 / Age95	3,005,601	3,091,539	**3,576,191**

*Variable DB yrs 1-15 with change to Level DB in yr 16+

As described above, CVAT generally illustrates a larger death benefit as you approach life expectancy, but GPT generally illustrates larger death benefit at later durations.

This second example compares illustrated CASH VALUE in the same scenarios. Bold numbers identify the 'leader'.

PruLife UL Plus Male 45, PNS – Pay $25,000/yr for 15 yrs – Minimum Non-MEC Death Benefit

Illustrated Cash Value	CVAT - Level Death Benefit	GPT - Level Death Benefit	GPT - B>A Death Benefit*
Yr 10 / Age55	289,133	266,737	**294,724**
Yr 20 / Age65	676,113	624,065	**687,921**
Yr 30 / Age75	1,118,610	1,035,501	**1,192,989**
Yr 40 / Age85	1,784,578	1,882,523	**2,073,797**
Yr 50 / Age95	2,757,432	3,060,930	**3,540,783**

*Variable DB yrs 1-15 with change to Level DB in yr 16+

If cash accumulation is the primary objective, using GPT and a variable death benefit during the premium paying period produces the highest illustrated cash value at all durations. If we were to illustrate a solve for maximum policy distributions, the last scenario (GPT – B>A DB Change) will generally produce the highest illustrated distributions.

Question: What if the client really doesn't have any strong preferences on these issues? Or what if I don't really know with any certainly what the client's premium payment plans are? Which should I choose?

Answer: If there is no clear emphasis on death benefit at life expectancy vs. at age 100….if there is no clear preference for long-term cash value over a long term death benefit…..if there are no definite plans to access cash value for supplemental retirement income (of course policy withdrawals and loans reduce cash value and death benefit, and may have tax consequences)…..if nothing to make it clear which test should be selected.….

When in doubt, select the default choice in our ISP illustration system – GPT - instead of CVAT. On balance, GPT offers more long-term premium flexibility, and generally results in lower COI (cost-of-insurance) charges over a long period of time, particularly at the later durations when a policy may hit the definition of life insurance corridor. The lower COI charges are because there is a lower net amount at risk.

Still unsure which test to select? Contact your advanced marketing unit with the particulars of a case – we'd be happy to discuss the alternatives for your case and suggest an appropriate choice for your client.

Minimum Non-MEC DB (death benefit) is the minimum death benefit you can have to avoid the policy being treated as a modified endowment contract.