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April 24, 2018

Mr. Philip Barlow
Chair, National Association of Insurance Commissioners (NAIC)
Life Risk-Based Capital (E) Working Group

Dear Philip,

The RBC Tax Reform Work Group (TRWG) of the American Academy of Actuaries' (Academy)¹ Life Practice Council is pleased to submit additional comments on how the recent change in U.S. corporate tax law,² in particular, the change in the corporate tax rate from 35% to 21%, will affect the NAIC's Life Risk-Based Capital ("Life RBC") calculation of Authorized Control Level RBC. This letter updates and expands upon the [letter](#) we submitted on this topic dated March 16, 2018. The March 16 letter continues to reflect the thoughts of the TRWG, except as noted below.

C-1o Risk

- In our March 16 letter, we make the following comment about bond RBC factors: "Therefore, if the NAIC makes tax changes to RBC factors for 2018, we suggest that the current pre-tax bond factors be multiplied by 0.97, to reflect discounting at a higher rate. 0.97 is an approximation developed from the corporate bond model used to develop the currently exposed bond RBC factors."
 - The March 16 letter makes no comment about the pre-tax factors to be used for other asset classes that currently use the same pre-tax RBC factors as bonds, such as preferred stock. The TRWG suggests that the any changes to pre-tax bond factors for 2018 should also apply to other asset classes whose pre-tax RBC factors are the same as the bond factors.
 - It should be noted that the 0.97 scaling factor was developed from a re-run of the model used to develop the updated C-1 bond factors that are currently in exposure, and the scaling factor is rounded to two decimal places.

- The March 16 letter makes no comment about the pre-tax RBC factors for commercial, farm, or home mortgages. The TRWG believes that the logic used to adjust the pre-tax bond factors, which considered the higher after-tax discount rate due to tax reform, should extend to the mortgage factors. The current mortgage RBC factors were not developed by the Academy, and

¹ The American Academy of Actuaries is a 19,000 member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

² [Public Law No: 115-97](#).

we have no comment on any potential adjustment. The scaling factor would depend in part on the time horizon and after-tax interest rate used to develop the mortgage RBC factors.

C-2 Risk

- In our March 16 letter, we make the following comment about C-2 individual and group life RBC factors: “Therefore, when the NAIC makes tax-rate RBC factor changes, we propose that the current pre-tax RBC C-2 individual and group life factors be multiplied by 0.97 until such time as changes are made to the underlying C-2 RBC factors.” It should be noted that the scaling factor of 0.97 for life insurance was developed by running a model that approximately replicates the current C-2 factors. When that model was run using a higher after-tax discount rate, the result was a scaling factor of 0.97, rounded to two decimal places. The unrounded factors for C-1 bonds and C-2 life insurance are slightly different.
- Subsequent to the March 16 letter, the Academy’s Health Solvency Subcommittee provided a recommendation to the TRWG about the effect of tax reform on C-2 RBC for health insurance. The recommendation is that the tax factors that are currently 0.35 be changed to 0.21, and the tax factors that are currently 0.00 remain at 0.00. Pre-tax factors are recommended to remain unchanged.

C-3 Risk

- The March 16 letter recommends that the RBC tax factor be changed from 0.35 to 0.21, and the base factors for C-3 low-risk, medium-risk, and high-risk liabilities be modified such that the after-tax RBC charge is not changed, recognizing that the original base factors were developed without considering taxes; hence, on a pre-tax basis. That recommendation remains unchanged, and is supported by the [Academy document](#) dated March 2001 and provided to the working group that discussed the incorporation of taxes into the Life RBC calculations. It should be noted that the C-3 base factors apply directly to life insurance, serve to create a floor for fixed annuity RBC determined with C-3 Phase 1 models, and do not apply to variable annuity RBC determined with C-3 Phase 2 models. Also, C-3 Phase 1 and 2 amounts are determined on an after-tax basis. The TRWG believes that the recommended use of a pre-tax rationale to determine base factors that are used on an after-tax basis is appropriate, in light of the underlying rationale.
- The March 16 letter makes this comment: “Based on our review of these instructions, we believe that the only NAIC action required for C-3 Phase 1 and C-3 Phase 2 testing at this time is to change any specific references to “35%” in C-3 Phase 2 instructions to refer to the current tax rate.” Upon further reflection, the TRWG suggests substituting “current, or enacted future, tax rates” for “current tax rate” in this sentence. For example, on Dec. 31, 2017, the then-current tax rate was 35%, but we believe that C-3 Phase 1 and 2 testing for year-end 2017 would have most appropriately been performed using the 21% tax rate that was enacted prior to that date, and effective starting in 2018.

C-4a and Operational Risk

- The March 16 letter is silent as to the C-4a pre-tax factors for direct life, annuity, and health insurance premiums, and proposed changing the RBC tax factor from 0.35 to 0.21. Upon further reflection, the TRWG suggests changing the pre-tax factors from 0.0308 to 0.0253 for life and annuity business, from 0.0077 to 0.0063 for health business, and from 0.0008 to 0.0006 for separate account liabilities. When the suggested pre-tax factors are combined with the suggested tax factor, the after-tax C-4a RBC will remain the same. The TRWG believes that changing both the pre-tax RBC factors and the tax factors will preserve the original “proxy” after-tax nature of the C-4a charge.

Please let us know if you have any questions about these recommendations. We stand ready to assist your working group as you move forward.

Sincerely,

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