EFFECT OF TAX REFORM ON NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS’ (NAIC) LIFE RISK-BASED CAPITAL (RBC)
Introduction

- Federal tax reform is effective for 2018
  - Corporate tax rate reduced from 35% to 21%
  - Several other provisions affecting life insurers

- Questions for NAIC to answer
  - Change Authorized Control Level (ACL) RBC due to tax reform?
  - If so, what changes should be made, and when should changes be effective?
Tax Reform Effects on RBC

- NAIC Life RBC compares two calculated items -
  - TotalAdjusted Capital (TAC) is compared to -
  - ACL RBC

- Our letter focuses on possible changes to RBC factors within ACL RBC

- Additionally, TAC is affected in many ways by tax reform
Tax Reform Effect on TAC

- TAC changes from tax reform (all in effect for 2018)
  - Tax rate changes from 35% to 21%
  - Tax reserve redefined; difference spread over 8 years
  - Deferred acquisition cost tax – higher capitalization, longer amortization
  - Dividend received deduction changed
  - Deferred tax asset/liability revalued
  - Asset adequacy testing uses lower tax rate
Should ACL RBC Be Changed?

- Underlying premises
  - ACL RBC estimates surplus needed for “stress” events
    - Examples of stress event – bond default, high mortality
  - In general, RBC factors were developed on a post-tax basis
    - Most life insurers are assumed to be profitable and pay taxes
    - When stress event happens, net surplus impact to insurer is cushioned by reduction in tax expense
Should ACL RBC Be Changed?

- Because RBC is on a post-tax basis, there is solid logic to change RBC factors as tax rates change.

- Illustrative example
  - Assume a $100 pre-tax “stress” event.
  - At 35% tax rate, after-tax cost (and RBC) is $65.
  - Same event at 21% tax rate has after-tax cost of $79.
  - So ACL RBC should go up.
ACL RBC Effective Date Considerations

- Possible date to implement proposed changes
  - For 2018 RBC filings
  - For 2019 RBC filings
  - Some type of phase-in

- Effective date decision is a regulator decision, taking into account public policy considerations
ACL RBC Change Date Considerations

- RBC factors should change as tax rates change
- “Discontinuities” in the trend of ACL RBC
  - Items that will likely raise ACL RBC
    - C-1 bond changes (targeting 2019)
    - RBC tax factor changes (date TBD)
  - NAIC should consider whether ACL RBC trend discontinuities should be focused in one year, or graded in
ACL RBC Effective Date Considerations

- As ACL RBC rises, more companies could be flagged as “weakly capitalized”
  - Suggest deeper monitoring of insurers with low ratios of TAC to ACL RBC until RBC changes are fully made
- RBC “Trend Test” will need careful interpretation
- Tax items that impact TAC are generally effective in 2018
**Recommendations if ACL RBC Is Changed for Relevant Year** *

| C-1 bonds              | For 2018 RBC filing –  
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<tr>
<td></td>
<td>Multiply pre-tax RBC factors by 0.97</td>
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<td>Change tax factor to 0.1575 or 0.1680</td>
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<td>For 2019+ RBC filing –</td>
<td>Use IRBC-updated bond factors, recalculated with 21% tax rate</td>
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<td>Change tax factor to 0.1680</td>
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<tr>
<th>C-1 other than bonds</th>
<th>Change 0.35 tax factors to 0.21 (for 2018 and 2019+ RBC filing)</th>
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<td>Change 0.2625 tax factors in line with C-1 bond tax factors</td>
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* Summary recommendations only; see letter for full detail
## Recommendations if ACL RBC Is Changed for Relevant Year *

| C-2 life insurance | For 2018 RBC filing –  
|                    | Multiply pre-tax RBC factors by 0.97  
|                    | Change tax factor to 0.21  
|                    | For 2019+ RBC filing –  
|                    | Until underlying RBC factors are updated – same pre-tax RBC factor and tax factor changes as for 2018  
|                    | When underlying RBC factors are updated – use updated pre-tax RBC factor and tax factor of 0.21  
| C-2 A&H            | To be determined in consultation with the Academy’s Health Solvency Subcommittee |

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Recommendations if ACL RBC Is Changed for Relevant Year *

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<th>For all RBC filing years –</th>
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<tr>
<td>C-3</td>
<td>Change pre-tax minimum factors to 0.0063, 0.0127, and 0.0253</td>
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<td>Change tax factor to 0.21</td>
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<td>(Note that C-3 Phase 1 and C-3 Phase 2 calculations should use current tax rate)</td>
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<tr>
<td>C-4</td>
<td>For all RBC filing years –</td>
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<tr>
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Additional Information

- Much more detail contained in March 16, 2018, letter to NAIC Life RBC Working Group
- We stand ready to assist the NAIC going forward
Contact Information

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