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October 18, 2018

Via email to: cbrown@naic.org

Patrick McNaughton
Chair, Health Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners (NAIC)

c/o Crystal Brown
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Re: Impact of Corporate Tax Rate Change on HRBC

Dear Mr. McNaughton:

The American Academy of Actuaries[1] Health Solvency Subcommittee ("subcommittee") is pleased to provide this response letter to the NAIC Health Risk-Based Capital (E) Working Group. This letter is in response to the Health Risk-Based Capital (E) Working Group request for comments on the impact on Health Risk-Based Capital (HRBC) from the *Tax Cuts and Jobs Act of 2017* (TCJA).

The TCJA is effective for 2018. A provision of the TCJA is a reduction in the corporate tax rate from 35 percent to 21 percent. The HRBC formula does not include any provision for a corporate tax rate adjustment. The general thought behind this treatment is that under a stress scenario where a carrier may be experiencing material underwriting losses, they are not likely to have had to report taxable income in the recent prior years to offset current year losses. Under this scenario, the results would be the same under a pre-tax or post-tax basis.

The subcommittee has reviewed the HRBC formula and the tax position and believes that no changes are required as a result of the change in the corporate tax rate from 35 percent to 21 percent.

As presented to the Life Risk-Based Capital (E) Working Group on Sept. 7, 2018,[2] by the Academy's Life RBC Tax Reform Work Group, certain C2 RBC factors for health insurance, the C3 "base" factors, and the C4-0 factor were adjusted downward so that the net post-tax RBC

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[1] The American Academy of Actuaries is a 19,500-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] American Academy of Actuaries, Letter re "Interpretation of 2018 Life Risk-Based Capital Results in Light of the 2017 Tax Cuts and Jobs Act," Sept. 17, 2018.

factor is unchanged. Therefore, the portion of the formulas that are common to both Health and Life will remain consistent.

For health insurers with taxable income, the reduction in the corporate tax rate as noted above will reduce tax expenses in 2018 and in future years. All else being equal, this would lead to an increase in Total Adjusted Capital (TAC). This increase in TAC could be partially or fully offset by:

- Some health insurers may have had a net deferred tax asset (DTA) on their balance sheets as of 2017. Accounting rules require that the DTA be recalculated using the lower tax rates. We understand that most health insurers that have a DTA reported this reduction, which reduced TAC, to the DTA in their 2017 annual statements.
- Carriers could choose to reinvest in their business through various mechanisms and thus create greater expenses. These higher expenses would also reduce TAC.

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We appreciate the opportunity to provide these comments and would welcome the opportunity to speak with you regarding these comments in more detail and answer any questions you might have. If you have any questions or would like to discuss further, please contact David Linn, the Academy's senior health policy analyst, at 202-223-8196 or linn@actuary.org.

Sincerely,

Tim Deno, MAAA, FSA
Chairperson
Health Solvency Subcommittee
American Academy of Actuaries