AMERICAN ACADEMY *of* ACTUARIES

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June 4, 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 further comments on how the recent change in U.S. corporate tax law[2]—in particular, the change in the corporate tax rate to 21 percent from 35 percent—will affect the NAIC's Life Risk-Based Capital ("Life RBC") calculation of Authorized Control Level RBC. This letter discusses two items that came up during your working group's April 26, 2018, conference call: the rounding of C-2 life insurance RBC factors and life RBC charges for certain health insurance coverages.

Rounding of C-2 Life Insurance RBC Factors

In our March 16, 2018, 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."

The C-2 life insurance RBC factors are carried to four decimal places. When the current RBC factors are multiplied by 0.97 and then rounded to four decimal places, most of the resulting factors are unchanged because the current factors are so small. For example, the current RBC factor for individual life insurance in excess of $25 billion is 0.0009, and when 0.0009 is multiplied by 0.97 and rounded to four decimal places, the answer is the same 0.0009.

We believe that it is too late in the year to make "structural" changes to Life RBC for 2018 filings. Therefore, we suggest that the currently exposed factors be used for 2018 filings. We expect that the impact of this issue on overall RBC levels is minimal. Your working group could consider "structural" changes to Life RBC for 2019 that would allow the 0.97 factor to be applied the entire C-2 life insurance charge. Also, we note that the Academy's C-2 Work Group is developing a proposal to update C-2 life insurance factors, which is expected to reflect the current tax rate and would eliminate the need for a 0.97 multiplier if implemented.

[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.

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Life RBC Charges for Certain Health Insurance Coverages

In our April 24, 2018, letter, we make the following comment about C-2 A&H RBC factors: "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."

During your working group's April 26 call, it was noted that changing the tax factors without changing the pre-tax RBC factors would create a disparity between the NAIC life and health blanks for post-tax RBC charges for disability income (DI), long-term care (LTC), and health claim reserves. To our knowledge, RBC factors for those items for companies filing the NAIC health blank are not proposed to be changed due to tax reform. If the tax factors for those items in the NAIC life RBC calculation are changed but the pre-tax factors are not changed, this will have the effect in increasing the post-tax RBC charges for those items for companies filing the NAIC life blank.

The TRWG reached out to the Academy Health Solvency Subcommittee (HSS) for additional guidance on this issue. In response, the HSS noted that the original health risk factors were based on a model that did not reflect tax impact in development of the factor, and did not use a "time value of money" concept. Therefore, it was the view of the HSS that the after-tax factors should remain the same for the life and the health RBC formulas, and that there is no rationale for a scalar such as 0.97 that is proposed to be used for certain C-1 and C-2 life insurance factors in the Life RBC formula.

The TRWG accepted this guidance from the HSS. Therefore, we wish to modify our April 24 recommendation concerning pre-tax factors for DI, LTC, and claim reserves. Rather than leaving these factors unchanged, we recommend that they be adjusted so that the RBC charge after application of the revised tax factor remains unchanged. For example, the current RBC charge for disability income premium in excess of $50 million is 23.1 percent and the tax factor is 0.35, leading to a post-tax RBC charge of 15.0 percent. For that cell, we propose that the pre-tax factor be changed from 23.1 percent to 19.0 percent. As previously recommended, the tax factor should be changed from 0.35 to 0.21, and the resulting post-tax RBC charge will remain unchanged at 15.0 percent.

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,

Wayne E. Stuenkel, MAAA, FSA, CERA
Chairperson, RBC Tax Reform Work Group
American Academy of Actuaries