

P/C PUBLIC POLICY UPDATE - SPRING 2018



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Today's Agenda & Speakers

- Rade Musulin, MAAA, ACAS—Vice-President, Casualty Practice Council
 - Update on National Flood Insurance Program
 - NAIC dialogue on P/C actuaries' qualifications and credentials
- Lynne Bloom, MAAA, FCAS—Director, Actuarial Services PwC
 - Impact of 2017 federal tax law changes
- Kevin Ryan, MAAA, FCAS—Academy Sr. Casualty Fellow
 - Recent changes in state laws and regulations; NAIC initiatives
- Lauren Cavanaugh, MAAA, FCAS—Chairperson, P&C RBC Committee
 - Update on bond factor revisions

The Academy

- 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.



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Impact of 2017 Tax Changes

Lynne Bloom



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Overview – Tax Update



The **TAX CUTS & JOBS ACT**



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US Tax Reform Overview—What are we facing?

- Most sweeping tax reform since 1986; signed into law on December 22, 2017 (effective 2018)
- Will drive significant impacts in the insurance industry beyond the tax function and financial reporting to operations broadly
- Three main drivers of change for P&C companies



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US Tax Reform Overview—What are we facing?

- Additional guidance anticipated from Treasury, IRS, and insurance regulators, including the NAIC and state regulatory authorities
- Most insurers currently focusing on tax calculations for immediate financial reporting
- We expect insurers to address business and operations impacts in the upcoming months



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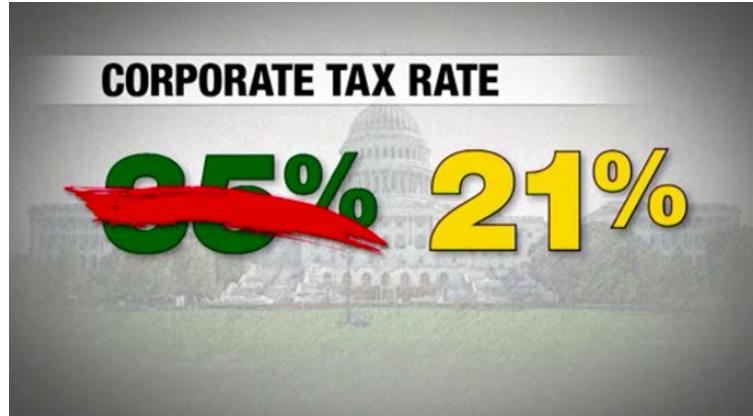
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Industry Impact

- Different segments of the insurance industry are affected differently by tax reform
 - US multinationals—generally beneficial due to lower rates and increased competitiveness
 - US domestics—generally increased competitiveness, but varies based on unique circumstances
 - Foreign multinationals—increased competition and costs
- Insurers need to consider how to strategically react to optimize operational and financial results
- Prioritization and timing of actions may vary significantly due to unique profiles, characteristics, operations, and exposures



Tax reform provisions that have an Impact—the Tax Rate



- Previous: 35% corporate rate and 20% corporate AMT
- TCJA: 21% rate for taxable years beginning after December 31, 2017. A blended rate applies for fiscal year taxpayers. Corporate AMT repealed. Prior year AMT credits refunded over 2018-2021.

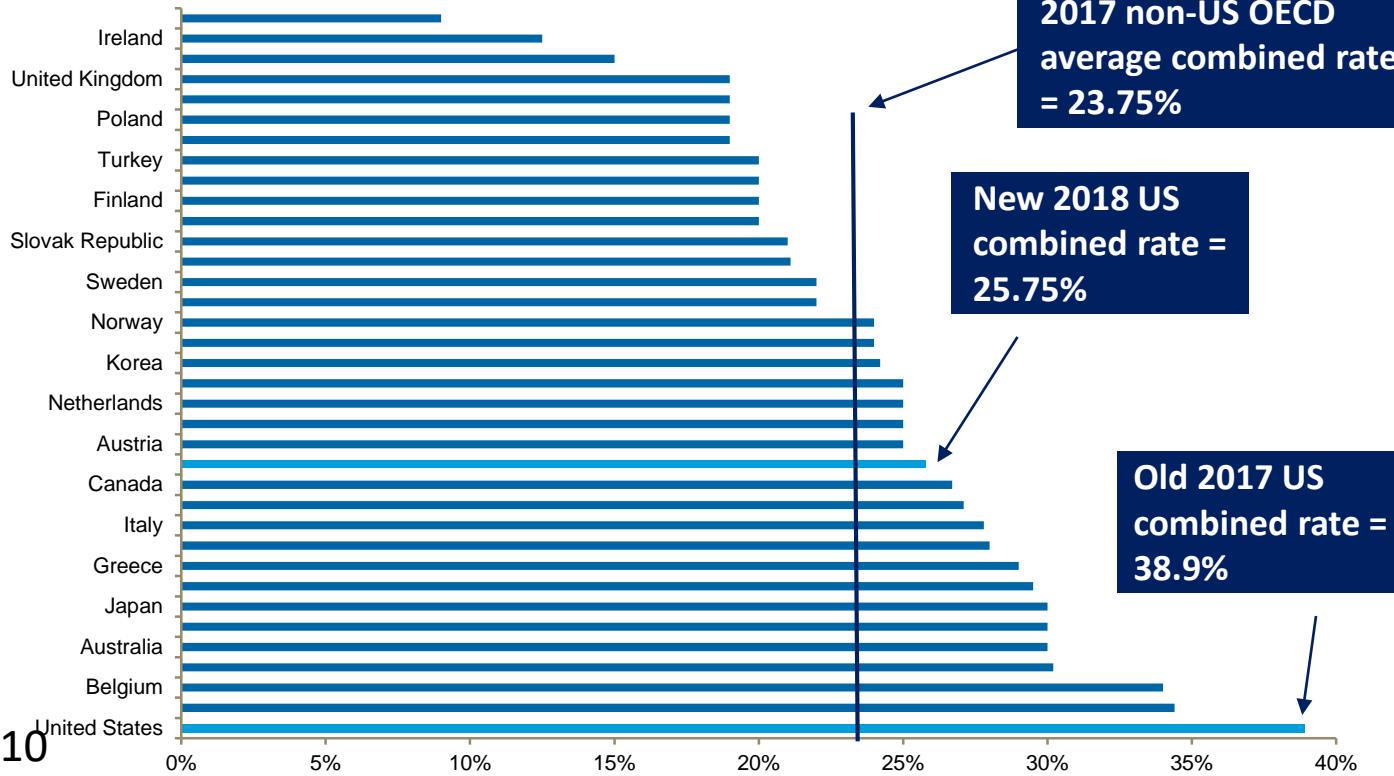


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New US statutory corporate tax rate (federal rate plus state average) closer to OECD Average (Org. for Economic Cooperation and Development)



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Tax reform provisions that have an impact—BEAT Tax (Base Erosion and Anti-abuse Tax)

- For US domiciled companies, new add-on minimum tax equal to the excess of:
 - (i) 10% of modified taxable income (5% in 2018 and 12.5% for tax years after December 31, 2025) generally determined without regard to amounts paid or accrued to a foreign related party*;
 - over
 - (ii) regular tax liability**

*Other than COGS and certain services, including amounts includable in the basis of a depreciable or amortizable asset.

** Determined after reduction by credits other than the R&D credit and capped amounts of certain other general business credits (GBC). For tax years beginning after December 31, 2025, the regular tax is reduced by all credits (including GBC).



US Industry Data (aggregate from Schedule P, per S&P Global)

At year-end 2016:

- Of the \$608 billion Direct Written Premium and 671 Gross Written Premium, \$137 billion was ceded
- Of the \$137 billion ceded, \$78 billion was ceded offshore
- Of the \$78 billion ceded offshore, \$48 billion was ceded to offshore affiliates and would be subject to BEAT tax
 - This is 35% of ceded premium and 33% of ceded reserves



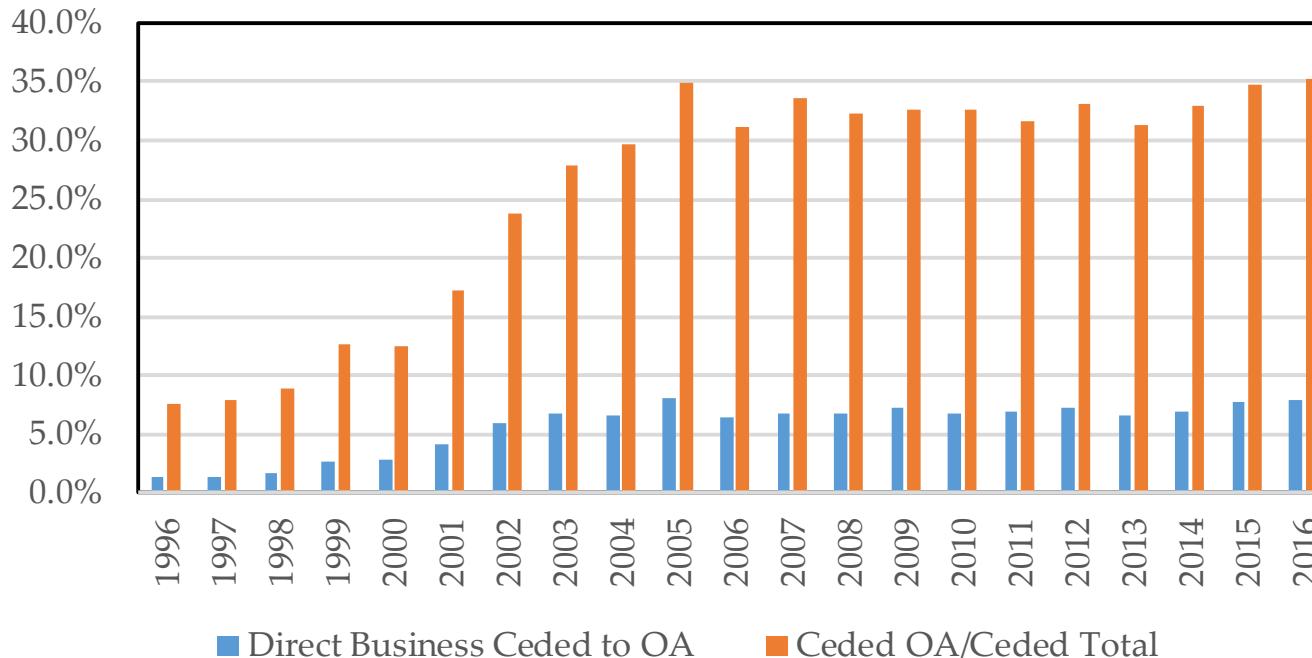
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US Industry Data Changes (aggregate from Schedule P, per S&P Global)

US OffShore Reinsurance



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Overview of tax reform provisions that have an impact— Discount factors

The amount of discount for tax purposes has increased due to lengthening of payment patterns and increase in interest rates used for discounting (from federal midterm rates to high quality bonds)

This will have an effect on the timing of taxes paid and also require companies to reevaluate their deferred tax asset

Note, the IRS has not released its discount factors under current rules and for financial reporting purposes companies need to develop reasonable estimates of these factors.



Other Provisions

Provision	Tax Cuts and Jobs Act
Deemed repatriation toll charge	Previously untaxed foreign earnings: <ul style="list-style-type: none">• 15.5% cash & cash-equivalents/8.0% non-cash assets• Payable over 8 years• Proportional reduction in foreign tax credits attributable to previously untaxed foreign earnings
Shift to territorial system	<ul style="list-style-type: none">• 'Territorial' system• 100% foreign dividend exemption
Global intangible low-taxed income (GILTI)	Subpart F generally maintained; US shareholders of Controlled Foreign Corporations subject to current US tax GILTI with a 50% deduction. An 80% foreign tax credit is permitted. The deduction is reduced to 37.5% for tax years beginning after December 31, 2025.
Pro-ration	Insurers do not receive full exemption for certain investments earnings <ul style="list-style-type: none">• Rate of 15% replaced with 25% so that the product of the proration percent and 21% corporate tax rate retains an effective rate of 5.25%• Linked to the corporate tax rate so that future changes also would change the proration percent



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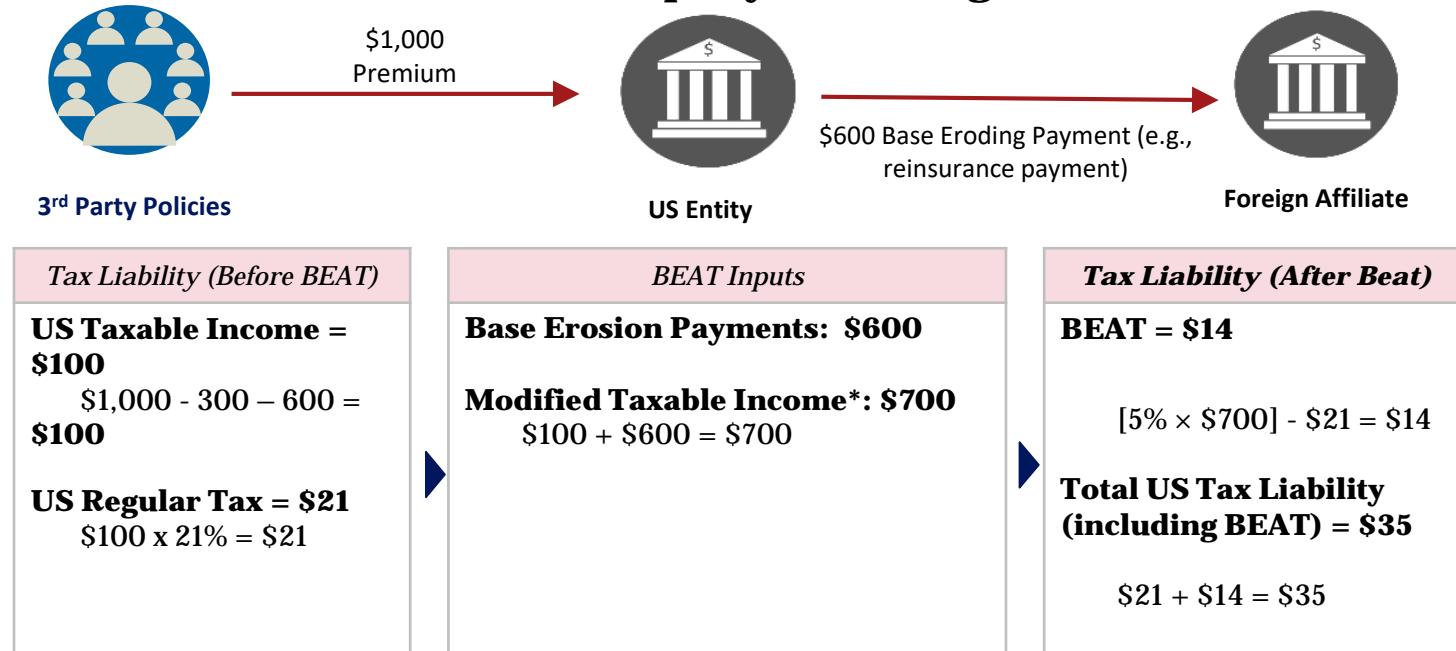
Market Opinions and Strategy—US-Based Insurers

While there are still uncertainties with the application and impact of tax reform, we see common themes start to emerge in response to tax reform

Theme	Commentary
Pricing	<ul style="list-style-type: none">▶ May level the playing field for US-based insurers from those with foreign affiliates (through BEAT)▶ Investment in policyholders by reducing rates▶ Regulatory uncertainty—some expecting a portion of savings to be passed to policy holder▶ Others waiting to see if competitors change rates
Internal Investment	<ul style="list-style-type: none">▶ Investment in technology or infrastructure to enhance operations▶ Investment in people, including increased wages, benefits and training▶ Charity and PR
Changing internal affiliated reinsurance	<ul style="list-style-type: none">▶ Some setting up or electing a 953d affiliated offshore entity (pays US tax)▶ Some canceling policies between the US and an affiliated offshore entity▶ Some exploring alternative structures such as stop loss to manage capital and taxes

Use Case Scenario: BEAT Tax Calculation

U.S. operating company affiliated reinsurance with Foreign Related Company Receiving BEP



Reinsurance Considerations – Stop Loss Illustration

Percentile	Probability	Losses	Gross G/L	Cedent G/L with 50% QS	Reinsurer G/L	Cedent G/L with Stop Loss between 85.0% and 115.0%	Reinsurer G/L
10.0%		47,188	27,812	16,347	11,465	20,768	7,044
30.0%		56,138	18,862	11,872	6,990	11,819	7,044
50.0%		63,313	11,687	8,285	3,403	4,644	7,044
Expected		65,000	10,000	7,441	2,559	2,956	7,044
80.0%	1 in 5	76,794	(1,794)	1,544	(3,338)	(8,837)	7,044
90.0%	1 in 10	84,947	(9,947)	(2,532)	(7,415)	(16,990)	7,044
95.0%	1 in 20	92,328	(17,328)	(6,223)	(11,105)	(17,044)	(285)
98.0%	1 in 50	101,407	(26,407)	(10,762)	(15,644)	(17,044)	(9,363)
99.0%	1 in 100	107,949	(32,949)	(14,034)	(18,916)	(17,044)	(15,906)
99.5%	1 in 200	114,307	(39,307)	(17,212)	(22,094)	(17,044)	(22,263)
Net Premium		100,000		50,000	50,000	92,956	7,044
Net P:S Ratios		2.54		2.90	2.26	5.45	0.32
EV Layer						972	
Expected G/L		10,000		7,441	2,559	3,929	6,071
BEAT Tax		-		4,181		272	

*Liability Treaty w/65%
Expected Loss Ratio,
25% Acq. Exp. &
Bermuda Parent
Reinsurer*

*Option 1: 50% QS (29.9%
Comm.)*

*Option 2: Stop Loss 85% to
115% LR (2019 BEAT Tax)*



Loss Reserve Discounting

- Extended duration of payment patterns up to 24 years from 15
 - Affects WC, NP Financial, Products Liability
- Repeal of election to use company specific data
- Raised rates from federal midterm rates (9 to 13 years) to High Quality Bond rates (Duration Unspecified)
- IRS has not published new factors but can be estimated
- Affects DTA, statutory admitted assets and possibly RBC

	Industry Discount (Billions)	Change from Previous Method	Annual Income Increase (8 Year Transition)
Previous patterns and rates	17.9		
Increase in old rate	20.1	2.2	0.3
Change of Pattern	20.2	2.3	0.3
Change to HQM	30.4	12.5	1.6
Change to HQM Longer Duration	41.1	23.2	2.9
Change To HQM up to 24 years	44.1	26.2	3.3

State and NAIC Updates

Kevin Ryan



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State Legislation and Regulation

- Medical Professional Liability
 - Many efforts to fine-tune tort reforms enacted in recent years and/or to respond to court rulings.
 - For example, New Jersey AB 1568 clarifies that claims must be filed within 2 years of discovery of an injury, but no more than 4 years after the event.

State Leg & Reg (cont'd)

- Wildfires, Mudslides
 - California Department of Insurance issued a notice saying that mudslides in early 2018 are considered to be the result of wildfires in late 2017 and therefore are covered events.



State Leg & Reg (cont'd)

- Wildfires, Mudslides (cont'd)
 - The Academy's Extreme Events and Property Lines Committee has formed a subgroup to look at the issue of growing losses due to wildfires.
 - Wildfires also came up in questions following the Academy's presentation on the Actuaries Climate Index at the NAIC's spring meeting.



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State Leg & Reg (cont'd)

- Taxes
 - Multiple states announced that regulatory review of P/C rate filings for 2018 will include consideration of the effect of lowering federal corporate tax rates from 35 percent to 21 percent.

State Leg & Reg (cont'd)

- Automobile Insurance
 - Numerous proposals to limit classifications used in calculating private passenger auto rates. Examples:
 - Michigan HB 5419 would prohibit insurers from using any driver characteristics other than safety record, miles driven, and years of experience.
 - Louisiana HB 636 (passed the House) would prohibit use of ZIP codes as sole rating criteria.



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State Leg & Reg (cont'd)

- Automobile Insurance (cont'd)
 - Maryland HB 656 and HB 657 (approved by committee) would prohibit the use of occupation, education, gender or marital status in ratings.
 - Many states are grappling with issues raised by autonomous vehicles. For instance, Oregon enacted a law setting up a study commission.



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NAIC Works in Progress

- Automobile Insurance
 - The Automobile Insurance Task Force continues its data collection for a study of the affordability of private passenger auto insurance.



NAIC Works in Progress (cont'd)

- Predictive Modeling
 - The Casualty Actuarial and Statistical Task Force has undertaken a series of “book club” conference calls to improve regulators’ understanding of the subject.
 - Academy’s CPC is hosting the May session.
 - NAIC staff has been charged with assessing need and developing requirements and cost estimates for an NAIC-based consulting group to assist state regulators.



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NAIC Works in Progress (cont'd)

- Travel Insurance
 - The National Council of Insurance Legislators issued its own draft of a new model law in 2017, but the NAIC has chosen to make significant modifications to the NCOIL proposal.
 - The NAIC's Travel Insurance Task Force continues to work on drafting a new model law.
 - The Academy has its own Travel Insurance Task Force which is writing a monograph.



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NAIC Works in Progress (cont'd)

- Pet Health Insurance
 - At the Spring 2018 NAIC national meeting, the Property and Casualty Insurance (C) Committee authorized creation of an ad hoc group to write a white paper on pet health insurance, an inland marine coverage.
 - The origin of the study is a request from another committee for help in understanding questions about pet health insurance producers and marketers.



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Risk-Based Capital: Bond Factors

Lauren Cavanaugh



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P/C Risk Based Capital Committee

- This committee works on Risk-Based Capital (RBC) and related solvency management tools. Naturally, there is significant interaction between the committee and the NAIC's Property/Casualty Risk-Based Capital (E) Working Group.
- Recent Activities related to Analysis of Bond Factors, with presentations at the NAIC Spring Meeting to:
 - Property/Casualty Risk-Based Capital (E) Working Group
 - Investment Risk-Based Capital (E) Working Group



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Upcoming Changes to Formula

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- Investment Risk Factors—NAIC Investment-RBC (E) Working Group has been working to implement new Life RBC fixed-income asset risk factors with increased granularity (from current six classes to 20 classes)
- The Working Group also plans to update the structure and factors for P&C and Health RBC formulas
- New structure and factors targeted to be completed and approved for 2019 Annual Statements



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Current Formula

$$R0 + \sqrt{R1 + R2 + R3 + R4 + R5 + Rcat}$$

R1 captures asset risk on fixed income securities.

NAIC Class	Factor
01	0.3%
02	1%
03	2%
04	4.5%
05	10%
06	30%

Total charge for unaffiliated bonds then subject to bond size factor, which varies by company based on number of issuers.



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Proposed Factors

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- Academy C1 (Life) Work Group (C1WG) submitted reports in 2017 that discussed:
 - Proposed Life fixed-income asset factors
 - Potential starting point for corresponding P&C and Health factors

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Proposed Factors, continued

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- During 2017, the Academy CPC and HPC were asked to analyze and provide recommendations for P/C and Health.
- The P/C RBC Committee formed a joint group with the Health Solvency Committee, to review the extent to which the C1WG model is applicable to P/C and Health.

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Proposed Factors, continued

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- We have issued a discussion draft on this topic, and target completing a report with recommended factors for consideration at the NAIC 2018 Summer meeting.
- Some of the differences we identified are:
 - ▣ Time Horizon, considering:
 - Consistency with other components of P/C RBC formula
 - Average Duration of Liabilities
 - ▣ Representative Portfolio and Bond Size Factor, considering:
 - Number of bonds in a typical portfolio for P/C insurers
 - Relative spread of bond sizes
 - ▣ Speculative-grade Bonds, considering:
 - These are booked at market value

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Flood Insurance, Qualifications

Rade Musulin



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Flood Insurance

- Two Tracks
 - Reauthorization of the National Flood Insurance Program (NFIP)
 - Revision of the NFIP

Flood Insurance (cont'd)

- Reauthorization of the NFIP
 - Authority expired September 30, 2017.
 - Six short-term extensions since then.
 - Current authority expires June 30, 2018.
 - The House has approved a five-year extension.

Flood Insurance (cont'd)

- Revisions to the NFIP
 - There are numerous proposals to revamp the NFIP.
 - The most significant changes are geared towards increasing the role of private insurance. These also are the most controversial proposals.
 - In 2017, the House passed an assortment of proposed changes, with the privatization proposals generally passing by narrow margins.



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Flood Insurance (cont'd)

- ❑ The Senate has held no hearings, taken no votes.
- ❑ Meanwhile, the Federal Emergency Management Agency recently announced administrative steps to facilitate the marketing of private flood insurance.



Flood Insurance (cont'd)

- In April 2017, the Academy's Flood Insurance Work Group published a monograph on the NFIP, discussing many of the proposed changes.
 - <http://www.actuary.org/files/publications/FloodMonograph.04192017.pdf>
- The Academy's P/C Extreme Events and Property Lines Committee will soon be issuing a new monograph on regulatory considerations associated with an increase in private flood insurance.



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Qualifications

- The NAIC continues to work on revising the requirements for P/C Statement of Actuarial Opinion (instructions).
- A small group of commissioners under the auspices of the NAIC Executive Committee is steering the project.



Qualifications (cont'd)

- The project's official name: P/C Appointed Actuary Educational Standards and Assessment of Professional Actuarial Organizations' Examinations and Educational Content for Designations.
- They have set an aggressive timeline for completion by year end.



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Qualifications (cont'd)

- Separately, the Casualty Actuarial and Statistical Task Force has been charged with:
 - Developing an attestation an actuary must complete and sign annually to verify the actuary is qualified to sign a statutory P/C Statement of Actuarial Opinion.
 - CASTF attestation proposal exposed for comment until May 11.
http://www.naic.org/documents/cmte_c_catf_exposure_attestation_proposal.docx



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Qualifications (cont'd)

- CASTF Charges, cont'd
 - Working with actuarial organizations to require P/C Appointed Actuaries participate in a continued competence process every one to three years.
 - Working with the American Academy of Actuaries to add clarity to the required three-year experience period in the *U.S. Qualification Standards* regarding the mentor's responsibilities and the learning expectations for the actuary.



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Q & A



P/C Public Policy Update—Spring 2018

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