TAX REFORM
IMPACT ON THE P&C INDUSTRY

CAS FALL MEETING 2018

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The

TAX CUTS & JOBS ACT

OVERVIEW

TAX UPDATE

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

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 and years

NAIC
National Association of Insurance Commissioners

IRS

POLL

What type of firm do you work for?

- Insurance/Reinsurance Company
- Regulator
- Consulting
- Audit
- Other

POLL

How much impact has tax reform had so far?

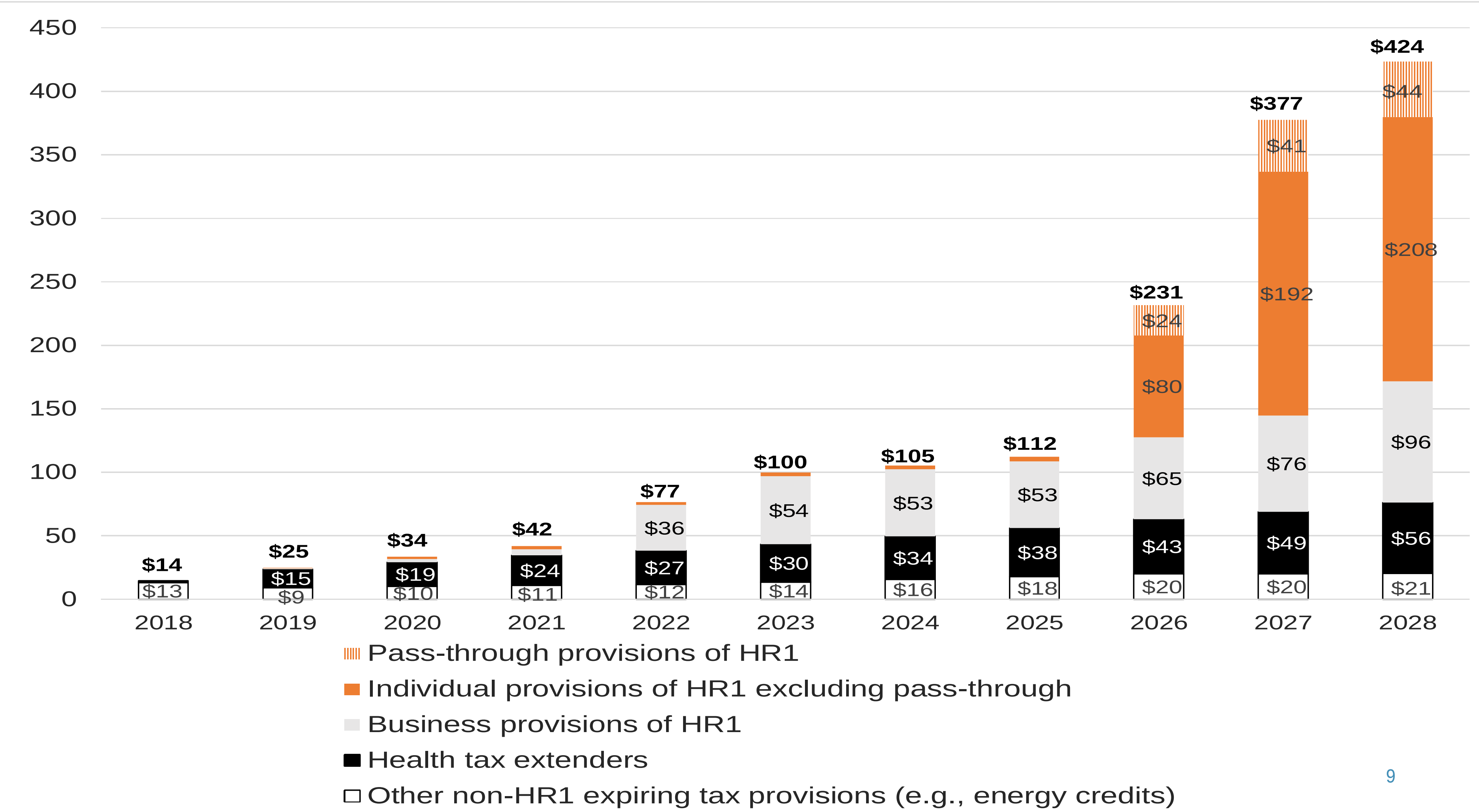
- We are working hard at processing changes and impacts
- I don’t think it will impact us
- I’m sure it matters to the tax team
- I wish I knew more!

INDUSTRY IMPACT

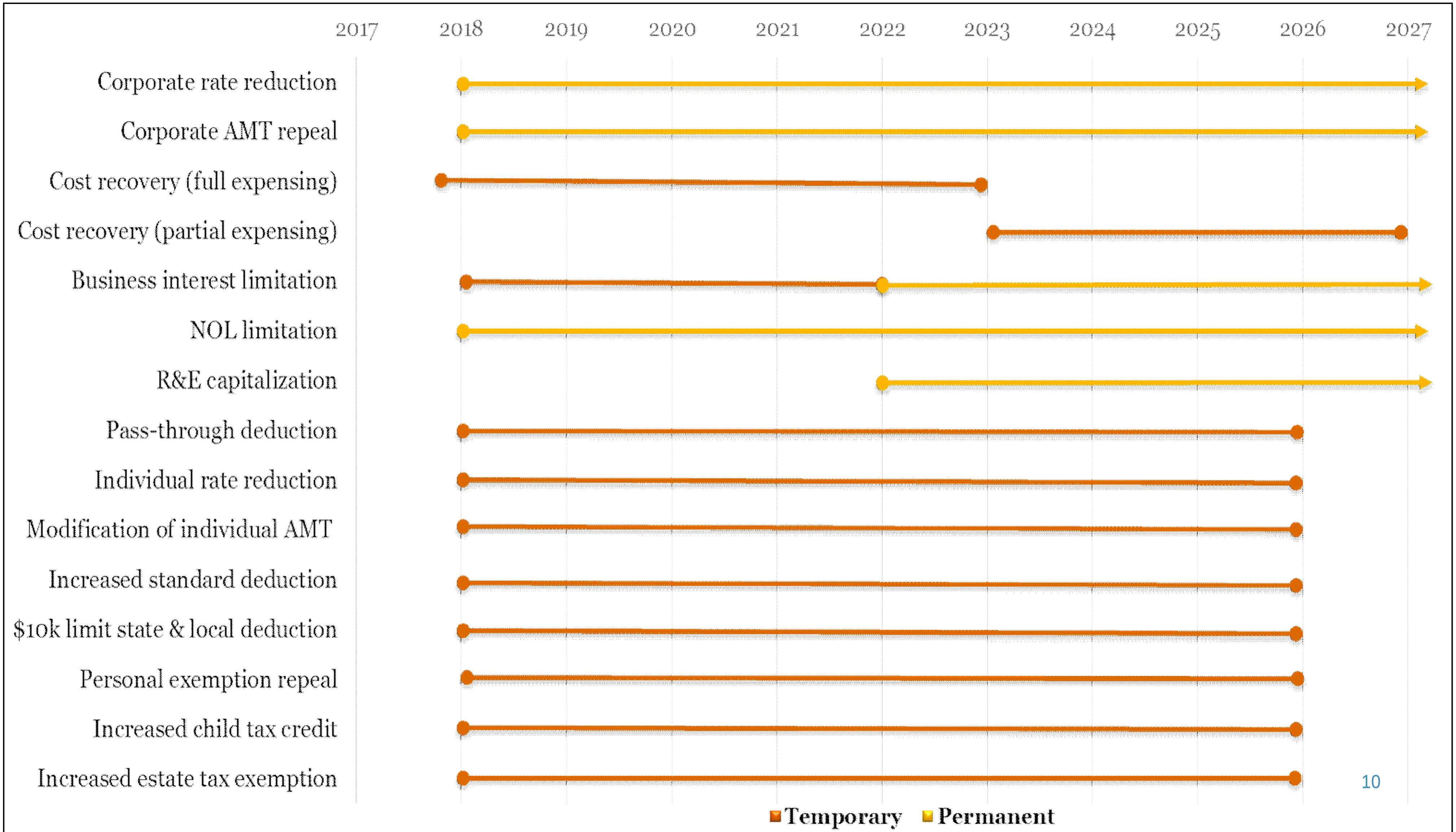
- Different segments of the insurance industry are affected differently by tax reform
  - US Multinationals - generally beneficial due to lower rates and increased competitiveness
  - US Domestics – generally increased competitiveness, but varies based on unique circumstances
  - Foreign Multinationals - increased competitiveness 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

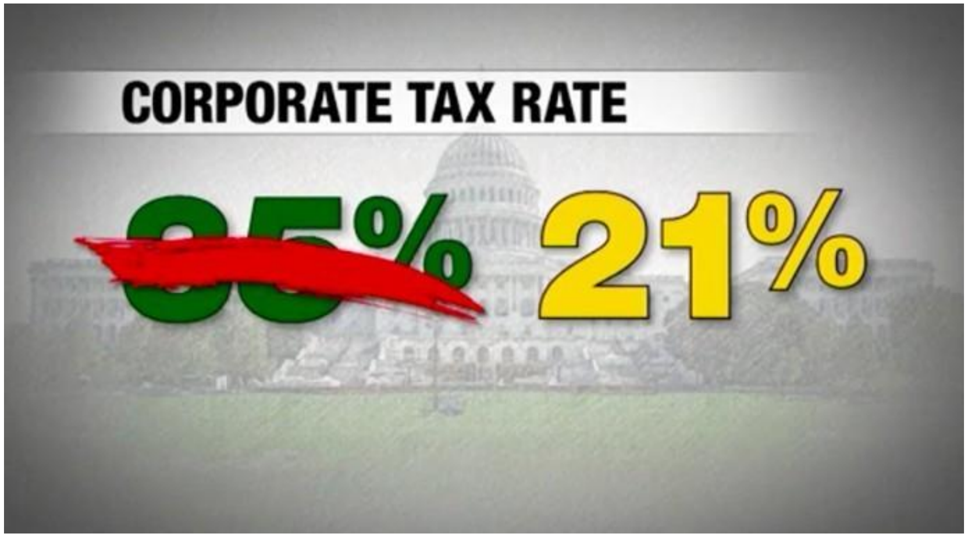
ANNUAL REVENUE COST OF EXTENDING VARIOUS TAX PROVISIONS ($ BILLIONS)



KEY TAX REFORM PROVISIONS THAT ARE PERMANENT OR TEMPORARY/SUBJECT TO SUNSET



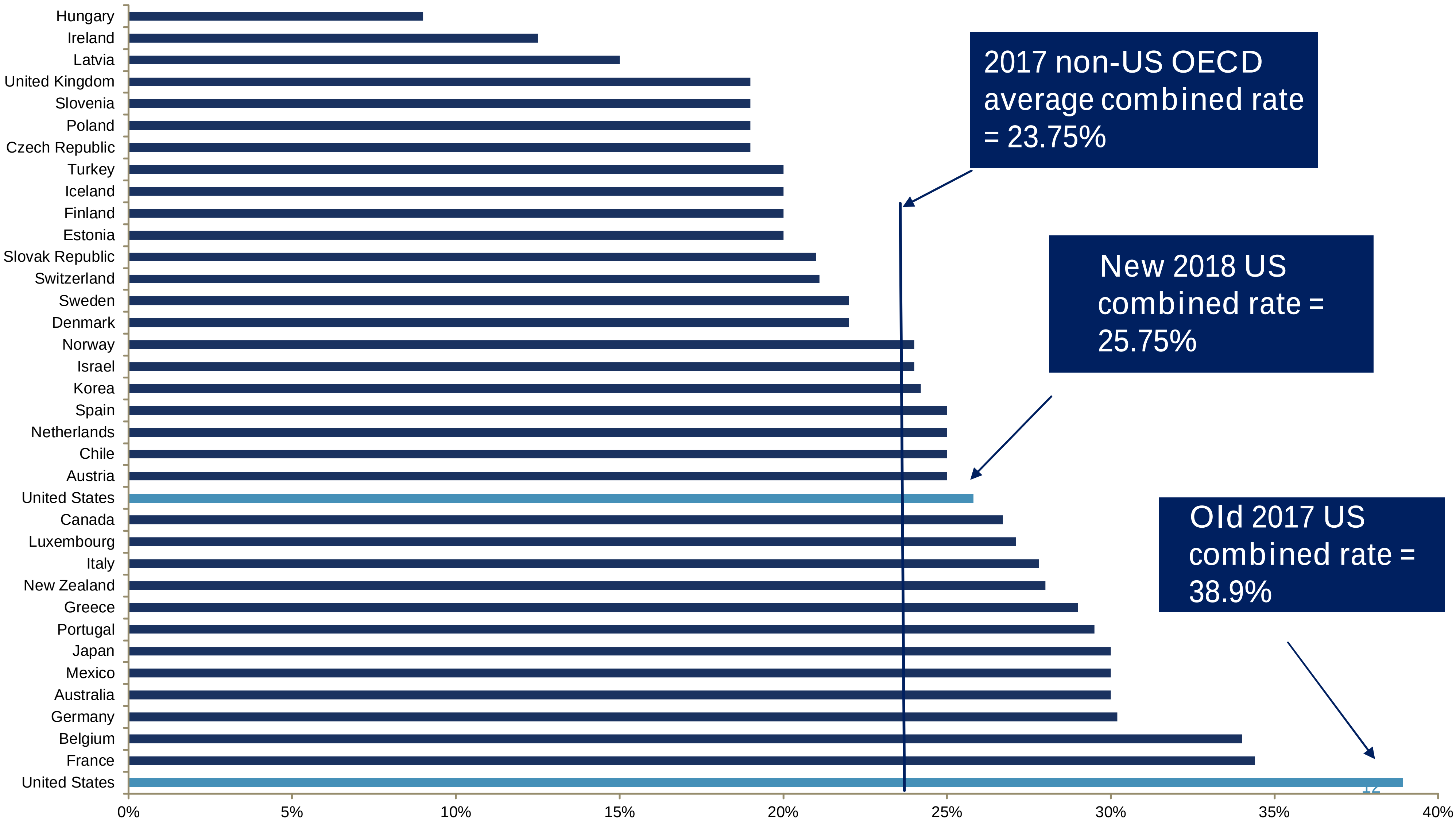
OVERVIEW OF TAX REFORM PROVISIONS THAT HAVE AN IMPACT – THE TAX RATE



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.

NEW US STATUTORY CORPORATE TAX RATE (21% FEDERAL RATE PLUS STATE AVERAGE) CLOSER TO OECD AVERAGE



OVERVIEW OF TAX REFORM PROVISIONS THAT HAVE AN IMPACT – BASE EROSION AND ANTI-ABUSE (BEAT) 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 includible 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. For tax years beginning after December 31, 2025, the regular tax is reduced by all credits (including GBC).

POLL

What percentage of reinsurance do you think is ceded to offshore affiliates?

- 5 – 7%
- About 10%
- About 15%
- 20 – 25%
- About 35%

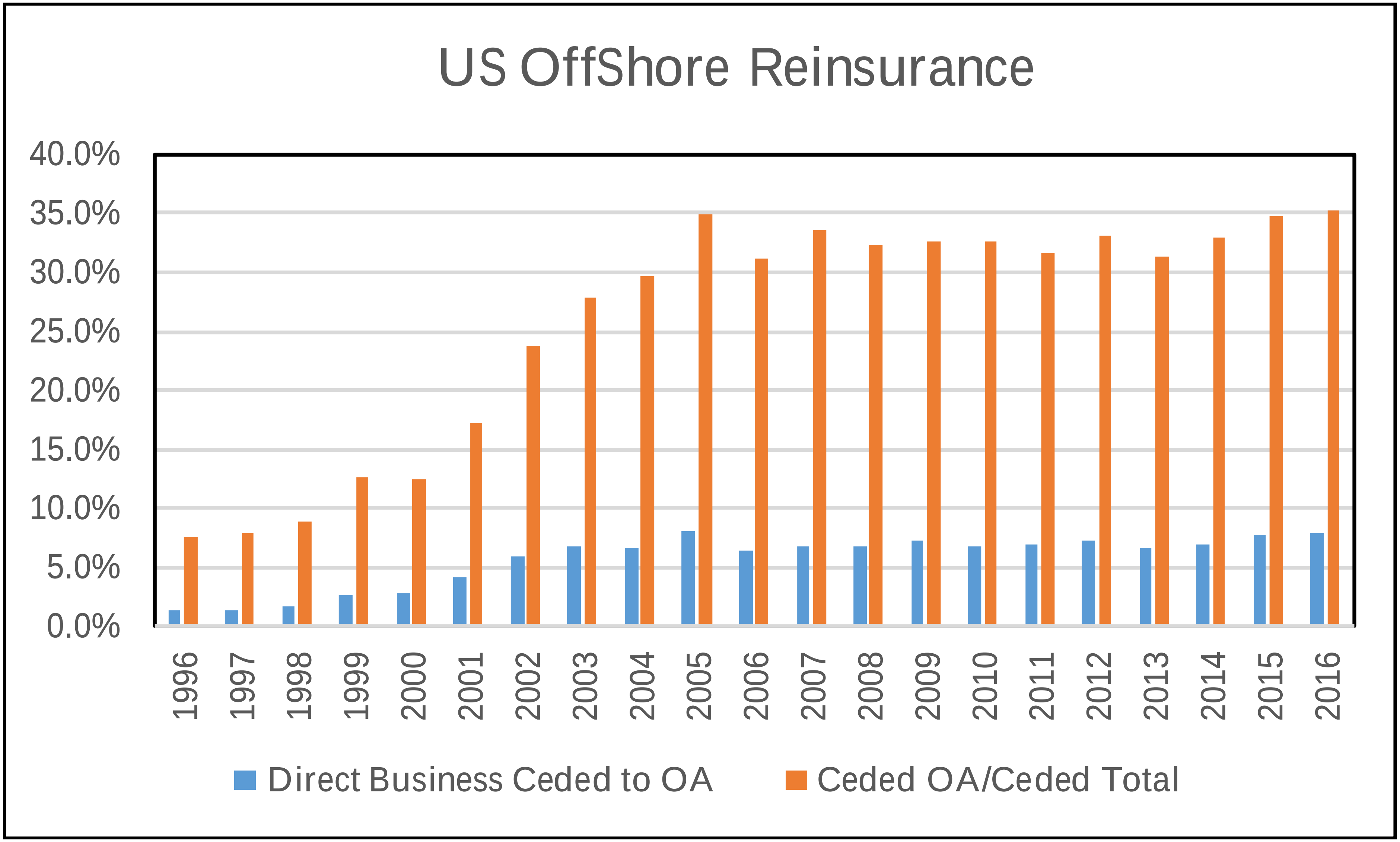
US INDUSTRY DATA

At year-end 2016:

- Of the $608 billion Direct Written Premium and $671 billion 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

US INDUSTRY DATA CHANGES



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.

POLL

Has your company estimated 2018 factors for stat purposes?

q Yes

q No, we said it could not be estimated

q Unaware

OTHER PROVISIONS

Provision	Tax Cuts and Jobs Act
Deemed repatriation toll charge	Previously untaxed foreign earnings: • 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	• 'Territorial' system • 100% foreign dividend exemption
Global intangible low-taxed income (GILTI)	Subpart F generally maintained; US shareholders of controlled foreign corporation (CFCs) subject to current US tax on 'global intangible low-taxed income' (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
Proration	Insurers do not receive full exemption for certain investments earnings — 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

BUSINESS IMPACTS

INDUSTRY CHANGES AND OPINIONS

US POLICY & LEGISLATIVE UPDATE
WHAT TAX REFORM MEANS FOR BUSINESSES

Lower income tax rates, domestic incentives and territorial taxation *could create a more favorable financial environment in the United States*

Potential actions

- Shift or relocate manufacturing, distribution, and IP generating activities
- Evaluate the financial efficiency of global supply chains and pricing approaches
- Move or domesticate headquarters functions or reconsider prior inversions
- Make additional capital asset investments (due to new expensing rules)
- Engage in strategic M&A and divestiture activity to support a pro-growth agenda
- Adjust global capital, financing, and debt flows to minimize cost
- Review global workforce planning strategies and the optimal location for talent
- Re-think incentive compensation and pension plan designs and benefits to align with new structures

US POLICY & LEGISLATIVE UPDATE
WHAT TAX REFORM MEANS FOR BUSINESSES

Repatriation of revenue located in foreign countries *could yield an influx of liquidity*

Potential actions

- Share buy-backs and/or increased dividends and returns to shareholders
- Change strategy on leverage: lower levels of borrowing to the extent deductible
- Pay down debt
- Raise investment in R&D, new products or services, and business innovations
- Invest in future-proofing competitive operations: advanced analytics, connectivity, automation
- Accelerate inorganic growth strategy

MAJOR CONSIDERATIONS FOR INSURERS DIFFER BY COMPANY PROFILE

		US Multinationals	US Domestic	Foreign Multinationals
Strategy	Competitiveness	Increased International/ Domestic Competitiveness	Increased Domestic Competiveness	Increased International Challenges
	Deals	Increased International Opportunities	Dependent upon strategy, cash flow, and other factors	Increased Competition from US-Based Insurers
	International Provision Changes	May affect strategy, operations, and financials	Not Applicable	May affect strategy, operations, and financials
Operations	Legal Restructuring	Legal Entity Analysis Required	Not Applicable	Legal Entity Analysis Required
	Product Offering/ Pricing	Product and Pricing Analysis Required		
	Human Capital/ Distribution	Increased Executive Compensation and Fringe Benefit Costs		
Finance/ Treasury	Cash Flow and Capital	Changes to cash flow; increased capital/liquidity pressure		
	Investment Management	Dependent upon current strategies and assets		
Reporting	Value of Tax Attributes	Dependent upon specific financial position		
	Financial Reporting	May require additional data capabilities and assessment of new reporting/ disclosure requirements		

POSITIVE THOUGHTS ON TAX REFORM HEARD IN THE INDUSTRY

While discussing the Q4 results, one CEO noted, "…tax reform is good for our economy, and [we] will benefit from both a lower corporate rate and additional insurance exposure growth as the economy continues to expand." The company gave a portion to its charitable foundation as well.

Another CEO said, "[i]t's a significant impact, it will allow, you know, companies to distribute even more money to their employees, following the tax reform, and it will allow the companies to invest more. So, the US will be even stronger because of that."

Many insurers have incurred a one-time negative impact from adjustments to DTAs, the toll charge, and other costs; however, they are optimistic that tax reform will present opportunities for the growth in the future

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	▸ 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 policyholder ▸ Others waiting to see if competitors change rates
Internal Investment	▸ Investment in technology or infrastructure to enhance operations ▸ Investment in people, including increased wages, benefits and training ▸ Charity and PR
Changing internal affiliated reinsurance	▸ Some setting up or electing a 953(d) 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

BEAT

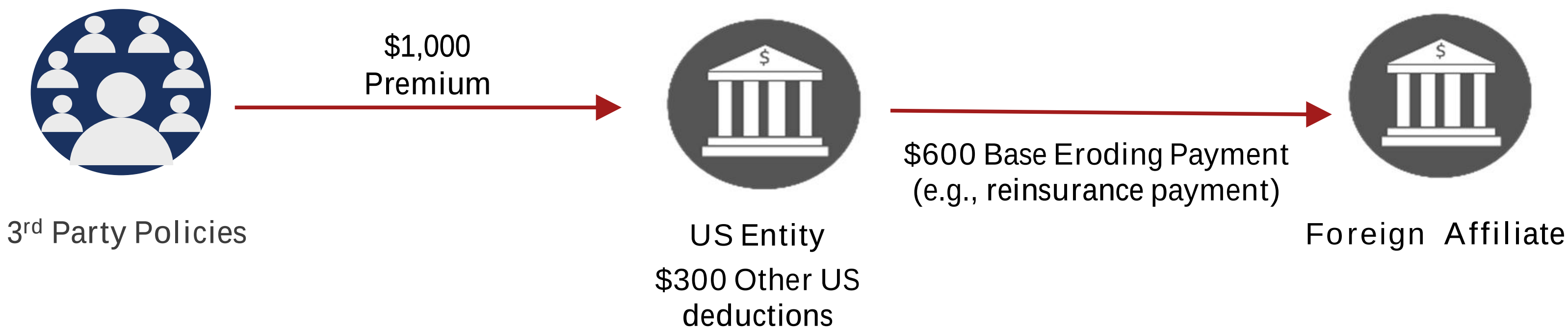
BASE EROSION AND ANTI-ABUSE TAX

IMPACT OF BEAT (BASE EROSION AND ANTI-ABUSE TAX)

- BEAT was intended to target multinational organizations that seek to reduce their US tax liability by making cross-border deductible payments to foreign affiliates/persons.
- What are companies doing?
  1. Determine if you are in scope for BEAT
  2. Determine if you have an obligation to pay BEAT
  3. Assess the overall impact of BEAT on your organization

USE CASE SCENARIO: BEAT TAX CALCULATION

US operating company affiliated reinsurance with Foreign Related Company Receiving BEP



Tax Liability (Before BEAT)	*BEAT Inputs*	*Tax Liability (After Beat)*
US Taxable Income = $100 $1,000 - 300 – 600 = $100 US Regular Tax = $21 $100 x 21% = $21	Base Erosion Payments: $600 Modified Taxable Income*: $700 $100 + $600 = $700	BEAT = $14 [5% × $700] - $21 = $14 Total US Tax Liability (including BEAT) = $35 $21 + $14 = $35

*Calculation does not include consideration for net operating loss impact to modified taxable income amount

REINSURANCE CONSIDERATIONS — STOP LOSS TREATIES

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)

REINSURANCE CONSIDERATIONS — ALTERNATIVE STOP LOSS LAYERS

	Cedent G/L with Stop Loss between				
Percentile	70.0% and 110.0%	85.0% and 115.0%	75.0% and 95.0%	90.0% and 115.0%	100.0% and 115.0%
10.0%	18,732	20,768	21,953	22,127	24,576
30.0%	9,782	11,819	13,003	13,178	15,627
50.0%	2,607	4,644	5,828	6,003	8,452
Expected	920	2,956	4,141	4,316	6,764
80.0%	(4,080)	(8,837)	(5,859)	(7,478)	(5,029)
90.0%	(4,080)	(16,990)	(5,859)	(15,631)	(13,182)
95.0%	(4,080)	(17,044)	(5,859)	(20,684)	(20,564)
98.0%	(5,487)	(17,044)	(12,266)	(20,684)	(28,236)
99.0%	(12,029)	(17,044)	(18,809)	(20,684)	(28,236)
99.5%	(18,387)	(17,044)	(25,166)	(20,684)	(28,236)
Net Premium	90,920	92,956	94,141	94,316	96,764
Net P:S Ratios	4.94	5.45	3.74	4.56	3.43
EV Layer	3,765	972	2,222	573	174
Expected G/L	4,685	3,929	6,363	4,889	6,938
BEAT Tax	393	272	-	31	-

REINSURANCE CONSIDERATIONS — STOP LOSS TREATIES CONSIDERATIONS

- Net premium ceded is a fraction of QS premium for similar capital protection
  - Results in lower margins to ceding company
  - Overall after tax margin with BEAT on Premiums of 10% much better with stop loss
- Profit commissions will lower expected margin to ceding company and provide no additional capital protection
- Aggregate Protection layer should be generally matched to the downside

1) Higher Layers are less costly
2) Wider Layers provide more capital protection but are more costly

OTHER IMPACTS

DISCOUNTING, NOL AND LIFE IMPACTS

LOSS RESERVE DISCOUNTING

- Extended duration of payment patterns up to 24 years from 15
  - Affects Workers' Compensation, Non Proportional Financial, Products Liability
- Repeal of Election to use company-specific data
- Raised rates from federal midterm rates (3 to 9 years) to High Quality Bond rates (Duration Unspecified)
- IRS has not published new factors but can be estimated
- Affects Deferred Tax Asset (DTA), Statutory admitted assets and possibly Risk Based Capital (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

NEW RULES AROUND NET OPERATING LOSSES

The following applies for losses arising in taxable years beginning after 12.31.17:

Entity Type	Current Year Taxable Income Offset	Carryback	Carryforward
General Corporation	Limited to 80% of income	NA	Indefinite
Life Insurance Corporation	Limited to 80% of income	NA	Indefinite
Non-Life Insurance Corporation	No Change	Up to 2 years	Up to 20 years

Considerations:

- Mixed Groups (e.g., P&C and General, Life/Non-Life, Other)
- Complexity combined with lack of clarity
- Tax Sharing Agreements
- Impact to Statutory Financial Statements

P&C COMPANIES — KEY CHANGES

- Reserves
  - Modification to existing tax loss reserve discounting rules.
  - A significantly higher discount rate will be used based on a 60-month corporate bond yield curve and will incorporate longer loss payment patterns.
  - Discount factors incorporating these changes have not yet been released.
- Proration
  - The proration adjustment to discounted unpaid losses, currently at 15% of tax-exempt interest and the dividends received deduction, would be increased to 25%.
  - This preserves the effective tax rate of the proration percentage as applied to tax-exempt interest post-tax reform.
- Changes to NOL provisions will not impact P&C companies but will impact the mixed groups of which P&C companies are members.

LIFE INSURANCE COMPANIES — KEY CHANGES

- Reserves
  - Tax deductible life insurance reserve for a contract (other than certain variable contracts) generally equals the greater of the net surrender value of the contract (if any), or 92.81% of the amount determined using the tax reserve method otherwise applicable to the contract
  - For variable contracts, the separate account reserves with regard to the contract would not be multiplied by the 92.81% factor. A statutory reserves cap would apply, as under prior tax law
  - 8-year spread of transition adjustment
- Deferred Acquisition Cost (DAC)
  - Acquisition costs with regard to life and annuity contracts continue to be capitalized and amortized based on a proxy percentage multiplied by net premiums received
  - Amortization period extended from 120 to 180 months and increases capitalization percentages by approximately 20%
  - Applies to premiums received in 2018 and after (no change to existing unamortized balances)
- Changes to NOL provisions
- Proration changed from company share and policyholder share, to fixed 70% and 30%, respectively
- Pre-1984 policyholder surplus account triggered with 8-year spread of related tax liability

GUIDANCE OUTLOOK

THE ROLE OF ACTUARIES

GUIDANCE EXPECTATIONS

- Notices
  - Treasury has issued three notices on the toll charge under Section 965 – Notices 2018-07, 2018-13, and 2018-26 – plus Revenue Procedure 2018-17
  - More notices are anticipated to be released on Section 965
  - Treasury also has issued Notice 2018-28 on new Section 163(j) interest deduction limitations
- Regulations
  - Proposed guidance on Sections 965 ‘toll charge,’ 168(k) bonus depreciation, 199A passthrough deduction, and 951A ‘GILTI’ issued in recent weeks
  - Additional proposed regulations are anticipated before end of 2018
  - Treasury’s goal is to complete final regulations by June 2019
- Technical Correction legislation
  - Not anticipated until late 2018, if at all
- JCT ‘Blue Book’ is anticipated in late 2018

OFFICIAL TIMELINE FOR SELECT GUIDANCE PROJECTS

Key provisions	Proposed guidance release dates*
Rules relating to Section 965 transition tax	August 1, 2018
Guidance under Section 168(k) bonus depreciation	August 3, 2018
Guidance under Section 199A (computational)	August 8, 2018
Global intangible low-taxed income (GILTI)	September 13, 2018
Foreign tax credit guidance under new tax law	*November 2018*
Section 250 regulations on deductions for foreign derived intangible income (FDII) and GILTI	*November 2018*
Rules regarding business interest limitation under Section 163(j)	*November 2018*
Regulations related to recent modifications of Sections 951(b) and 958(b)	*December 2018*
Anti-hybrid and BEAT regulations	*December 2018*
Guidance under Section 199A (anti-abuse)	*December 2018*
Guidance under Section 199A (definitions)	*December 2018*

Source: Treasury Department and OMB Office of Information and Regulatory Affairs   * Expected release dates in *italics*

CONCLUSIONS

THE ROLE OF ACTUARIES

AREAS WHERE ACTUARIES ARE ENGAGED AND ADDING VALUE

- Overall Impact of Tax Reform on Products and Pricing
- BEAT Planning
- Reserves
  - P&C
  - Life
- NOL Planning for Mixed Groups