

Tax Issues for P&C Actuaries

CAS Spring Meeting
Colorado Springs, CO
May 19, 2015

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AAIS

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Outline

§ IRS Recent Audit History

§ Why the Insurance Industry?

- Income
- Loss Reserve Releases

§ Typical Characteristics of Audited Companies

§ “Isn’t This Just a Timing Issue?”

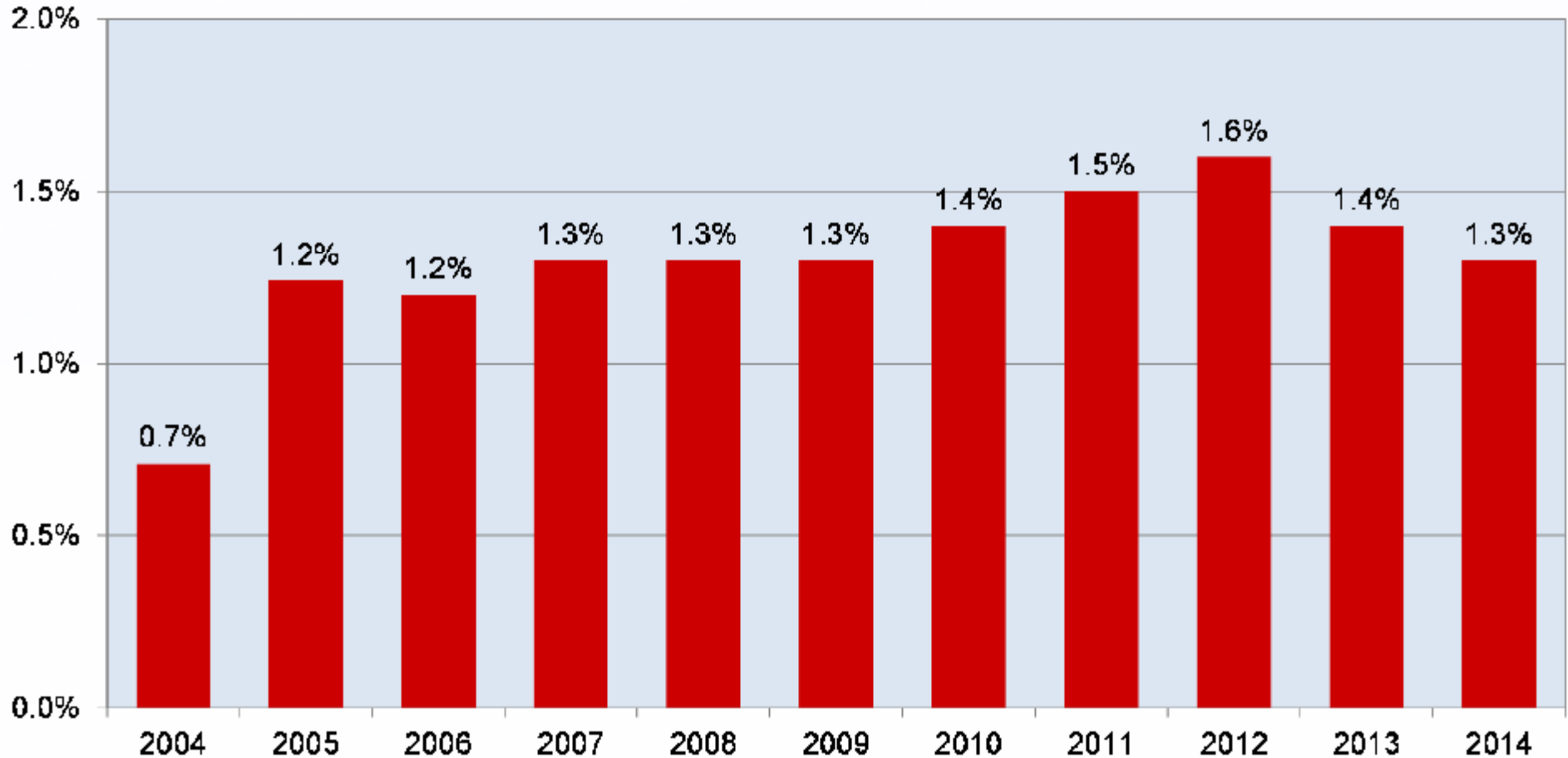
§ Other Considerations

Audit Rates and Macroeconomic Context

IRS RECENT AUDIT HISTORY

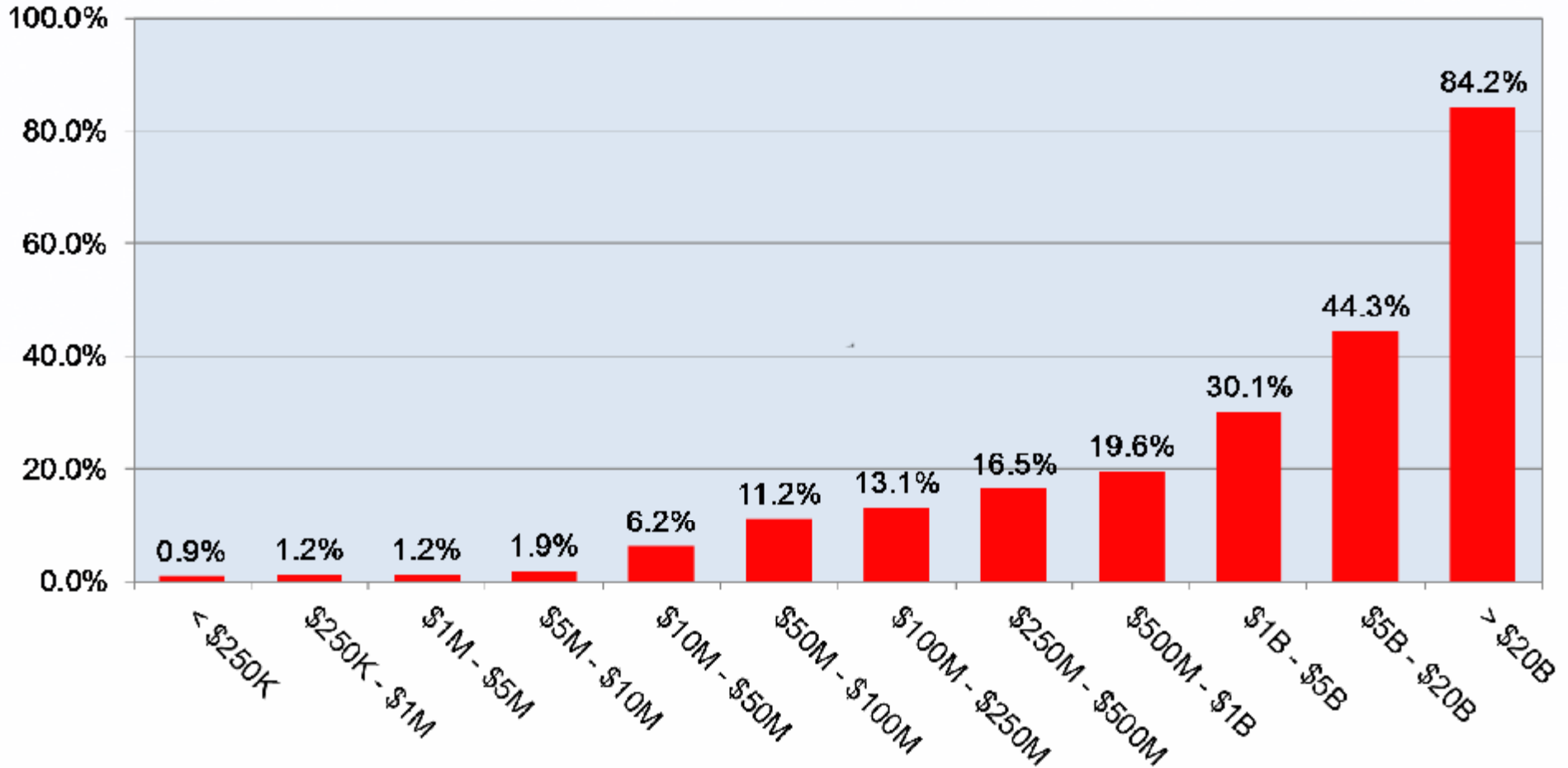
IRS Returns – Audit Rates by Fiscal Year

Corporate Income Tax Returns Only



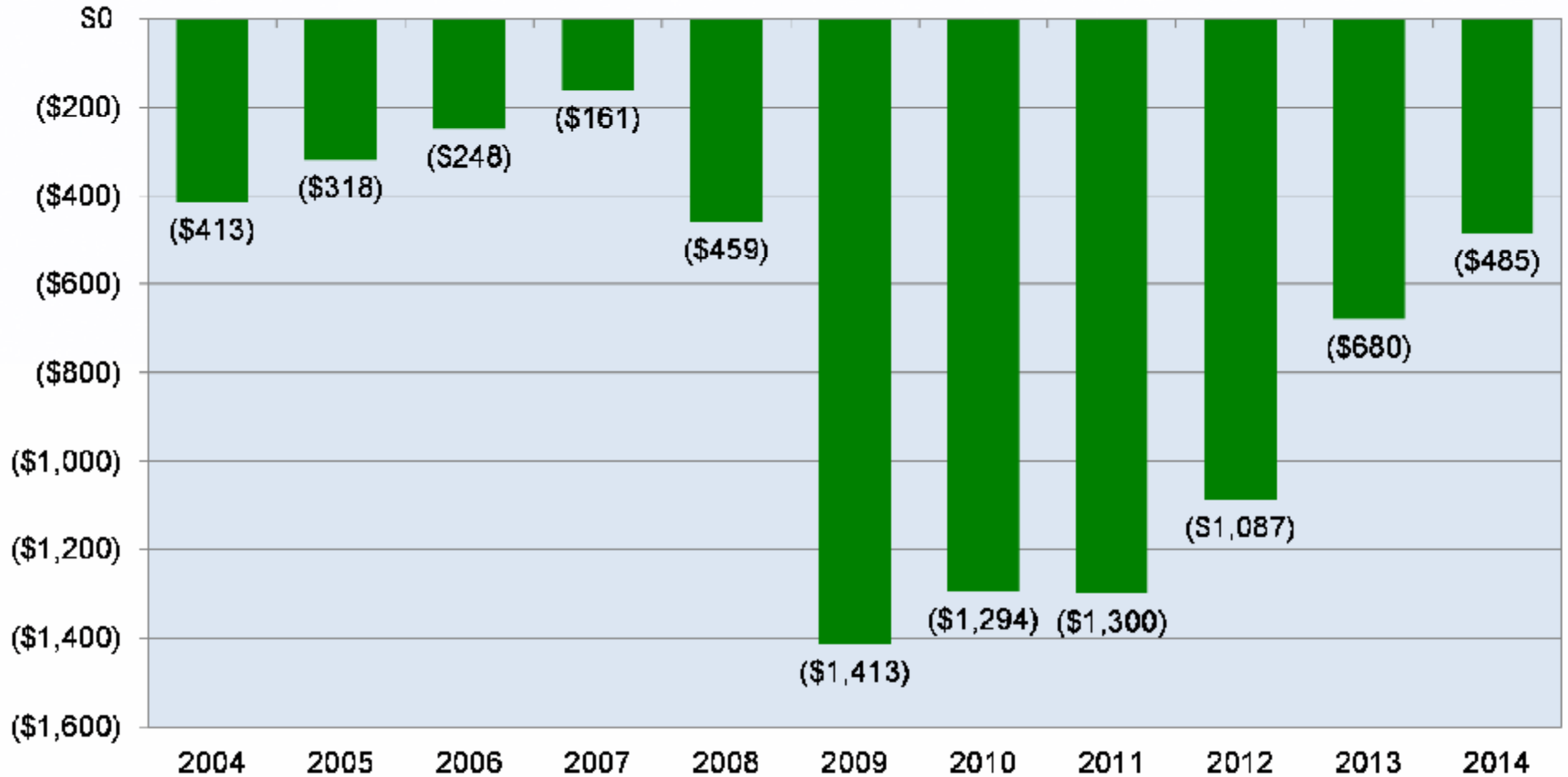
Source: IRS Data Books, successive years.

IRS Returns – 2013 Audit Rates by Size Of Total Assets Corporate Income Tax Returns Only



Source: 2014 IRS Data Book

Federal Deficit (In Billions)



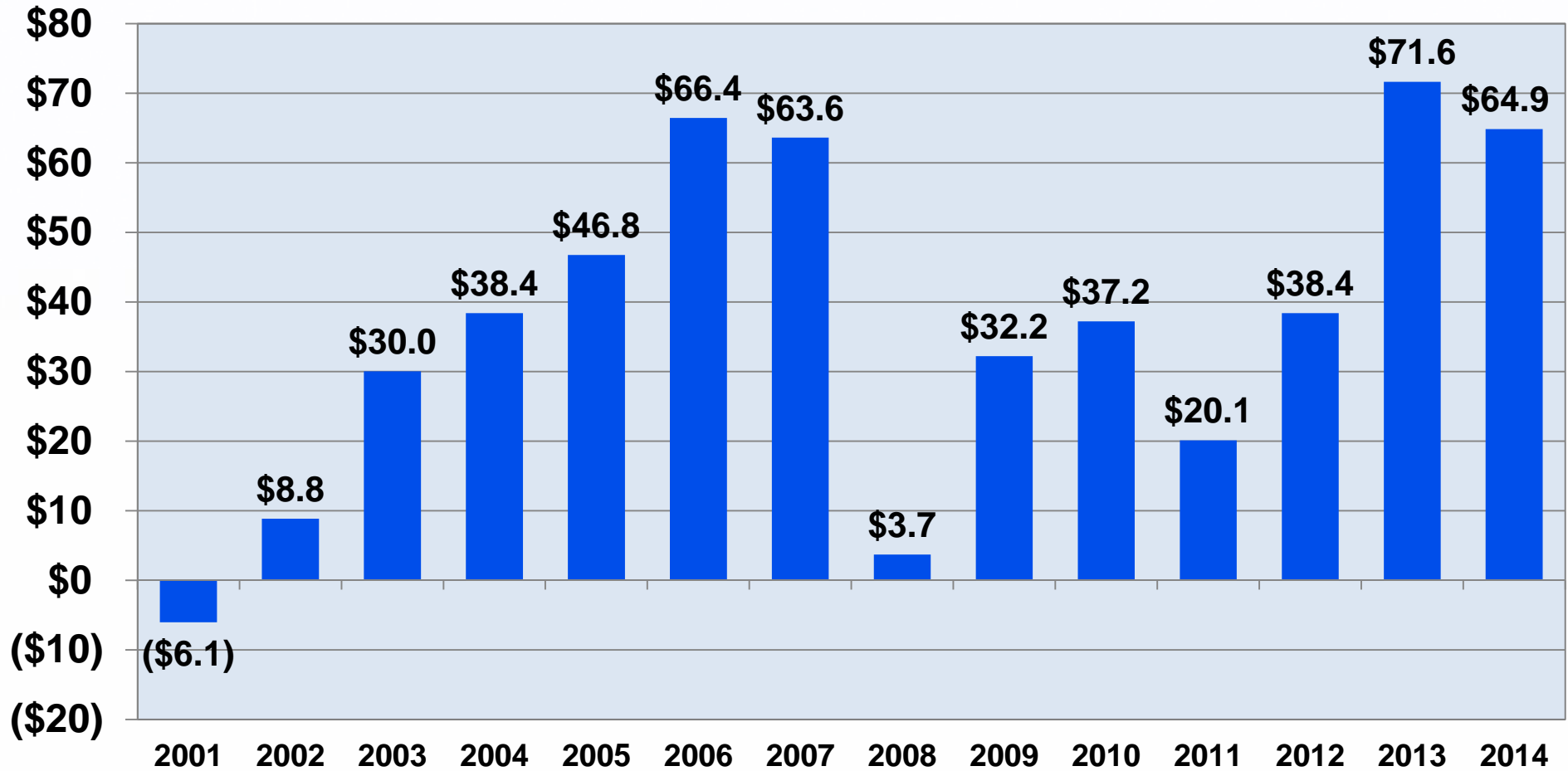
Source: Congressional Budget Office

A Discussion of Reserve Development

WHY THE INSURANCE INDUSTRY?

Industry Net Income

Net Loss & ALAE (In Billions), by Calendar Year



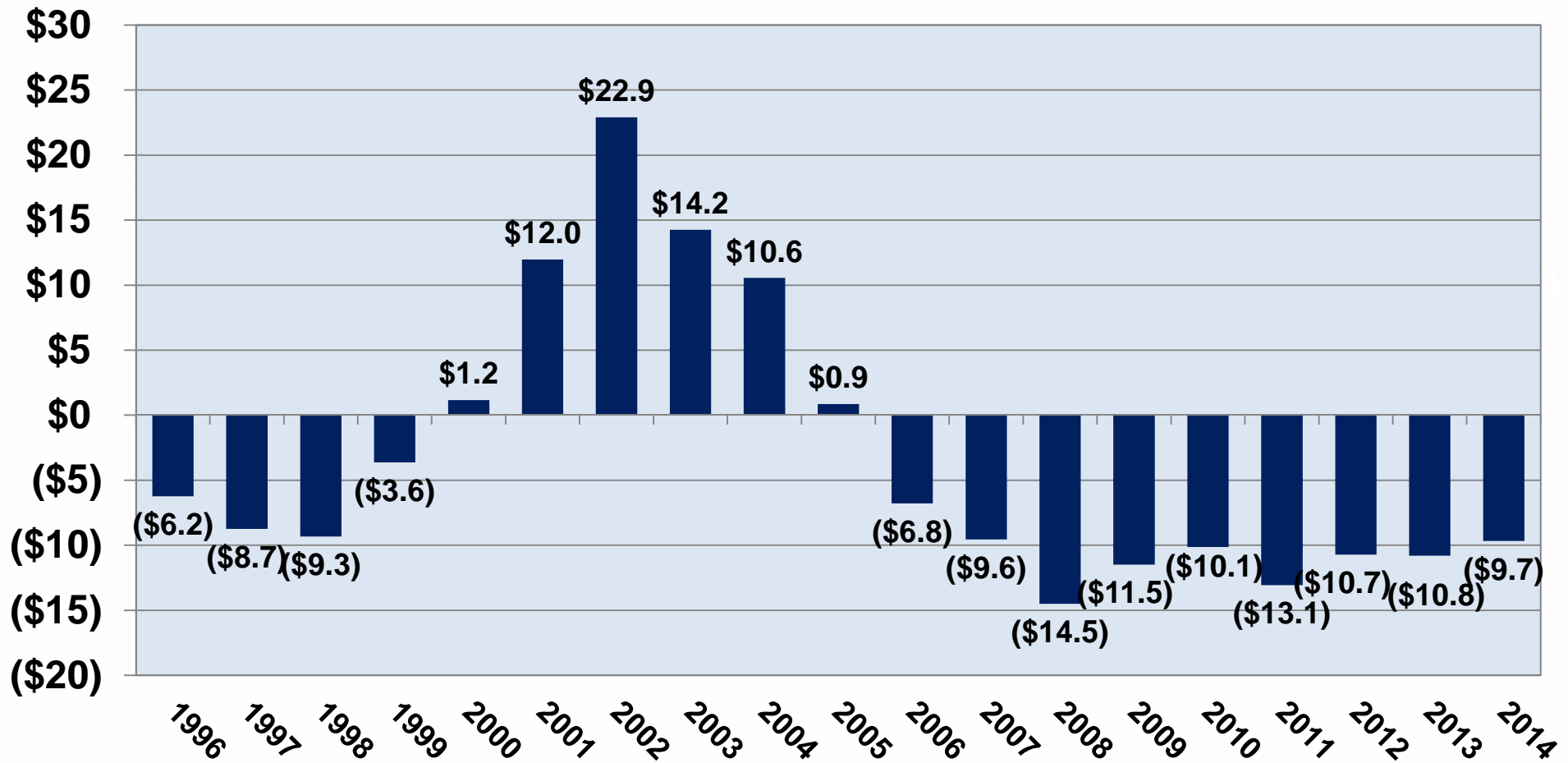
Source: Milliman analysis of Property & Casualty Statutory Annual Statements



Industry Reserve Development

Excluding Mortgage & Financial Guaranty

Net Loss & ALAE (In Billions), by Calendar Year



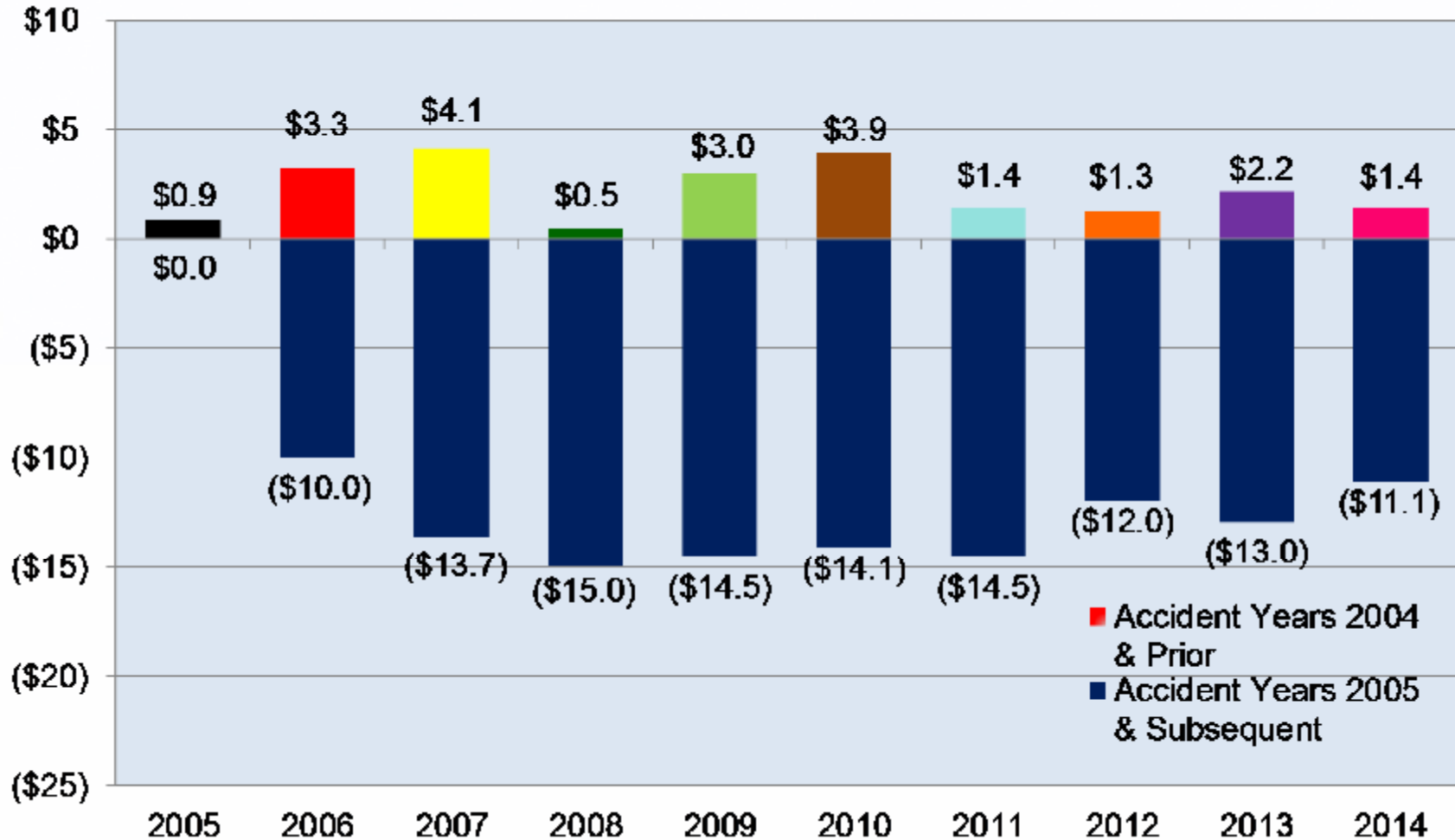
Source: Milliman analysis of Property & Casualty Statutory Annual Statements
Excludes Mortgage & Financial Guaranty



Industry Reserve Development

Net Loss & ALAE (In Billions), by Calendar Year

Split Between “Prior” and “Recent” Accident Years



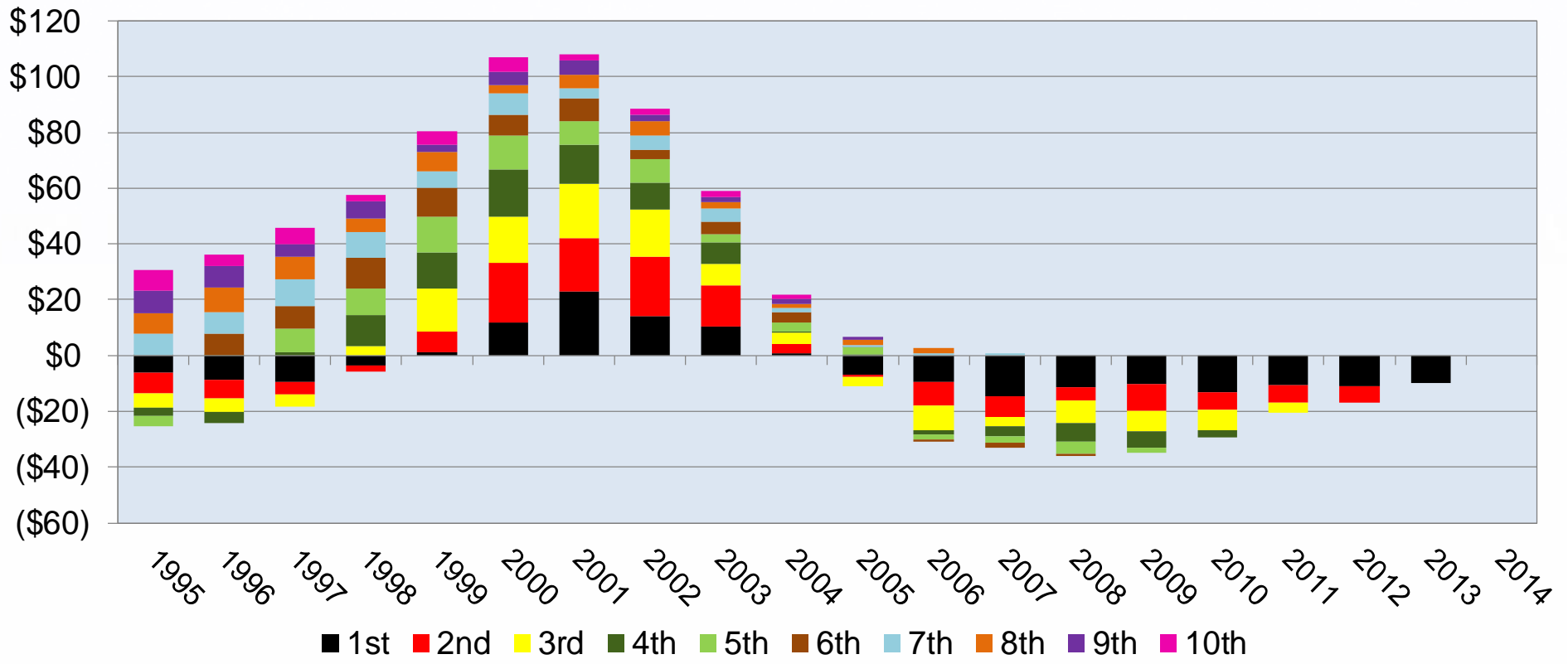
Source: Milliman analysis of Property & Casualty Statutory Annual Statements
Excludes Mortgage & Financial Guaranty



Statement Year Development

By Calendar Period, as of December 31, 2014

Net Loss & ALAE (In Billions)



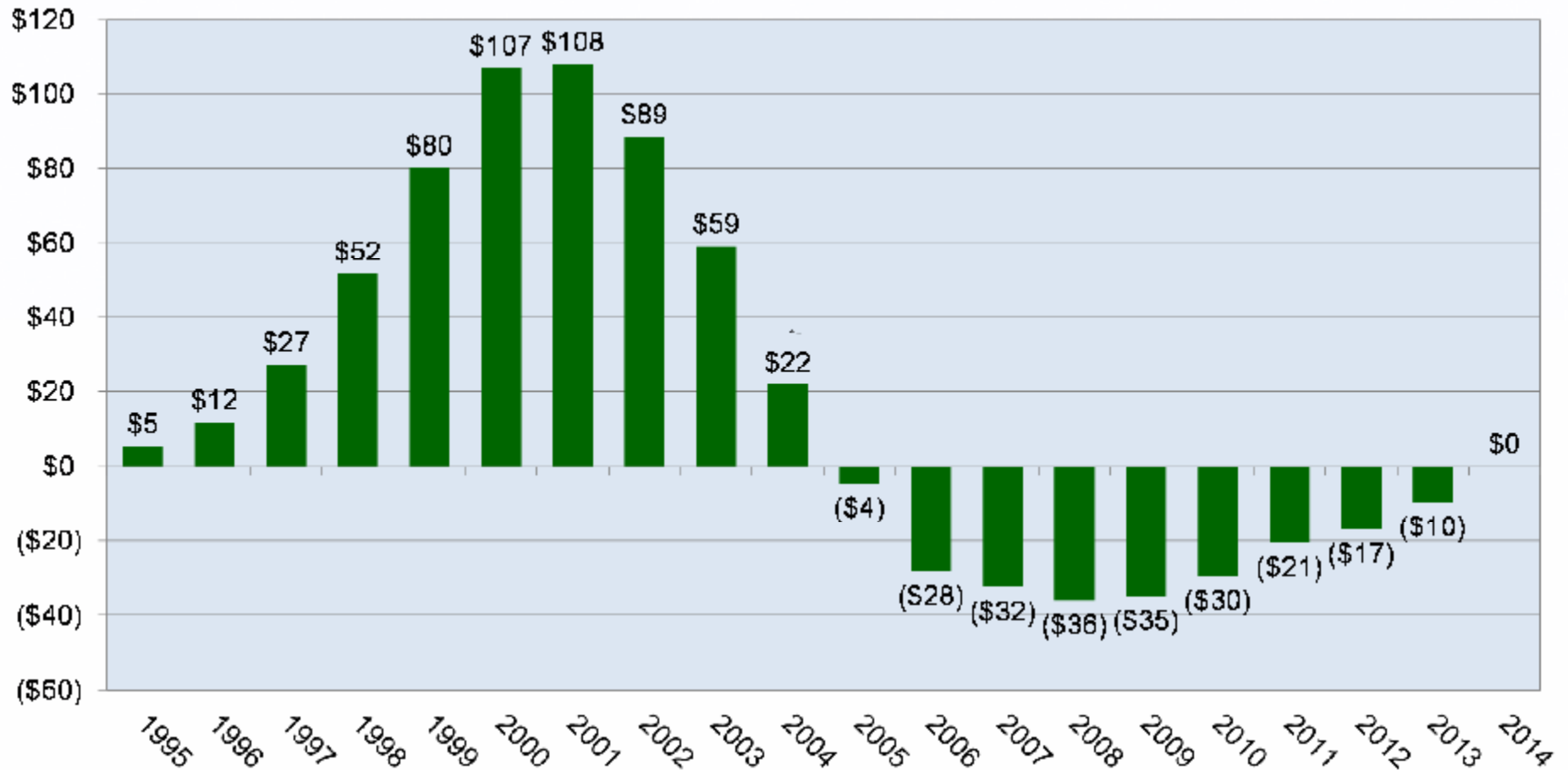
Source: Milliman analysis of Property & Casualty Statutory Annual Statements
Excludes Mortgage & Financial Guaranty



Development by Statement Year

Net Loss & ALAE (In Billions)

As of December 31, 2014



Source: Milliman analysis of Property & Casualty Statutory Annual Statements
Excludes Mortgage & Financial Guaranty



Property & Casualty Industry – Audited Companies

TYPICAL CHARACTERISTICS

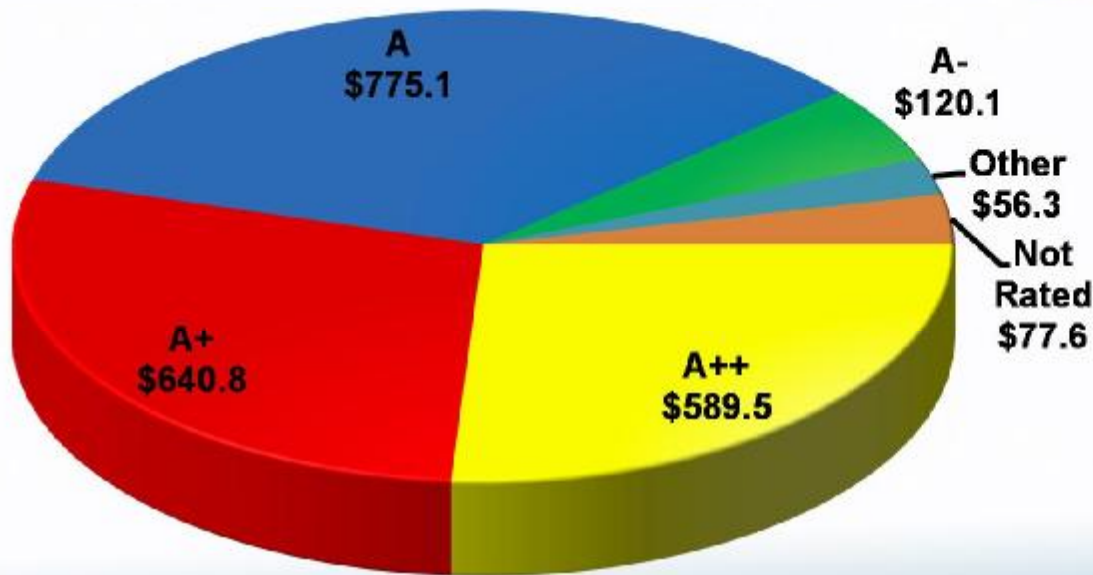
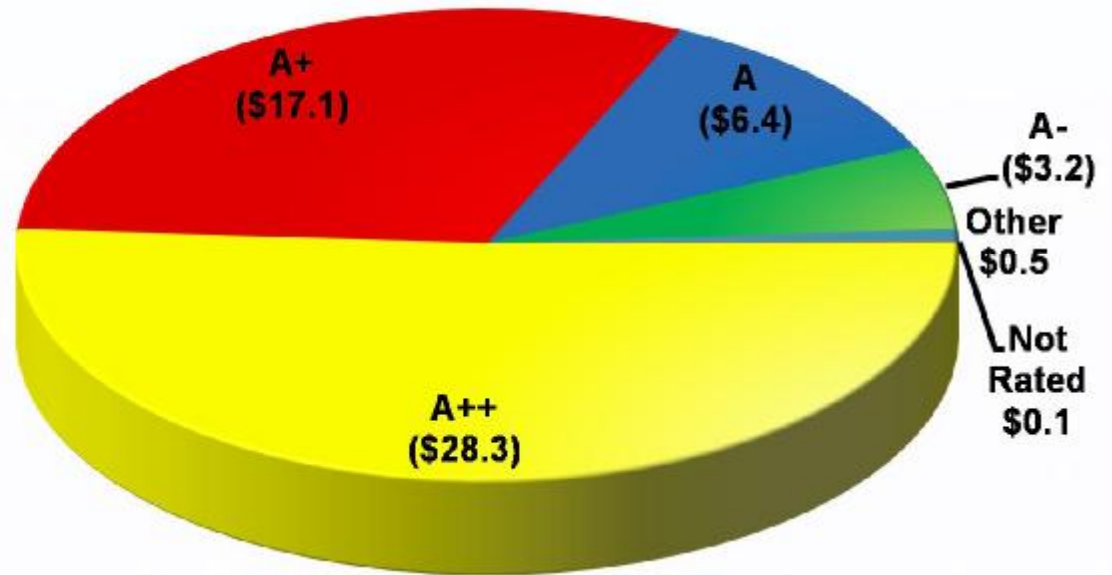
Typical Characteristics

- § Well run, financially sound
 - “A” rated or better
- § Often mutual insurers
- § Size threshold
 - \$100 million+ net earned premium
- § Both multi-line and mono-line writers

Financial Strength

2010 – 2014

(Net, In Billions)

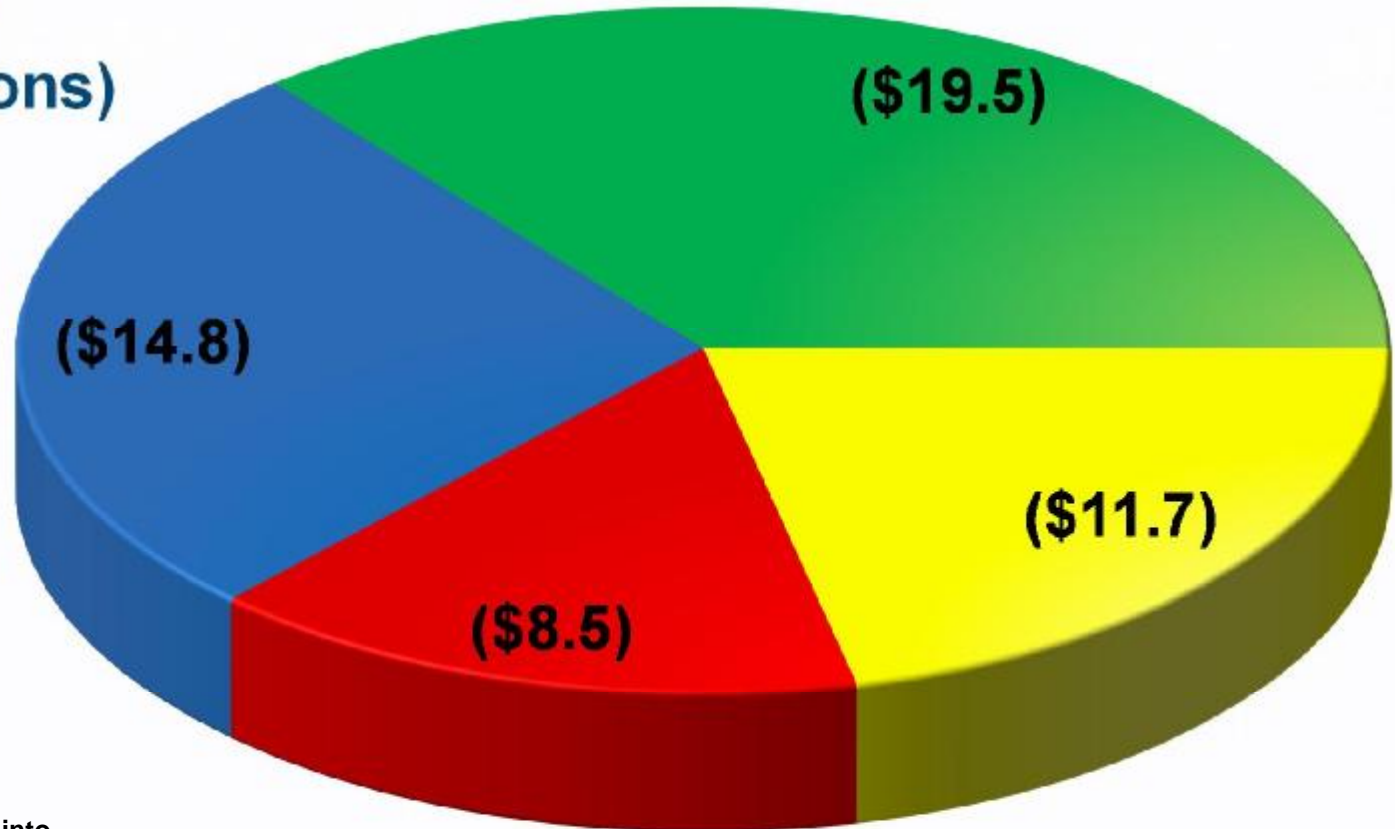


Source: Milliman analysis of Property & Casualty Statutory Annual Statements
Excludes Mortgage & Financial Guaranty

Reserve Development by Company Size

2010 – 2014

(Net, In Billions)



Companies are separated into quartiles based on earned premium

i.e. The “Largest” quartile is comprised of 7 companies that amount to 25% of total industry earned premium

■ Largest

■ 2nd Largest

■ 3rd Largest

■ Smallest

Source: Milliman analysis of Property & Casualty Statutory Annual Statements
Excludes Mortgage & Financial Guaranty



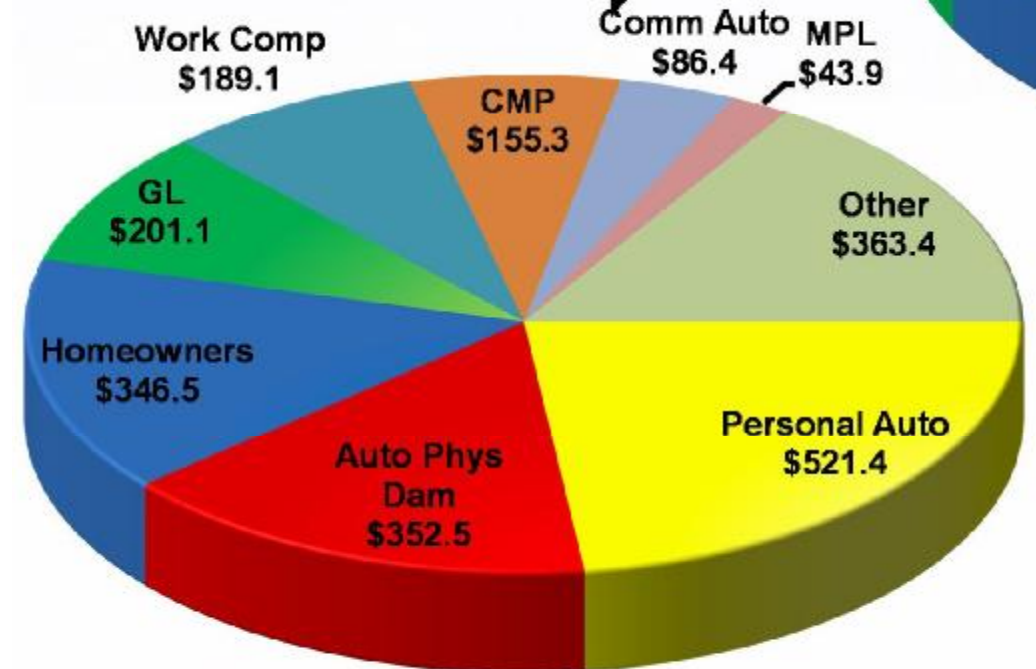
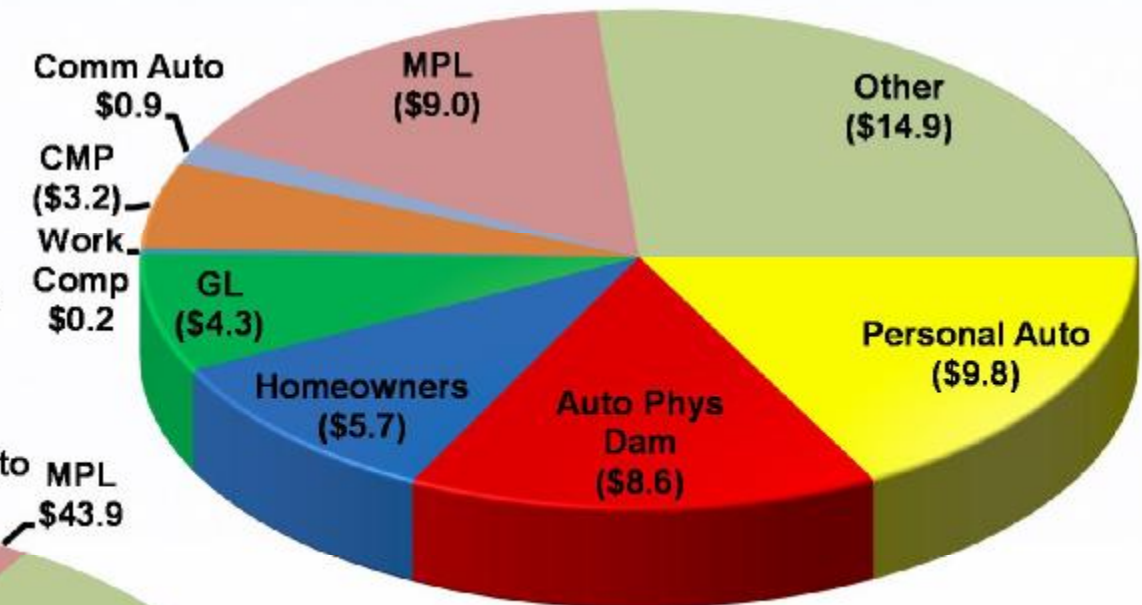
Line of Business

2010 – 2014

(Net, In Billions)



**Reserve
Development**



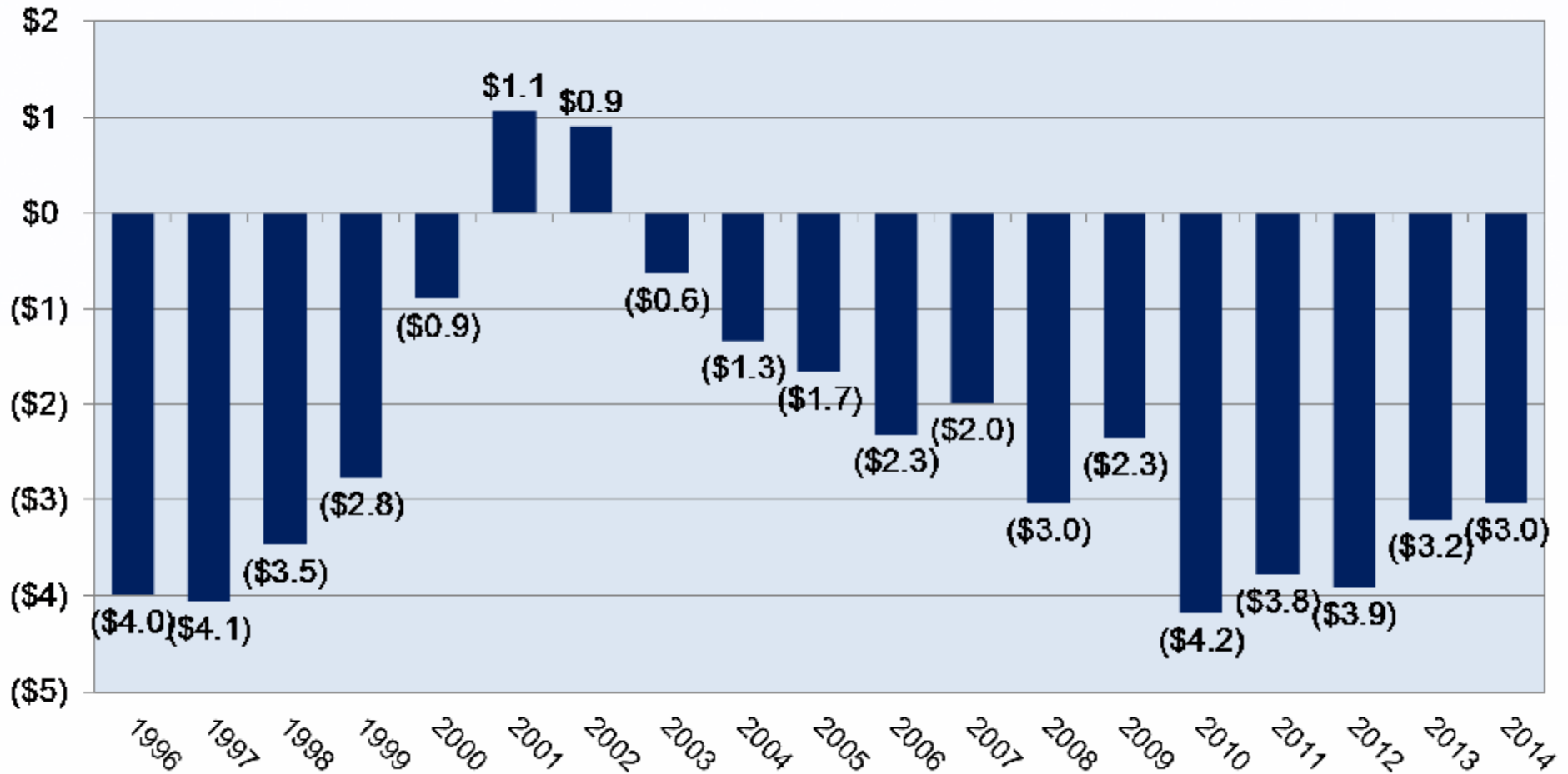
**Earned
Premium**

Source: Milliman analysis of Property & Casualty Statutory Annual Statements
Excludes Mortgage & Financial Guaranty

Mutual Companies Only

Calendar Year Reserve Development

Net Loss and ALAE, In Billions



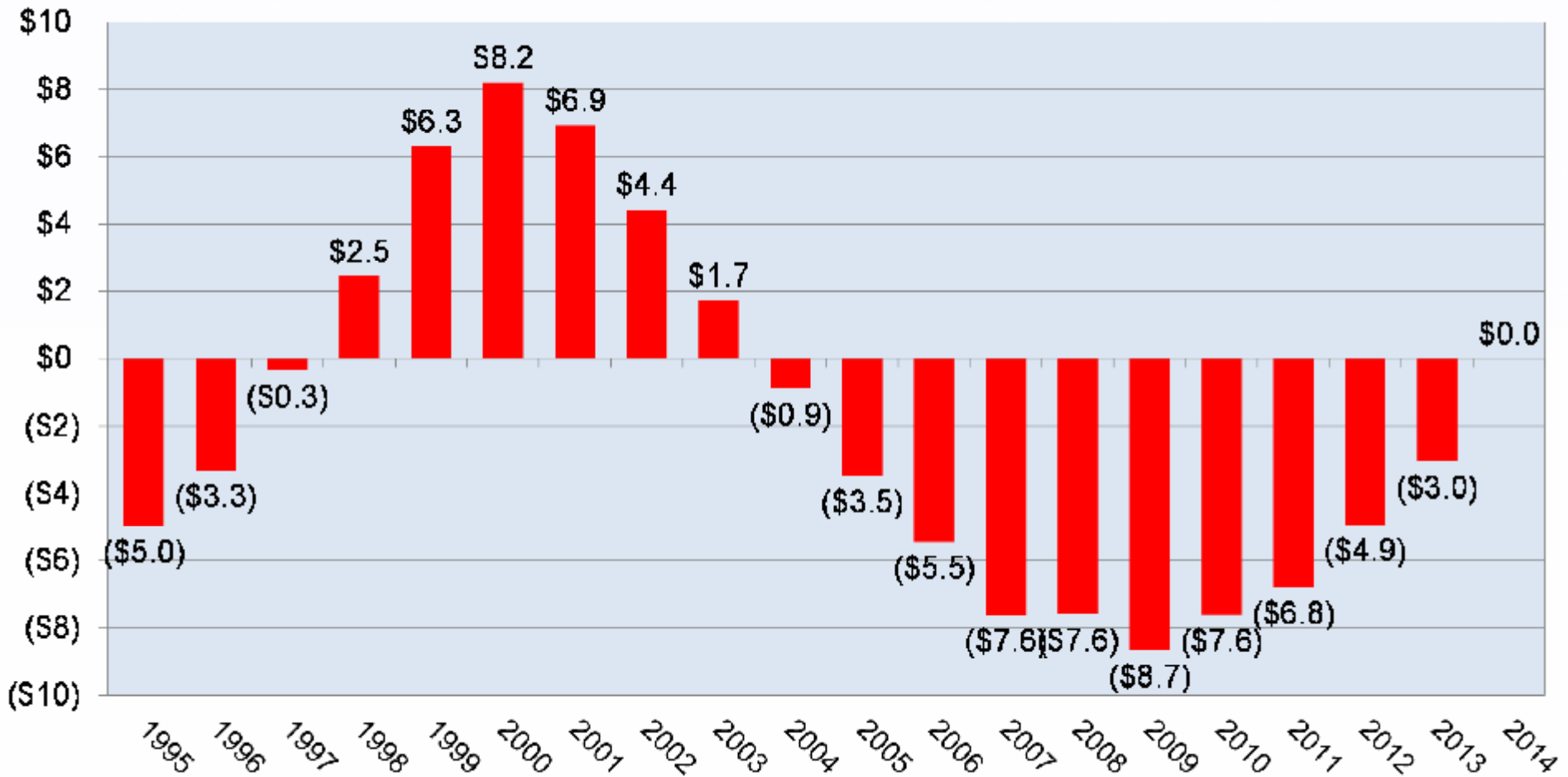
Source: Milliman analysis of Property & Casualty Statutory Annual Statements
Excludes Mortgage & Financial Guaranty



Mutual Companies Only

Statement Year Reserve Development

Net Loss and ALAE, In Billions, as of December 31, 2014



Source: Milliman analysis of Property & Casualty Statutory Annual Statements
Excludes Mortgage & Financial Guaranty



**“ISN’T THIS JUST A TIMING
ISSUE?”**

“Isn’t this Just a Timing Issue?”

In Some Ways, Yes

§ Eventually, reserves develop to ultimate

- Over the long term, income will be recognized

§ Settlements with IRS affect subsequent tax years

- Example: settlement of 2011 will affect 2012 tax
 - 2011 income increases, 2012 income decreases
- However...
 - Requires claiming a refund
 - Can continue to audit subsequent years
 - IRS unlikely to settle subsequent years immediately

“Isn’t this Just a Timing Issue?”

In Other Ways, No

§ Audits consume companies’ time and expense

§ High interest rate on deficiencies

- Currently 5% for “large corporate underpayments”
- Has been as high as 10% for 2006 tax year

§ IRS wasn’t actively auditing reserves in prior years

- Can’t collect interest on prior year “overpayments”
- Even if you could...
 - Interest rate on overpayments 4.5% less
 - So currently 0.5%
- And reserve audits will likely slow again

SUMMARY OBSERVATIONS

Summary Observations

§ P&C Industry Likely Not Over-Reserved

- In hindsight, 1995 – 2004 statement years under-reserved
- 2005 & subsequent statement years
 - Have run off favorably to date
 - But will likely develop adversely due to tail liabilities

§ Typical Characteristics of Audited Companies

- Medium size
- Mutual structure
- Financially sound

§ Not Simply a Timing Issue

- High interest rate on underpayments
- Reserves audited selectively

OTHER CONSIDERATIONS

Other Considerations

§ Accompanying Oral Discussion

- This document is not complete without the accompanying oral discussion and explanation of the underlying information and concepts as well as any interpretational limitations.

§ Limited Distribution

- This document should not be distributed, disclosed or otherwise furnished, in whole or in part, without the express written consent of Milliman.

§ Data Reliance

- We have relied upon data and other background information provided by the Internal Revenue Service, Congressional Budget Office, and SNL Financial without audit or independent verification. We have performed a limited review of the data for reasonableness and consistency and have not found material defects in the data. If there are material defects in the data, it is possible that they would be uncovered by a detailed, systematic review and comparison of the data to search for data values that are questionable or relationships that are materially inconsistent. Such a review was beyond the scope of our assignment.