NATIONAL COUNCIL OF INSURANCE LEGISLATORS
STATE-FEDERAL RELATIONS COMMITTEE AND INTERNATIONAL INSURANCE ISSUES COMMITTEE
ATLANTA, GEORGIA
MARCH 2, 2018
DRAFT MINUTES

The National Council of Insurance Legislators (NCOIL) State-Federal Relations Committee and International Insurance Issues Committee met at The Whitley Hotel in Atlanta, Georgia on Friday, March 2, 2018 at 11:45 a.m.

Senator Jerry Klein of North Dakota, Chair of the International Insurance Issues Committee, presided.

Other members of the Committees present were:

Rep. Sam Kito, AK
Asm. Ken Cooley, CA
Rep. Park Cannon, GA
Rep. Richard Smith, GA
Rep. Matt Lehman, IN
Rep. Steve Riggs, KY
Rep. George Keiser, ND
Sen. Neil Breslin, NY
Asm. Andrew Garbarino, NY
Sen. James Seward, NY
Rep. Glen Mulready, OK
Sen. Bob Hackett, OH
Rep. Tom Oliverson, TX

Other legislators present were:

Rep. Charisse Millett, AK
Rep. Deborah Ferguson, AR
Rep. Paul Mosley, AZ
Rep. Bryon Short, DE
Rep. Darlene Taylor, GA
Sen. Thomas Middleton, MD
Rep. Justin Hill, MO
Sen. Paul Wieland, MO
Sen. Ed Buttrey, MT

Also in attendance were:

Commissioner Tom Considine, NCOL CEO
Paul Penna, Executive Director, NCOIL Support Services, LLC
Will Melofchik, Legislative Director, NCOIL Support Services, LLC

MINUTES

Upon a motion made and seconded, the Committee unanimously approved the minutes of its November 17, 2017 meeting in Phoenix, Arizona.

DISCUSSION ON THE IMPACT OF FEDERAL TAX REFORM ON THE INSURANCE INDUSTRY

Bridget Hagan of The Cypress Group began by stating that there was a lot of background work that led up to federal tax reform but the actual drafting of the legislation occurred quickly, and noted that federal tax reform is always a zero sum game – you need to pay for tax benefits that will benefit some at the expense of others. Federal tax reform created $5.24 trillion in tax cuts over 10 years. To off-set that, taxes were raised on others for a total of $3.77 trillion over 10

years, which means the total cost of the tax reform bill was $1.47 trillion over 10 years. Those numbers are important because, in the context of the bill's treatment of the insurance industry, Congress searched thoroughly for industries that could be the target for some of the off-sets.

Ms. Hagan continued that much of the animus behind the bill centered on corporate and international tax reform since the bill moved the U.S. from a worldwide classification to a territorial classification. The corporate tax rate was lowered from 35% to 21%, and the corporate alternative minimum tax (AMT) was repealed. Ms. Hagan stated she thinks the insurance industry was particularly targeted in the bill – not because of any concern over policy – but because of the need for sources of revenue under the bill, and due to a general lack of understanding of how insurance works and how it is regulated. In the life insurance industry there has been a longtime concern about the preservation of the tax treatment of certain products. Making sure retirement products are taxed in a way that underpins the social benefit they provide has always been important.

Ms. Hagan stated that the insurance tax increases in general totaled about $40 billion. The only other part of the economy that was targeted nearly as much was colleges. The life insurance industry was targeted to raise about $23 billion in revenue, and there is a lot of concern that there was not proper understanding of the current insurance industry in general which sets a troublesome precedent for when Congress is in need of revenue in the future.

Ms. Hagan then discussed some life-insurance specific provisions in the bill, the first being the computation of life insurance reserves which raised about $15.2 billion over 10 years. The provision limits the tax-deductible reserves of life insurance companies to about 92.81% of actuarial reserves – that specific percentage was not arrived at due to any policy consideration but rather due to a targeted amount of revenue needed. Another provision is the change in treatment of deferred acquisition costs which raised about $7.2 billion over 10 years. Lastly, there was a modification to the dividends-received deduction in that the bill changed the proration rules for life insurance companies and limits that deduction to 70% - that raised about $1.6 billion over 10 years. There was also a change in the treatment of net-operating losses for only life insurance companies. Ms. Hagan stated that as a general matter, it was very positive to lower the corporate tax rate, but the life insurance industry nonetheless felt targeted.

With regard to the P&C industry, Ms. Hagan stated that besides some minor negative changes, the industry was treated positively, particularly since it has no change in its net operating loss structure. Ms. Hagan then stated that insurance companies so far have either had an immediate tax benefit or "hit" because of the bill's treatment of deferred tax assets, but that is mainly due to a quirk in the tax-transition. It is too soon to tell what the impacts of the tax reform will be but there certainly has been positive news of companies providing bonuses and increasing minimum wage. Ms. Hagan noted that such positive news in no way correlates to the accusation that some companies have received a "windfall" under the bill. Ms. Hagan closed by stating that any tax reform that benefits "c" corporations in America will benefit insurers which is appropriate, and the long-term challenge is making sure Congress properly understands the state-based system of insurance regulation and taxation.

Julie Gackenbach of Confrere Strategies began by discussing what is not in the tax reform, the first being a formal title, although it is commonly referred to in the press as The Tax Cut and Job Reform Act of 2017. The most immediate impact of the decreased corporate tax rate is that corporations either have deferred tax assets or liabilities. Many insurers have a significant book of deferred tax assets in the form of credits such as un-used AMT credits. Under guidance that was issued by the SEC applicable to publicly traded companies, companies needed to book

those changes by the end of 2017 to the extent they knew the changes and then going forward there is some flexibility. That does have an impact on capital for many insurers because that was considered capital on their books. That is an issue that the NAIC will address under risk-based capital requirements at its next meeting.

With regard to the repeal of the AMT tax, continued Ms. Gackenbach, many companies will carry off their AMT credits over the next few years which will significantly reduce and in some cases, eliminate the taxable liability for companies going forward because for the first two years you can offset up to 50% at which point they will become refunds. Another important aspect to note is how companies book their assets and capital because the U.S. budget sequester rules apply to tax refunds so much like federal government spending is subject to across the board sequester, so are corporate refunds. Last year the sequester amount was 6.6%. As part of the budget agreement, the PAYGO scorecard was reset to zero which should help eliminate some of that detrimental impact but over the next several years as the AMT credits are run-off, if Congress does not have budget discipline and that sequester comes back in, companies will be losing a percentage of that carry-back and would need to consider that as they book that in their financial statements.

Ms. Gackenbach stated that with regard to the net operating loss (NOL) limitation, Congress had always allowed corporations the ability to carry their net operating losses back two years and forward for 20 years, except for life insurance corporations which have different rules. In an attempt to move towards a more cash flow type method, Congress has decided to completely eliminate that ability for all corporate taxpayers to carry back net operating losses. The provision is effective for losses that occur after December 31, 2017, so on a going forward basis, with the NOL's that are sitting out there, Congress must address both old and new NOLs. However, the ability to carry-back was preserved for P&C insurers so in the case of consolidated groups that have both P&C and non-insurance entities, it gets more complicated, but it was undoubtedly a "win" for P&C insurers to preserve that ability. Ms. Gackenbach further stated that the bill also changed the tax treatment for people that have pass-through entities to allow for the deduction of up to 20% of qualified business income except for certain specified service providers.

With regard to the impact of the bill on the health insurance industry, Ms. Gackenbach stated that in order to comply with the budget reconciliation rules, repeal of the individual mandate would not have been possible since that would have been a policy-based change and not revenue related. Accordingly, the individual mandate is not eliminated but the penalty for non-compliance has been set to zero. Several States are now asserting that the ACA is rendered unconstitutional without any exercise of Congress' taxing power. Also, for years beginning after December 31, 2016, and ending before January 1, 2019, the bill reduces the medical expense deduction floor to 7.5% of adjusted gross income (from 10%) and eliminates the minimum tax preference.

Ms. Gackenbach then discussed the bill's impact on the life insurance industry and agreed with Ms. Hagan's statement that the industry was targeted for a significant amount of money. Congressional staff assert that while the industry was targeted, it ended up being nowhere near the amount initially proposed in Congressman David Camp's initial draft. The biggest change is the modification to rules for computing life insurance reserves. Ms. Gackenbach stated that many Congressional staff members thought they were being helpful by simplifying the calculation, but the Joint Committee on Taxation unfortunately does not have a good track record of revenue-estimating in the insurance industry, and their estimates greatly conflicted with the industries calculations. The bill also repeals the small life insurance company

deduction that allowed life insurance companies with assets below $500 million to deduct 60% of their first $3 million in income. The most significant change in terms of creating new policy is in the area of life settlement reporting. Congress has been very concerned about the proliferation of sales of life insurance products and has written in a new set of reporting mechanisms that will impose obligations on the purchaser of a life insurance product. The purchaser must report certain information to the IRS, to the insurance company that issued the contract, and to the seller. The requirements do not apply to transactions between what Congress views as a legitimate bona-fide relationship, only to unrelated third-party transactions. These changes were negotiated and not opposed by the life insurance settlement industry.

With regard to the P&C industry, Ms. Gackenbach stated that the bill amends IRC § 846, which provides rules for determining discounted unpaid losses, by extending the discount period and increasing the discount interested rate. The bill replaces the applicable federal rate (AFR) with a rate determined on the basis of the corporate bond yield curve that reflects the average, for the preceding 60-month period, of monthly yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available. Congress wanted to make that change because it felt that the AFR was a completely risk-free rate that did not affect company portfolios. Ms. Gackenbach also noted that the IRS is looking into the possibility of having split rates when looking at long term lines vs. short term lines. The bill also replaced the fixed 15% proration percentage with a formula that is tied to the highest corporate rate – 5.25% divided by the highest corporate tax rate. As a result, the applicable percentage reduction for tax years after December 31, 2017 is 25%. There had been proposals to increase that rate, but it was met with opposition from both industry and state and local governments who issued bonds because they did not want to disrupt that market because the P&C market is one of the most stable markets they have.

Lastly, Ms. Gackenbach stated that the bill established a new base erosion and anti-abuse minimum tax (BEAT) which is designed to restrict the ability of multi-national companies to erode the U.S. tax base through deductible related-party payments. Notably, premium or other consideration for reinsurance payments are specifically included in the definition of a base erosion payment so it will have a significant impact on how people cede with affiliated reinsurance. Also, unlike the AMT, the BEAT is not creditable, and as such does not reduce future regular income tax liabilities. For companies that have internationally affiliated transactions, this will be an interesting dynamic.

Frank O'Brien of the Property Casualty Insurance Association of America (PCI) stated that not long after the bill was passed, the Consumer Federation of America (CFA) sent a letter calling upon Insurance Commissioners across the country to take immediate action to prevent a windfall to the insurance industry for the reduction in the corporate tax rate. Many regulators, most notably the California Insurance Commissioner David Jones, took note of the letter and examined the implications of the corporate tax rate reduction and whether insurers should reduce their rates. Mr. O'Brien stated that the impact of tax reform on individual companies will depend on the structure of that particular company, the marketplace in which it operates, and the type of products that it provides. Various Insurance Commissioners have communicated to the industry as a whole in their States that they expect the industry to look at their expense structures when determining their rates. Mr. O'Brien closed by stating that we are still in the implementation period of tax reform and the industry will soon see the intended and unintended consequences of said reform.

DISCUSSION ON THE STATUS OF THE NFIP AND STATE FLOOD INSURANCE MARKETS

David Maurstad, Assistant Administrator for Federal Insurance at the Federal Emergency Management Association (FEMA) stated that his responsibilities include handling the business operations of the National Flood Insurance Program (NFIP). 2016 and 2017 were demanding years for the NFIP. In 2016, the NFIP received more than 84,000 claims and paid out $4.3 billion to insured survivors. Last fall there were three consecutive category 5 hurricanes across the southeast and Caribbean, in addition to the wildfires in California which were followed by severe flooding and mudslides. The magnitude, frequency, and geographic dispersion of the 2017 events provided a rare stress-test to the NFIP and the changes implemented over the past several years. In all areas across the South, FEMA issued financial assistance to hurricane survivors in record sums and in record amounts of time. The NFIP received nearly 125,000 claims, amounting to more than $9.1 billion in total claims paid from just Hurricanes Harvey, Maria, and Irma. The past two years of severe weather events have made it clearer than ever before how important flood insurance is for survivors. Reaffirmed are the notions that coverage matters and resilience matters. Part of a community's resilience, and part of a person's resilience, is taking actions necessary to reduce your risk, and for risks you can't reduce, you insure those. The NFIP is an important piece of that resilience puzzle – it helps identify flood risk; helps communities and individuals do what's possible to reduce their flood risk; and helps property owners insure their flood risk which can't be reduced. The NFIP is an important part of community and individual flood resilience. Residential flood insurance, the bulk of which is provided by the NFIP, is the best protection against major destroyers of homes.

Mr. Maurstad stated that 2018 marks the 50th anniversary of the NFIP and it has built a proud legacy. It has built a program that has a presence in 22,300 communities where they have chosen to protect themselves from floods by managing their flood plains. While most FEMA programs only arrive after a disaster is declared, through the NFIP's flood-plain management assistance and regulations to local governments, the NFIP impacts one its 22,300 communities every day by lowering the built-in environment's exposure to floods, saving the nation $1.6 billion per year in avoided losses. In many NFIP communities, their flood-plain management ordinance guiding building placement and construction is the only building requirement a community has. More than 1,500 communities have taken a more assertive approach to keep their neighbors safe by joining the NFIP's community rating system which provides them discounts for their flood insurance policies because their community achieved higher than the minimum standards that the federal government imposed. The NFIP has built a program that protects more than 4 million properties and 5.1 million policyholders from financial losses from flood. Thousands of property owners have been enabled to mitigate their riskiest structures through more than $3.7 billion in flood grants to buy out or elevate flood properties. The NFIP has determined the flood risk and communicated said risk to more than 95% of the nation, and all of the nation's populated areas. Before the NFIP, there was no scientific and systematic way to determine flood risk or let people know about it.

In 2015, the NFIP began a generational change in an effort to prepare for its second 50 years in existence. The NFIP is emphasizing customers first, reducing program complexity, updating policy product offerings, improving the ways it analyzes and communicates risk, and the way it rates insurance policies based on risk. The handling of claims and appeals is also being improved, in addition to improving customer transparency in way that clarifies each step of the customer transaction and confusing jargon is eliminated. These changes are being implemented in order to cultivate value in its policy, and trust in the program. The NFIP is also aiming to insure more homes, families, business properties and renters against flood losses so in the aftermath of a flood event, regardless of whether it is a presidentially declared disaster, there are more insured survivors. Substantial strides in data-accessibility has allowed the NFIP, in near real-time, the ability to improve the quality of its statistics, analysis, and information it

provides its partners and to serve survivors before, during, and after a flood event. Advanced data-analytics are being used to provide better information and more accurately portray and communicate flood risk. That information is used when discussing reinsurance, long term risk to the program, and affordability. There has also been a commitment to eliminating red tape and confusing policies.

Mr. Maurstad stated that a re-design of the program's entire product offering has also been underway to better align with industry standards. As the NFIP continues to change and grow, the public needs to understand what it's doing more clearly. Accordingly, the NFIP aims to educate communities about flood risk and about the benefits of protecting their properties with flood insurance, in addition to educating about how to get the help they need after a flood event. For example, in 2017, the NFIP communications team developed 26 new external communication tools in the first 30 days after Hurricanes Harvey and Irma to better understand their claims and coverages. The NFIP is looking to improve the claims-journey for policyholders. Advance payment tools have been improved to get money into the hands of those subject to a flood event faster. The process surrounding total-loss claims has also been revamped and improved. Additionally, a branch of the NFIP set up solely for handling appeals is in its second year of existence and has received positive feedback.

Mr. Maurstad stated that Brock Long, FEMA Administrator, has laid out three strategic goals for 2018: a.) building a culture of preparedness; b.) readying the nation for catastrophic disasters; and c.) and reducing the complexity of FEMA. With regard to NFIP and the culture of preparedness, closing the insurance gap is very important. For example, nearly 70% of the flood damage from Hurricane Harvey was uninsured. Mr. Maurstad stated that in building a culture of preparedness, we must change the social norm around flood insurance. Additionally, governments need to provide an effective regulatory environment, set and enforce building standards and codes, and promote and fund mitigation to reduce exposures. State legislators can thus join the effort in building a culture of preparedness and closing the insurance gap. Mr. Maurstad noted that the NFIP must be reauthorized by March 23. Last year, FEMA leadership set two ambitious goals that align with building a culture of preparedness: a.) committing to doubling the number of contracts in force by 2023; b.) committing to quadrupling the public and private and investment in mitigation activities by 2023. Mr. Maurstad closed by urging State legislators to do all they can help FEMA achieve those goals.

Rep. Park Cannon (GA) asked why the submitted claims from Hurricane Maria in Puerto Rico were lower than those of Hurricanes Harvey and Irma. Mr. Maurstad stated that there is more private flood insurance sold in Puerto Rico than NFIP policies, and that without having the specific information in front of him, he suspects that it relates to property values that correlates to the number of claims, and also issues with the affordability of flood insurance policies there. Rep. Cannon then asked if similar corrective measures were taken by the NFIP within the first 30 days after Hurricane Maria, as they were done after Hurricanes Harvey and Irma. Mr. Maurstad stated that the responses of the NFIP and FEMA met the needs of wherever the disasters occurred. The timing of responses is always going to be different depending on geographic location, accessibility, and specific information from adjusters and others as to where to go. FEMA and the NFIP have a commitment to responding as quickly as possible as allowable by the local jurisdictions.

Sen. James Seward (NY) asked what the plan is for the long term financial stability of the NFIP, keeping in mind that affordability of the policies plays a big part in that. Mr. Maurstad stated that the last re-authorization of the NFIP required FEMA to conduct a long-term affordability study – the study should be released soon. For the first time, FEMA worked with the IRS to get a solid

understanding of its policyholder makeup. It was determined that there was a group of folks where purchasing flood insurance would be problematic and proposed affordability solutions are being circulated. That is part of the development of a sound, financial program moving forward. Overall, Congress designed the NFIP to charge reasonable premiums and handle average annual loss share. The events since 2004 have well-exceeded the average annual loss share and accordingly, the NFIP purchased reinsurance for the first-time last year and hopefully that can be expanded going forward. Last year, for the first time, Congress forgave $16 billion of the NFIP's debt because there is an understanding it can't sustain even the interest on the program. Funding of the NFIP is therefore a big topic of discussion surrounding its reauthorization.

ADJOURNMENT

There being no further business, the Committee adjourned at 12:45 p.m.