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ACCOUNTING ISSUES FOLLOWING TAX REFORM

Tax reform created a multitude of accounting issues for life insurance companies. With a lower corporate rate enacted on Dec. 22, 2017 and effective on Jan. 1, 2018, little time was available for companies to determine the effects of all aspects of the new tax law on 2017 financial statements.

All U.S. accounting regimes require accounting for the effect of a rate change on the date of enactment. As a result, all deferred tax assets (DTAs) and liabilities (DTLs) had to be reassessed and restated for purposes of filing Dec. 31, 2017 GAAP and statutory financial statements. In addition, the tax effects of amounts held in Accumulated Other Comprehensive Income (AOCI) were also required to be restated. All changes resulting from tax reform had effects on either continuing operations, capital and surplus, or both for insurers.

The U.S. accounting standards setters immediately recognized the need to act quickly to provide necessary guidance for companies where accounting questions arose as a result of new tax law provisions. On the day President Trump signed H.R. 1 into law (the enactment date), the SEC issued Staff Accounting Bulletin (SAB) 118, allowing registrants to record provisional amounts during a "measurement period," similar to the measurement period used when accounting for business combinations. During the measurement period, adjustments for the effects of the law must be recorded to the extent a reasonable estimate for all or a portion of the effects of the law can be made. To the extent that all information necessary (including computations) is not available, prepared or analyzed, companies may recognize provisional amounts. Companies are to adjust their provisional amounts when they obtain, prepare or analyze additional information about facts and circumstances that existed at the enactment date that, if known, would have affected the amounts that were initially reported as provisional amounts. Disclosures are required detailing the description and effects of estimates as well as the subsequent finalization of those estimates during the measurement period.

On Dec. 21, 2017, ACLI wrote to the Financial Accounting Standards Board (FASB) to request that it consider a more accurate reflection of the impact of the tax rate change on balances in AOCI due to the large amount of investments carried at fair value in AOCI by our member companies. ACLI requested that FASB allow companies to reclassify amounts from AOCI to retained earnings to correct the mismatch between historical tax rates recorded in AOCI and the newly enacted tax rate. ACLI subsequently met with the FASB about this issue, and in early January, the FASB held a board meeting at the request of the banking and insurance industries to consider this item. At the same board meeting, FASB considered other tax reform implementation issues, including whether SAB 118 should be adopted for private companies and not-for-profit entities, whether to discount tax liabilities for repatriation and alternative minimum tax (AMT) credits that become refundable, and how to account for the new base erosion anti-abuse tax (BEAT) and global intangible low-taxed income (GILTI) provision.

During the FASB meeting, the members decided to permit, but not require, reclassification of stranded tax effects related to the newly enacted reduction in the corporate tax rate as well as other issues created by tax reform from AOCI to retained earnings. They also considered opening a broader project in the coming year to look further at allowing backwards tracing for accounting for the release of all past and future stranded tax effects in AOCI. They determined that neither the repatriation tax liability nor the AMT credit refund receivable should be discounted. The FASB determined the BEAT should be accounted for as a period cost and GILTI could be accounted for through a policy election as deferred taxes or as a period cost. Finally, the FASB determined that private companies and not-for-profit entities should have the option to apply SAB 118. After the meeting, the FASB staff issued an exposure draft on the reclassification of certain tax effects from AOCI, on which ACLI commented, and subsequently decided to proceed with drafting a final standard. They also released guidance in the form of staff Q&As on the repatriation, AMT, GILTI and BEAT tax accounting issues. The FASB Emerging Issues Task Force (EITF) briefly considered the staff Q&As on those issues, and there was general agreement among the members that the answers presented do not represent new guidance, but interpret what is already applicable in codification. The FASB has developed a webpage within the "STANDARDS—Implementing New Standards" site to house tax reform materials.

While the ACLI was working with the FASB to secure needed guidance for GAAP companies, the industry also recognized the need for immediate guidance from the National Association of Insurance Commissioners (NAIC) on statutory accounting matters post-tax reform. The Statutory Accounting Principles Working Group (SAPWG) exposed (via e-vote) agenda item 2018-01 to consider the impact of the Tax Cuts and Jobs Act (TCJA) on *SSAP No. 101—Income Taxes*. However, the ACLI was

more immediately concerned with a few other pressing matters affecting 2017 financial statements resulting from tax reform.

The ACLI contacted the NAIC, asking them to adopt SAB 118 immediately for statutory accounting purposes. SAPWG Chair Dale Bruggeman quickly issued a letter to all state insurance commissioners on Jan. 8, addressing the impacts of tax reform on statutory financial statements. Mr. Bruggeman advised states that DTAs and DTLs (i) should be computed using the newly enacted tax rate of 21 percent for year-end 2017 financial statements, and (ii) the change in DTAs and DTLs to reflect the new tax rate should be recognized in the designated reporting line as a separate component of gains and losses in unassigned funds (surplus). He further noted that guidance for admittance calculations for the year-end 2017 statutory financial statements would not change, but companies might have to take into account the elimination of the net operating loss carryback provisions as they assessed reversals of DTAs and DTLs.

Subsequent to Mr. Bruggeman's letter to state insurance commissioners, the ACLI worked through the NAIC Interested Parties on a letter to the SAPWG and spoke with the NAIC staff to request formal, authoritative guidance on the adoption of guidance consistent with SAB 118 and clarification regarding how and when to record the effects of changes in tax rates. Subsequently, the NAIC staff issued interpretive guidance (INT 18-01) to provide a limited-time, limited-scope exception to the Type I subsequent event guidance in SSAP No. 9 and to specify the reporting lines for reporting changes related to tax rate changes. The ACLI commented on the items in the INT though the NAIC Interested Parties and the SAPWG voted to adopt the INT with the changes suggested by the ACLI and Interested Parties.

As noted above, SAPWG exposed an agenda item to consider the impact to SSAP 101 of changes made in TCJA. On Feb. 6, SAPWG modified the exposure to include updated NAIC staff recommendations in response to FASB exposed accounting guidance and FASB staff interpretations pertaining to federal tax reform that were released by the FASB after the original exposure of agenda item 2018-01. ACLI and member companies joined with NAIC Interested Parties on a Feb. 20 comment letter that addressed the SSAP 101 proposed changes as well as the NAIC response to FASB guidance on accounting for repatriation, AMT credit refunds, BEAT and GILTI. The comment letter generally agreed with NAIC that because, as noted in the exposure draft, SSAP No. 101 already makes references to enacted tax rates and tax law loss carryback provisions, the necessary revisions to SSAP No. 101 for the tax law changes are minor and non-substantive in nature. On March 24, ACLI presented its comments and answered questions from SAPWG at its hearing on SSAP 101 during the March NAIC meeting. At that hearing, SAPWG decided to re-expose, for a 30-day period, revisions to SSAP No. 101 that largely incorporate Interested Parties' comments. However, two items—treatment of AMT credit carryovers and accounting for GILTI tax—were deferred for consideration as separate agenda items.

ACLI and NAIC Interested Parties reviewed the March 24 re-exposure and in their April 23 comment letter, reiterated the positions set forth in previous comment letters, and responded to a request for comments by SAPWG on the assessment by companies of reversal patterns of deferred tax items as a result of TCJA.

ACLI looks forward to continuing to work collaboratively with SAPWG regarding accounting changes that are needed or would be helpful as a result of the TCJA.

UPDATE ON CAPITAL/RBC ISSUES POST-TAX REFORM

The new tax law has a significant impact on risk-based capital (RBC) requirements at companies. The impact of the law on RBC results from both the drop in the federal corporate income tax rate from 35 percent to 21 percent and the reduction in the value of DTAs (also attributed to the tax rate drop as well as the elimination of net operating loss carrybacks).

The ACLI spent several months working with a group of member company actuarial, tax and accounting personnel regarding the changes required to adjust RBC ratios to reflect the newly enacted 21 percent corporate tax rate.

The 35 percent tax rate is currently hard-coded into many aspects of the RBC ratio calculations. Therefore, the NAIC must make some changes to restate RBC requirements using a 21 percent enacted tax rate. While in many cases the new tax rate will simply flow through the calculations, there are a few instances where a significant modeling effort is likely needed to accurately reflect the new tax rate. The changes are required because of the tax rate reduction interaction with the C-1 (asset default risk) and C-2 (mortality and morbidity risk) RBC factors that are modeled using tax cash flows and after-tax discount rates. For example, ACLI has determined that the move from a 35 percent to 21 percent maximum federal tax rate could reduce the C-1 bond factors recently proposed by the AAA by as much as 3.2 percent, partially offsetting the impact to RBC ratios that would occur from the corporate income tax rate drop alone. For the purposes of expediency, it appears that the NAIC will estimate these impacts by reducing certain pre-tax factors by 3 percent, with the knowledge that the more accurate impact will be incorporated in upcoming NAIC projects to update RBC factors for bonds, real estate and mortality risk.

Additionally, ACLI determined that the C-3 (interest rate disintermediation risk—non-modeled) and C-4a factors (general business risk) were not originally developed with tax cash flows, but were point estimates of post-tax factors based on judgment. Therefore, ACLI recommended that these factors themselves be reduced by the same amount as the reduction in tax offset from the new tax rate. These recommendations might reduce by about half the increase (which otherwise could be as much as 20 percent at companies) in capital requirements required by tax reform.

On Feb. 12, ACLI sent a letter to the NAIC addressing the impact of federal tax reform legislation on RBC. The letter concluded that overall, the impact of tax reform on the RBC calculation is significant, noting that there are factor changes that would increase RBC and factor changes that partially offset the increase. ACLI recommended that the impact of the increases and the offsets be implemented at the same time, and due to the complexity of some of the changes, that the target date for completion be 2019. Also, the letter noted that one particular use of RBC that will need recalibrating is the minimum 450 percent RBC ratio requirement for the small company exemption within the principle-based reserve (PBR) requirements. ACLI recommended that the 450 percent RBC requirement be decreased to 360 percent (with the final number subject to review after other RBC changes are completed).

The impact of federal tax reform on RBC was addressed at the recent NAIC meeting, where regulators were not willing to rule out getting all items changed for 2018 filings. They did commit, however, to not implementing the changes in a piecemeal fashion. While they also acknowledged that it would be difficult to complete everything for this year's deadlines of exposure by April 30 and adoption by June 30, significant work effort has been undertaken by the NAIC to meet those deadlines, and it has become more likely than not that the changes to RBC will go into effect for 2018 RBC calculations. The RBC work through the NAIC is fast-moving and this article only represents the status as of the end of April 2018. ■

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