



January 31, 2018

To: Insurance Commissioners
50 states and the District of Columbia

RE: Federal Tax Changes and Rate Filings

Dear Commissioner:

On behalf of the member insurance companies of the American Insurance Association (AIA) and the Property Casualty Insurers Association of America (PCI), we write in response to the January 23, 2018 letter sent jointly to you by the Center for Economic Justice (CEJ) and the Consumer Federation of America (CFA). In that letter, the CEJ and CFA attempt to sensationalize the impact of changes in federal tax law as they relate to insurance rates.

The CEJ/CFA letter misleadingly over-simplifies and overstates the impact of federal tax changes in a number of ways. Specifically, the letter refers to the impact on insurance companies as “massive” and a “windfall.” In truth, the impact of lower federal taxes will vary greatly for each insurer, in each state, and for each line of business. Therefore, we respectfully ask you to consider the following facts before responding to the CEJ/CFA letter.

The CEJ/CFA letter erroneously compares insurers to utility companies. Simply stated, while insurers operate in a regulated industry, the business model is dramatically different from a utility. Utilities know their costs of extraction, production, and distribution in advance, so they can more reliably estimate the rates needed in order to cover their costs and provide a reasonable profit. By contrast, insurers receive premiums upfront and pay losses and related expenses later while most other businesses incur their expenses up-front and sell their products and services later. Further, the industry is frequently subject to periodic and unpredictable severe catastrophe losses, and companies must price and sell their products in advance of knowing the true nature of these and other future costs. Finally, insurers often use profits to strengthen their capital positions in order to ensure policyholder claims can be paid in the aftermath of catastrophic events.

In addition, utilities are typically state-sanctioned monopolies, while insurers must truly compete for business in a market place where consumers have many options. The property and casualty insurance industry’s outstanding track record of price competitiveness means that any bottom-line benefits of the tax bill will ultimately be felt by consumers in the market place.

The CEJ/CFA letter inaccurately portrays the correlation between a reduced federal corporate tax rate and the impact on insurance rates for the following reasons:

- The CEJ/CFA calculations assume that insurers are achieving their after-tax rate of returns at current rates, something that will vary greatly from insurer to insurer, from line of business to line of business, and from state to state. Given several recent years of a relatively soft pricing environment, record catastrophe losses in 2017, and unprofitable results in some lines of business, this assumption is particularly untimely and misleading.
- The CEJ/CFA calculations fail to consider the effect of other factors in rate filings – such as upward loss trends and the resulting increase in reinsurance costs – some of which will offset the impact of a tax reduction.

Furthermore, the CEJ/CFA letter distorts the impact of the federal tax change itself. The recently enacted legislation includes a number of complicated provisions that will offset a significant portion of the tax benefit that insurers would have realized if the rate reduction were enacted in isolation as the CEJ/CFA letter suggests. Moreover, other provisions in the new tax law that increase taxable income such as the changes to how reserves are discounted for tax purposes will off-set a sizable amount of any reductions. The new tax law is highly complex and it is incorrect and simplistic to assume that the corporate rate reduction of fourteen percentage points is the law's sole impact on P&C companies. Indeed, there are many issues that require regulatory interpretation and guidance from the Treasury and IRS in order to understand the law's full impact. As with any piece of complex legislation, secondary consequences of the tax reform bill will emerge over time, including issues that may affect the pricing of insurance or reinsurance.

It is going to take time for insurers to re-evaluate risk and return measures such as effective cost of debt, cost of capital, or return on equity. And, given that taxes are just one of many factors in ratemaking, the speed with which P&C rates will reflect lower tax rates can and should vary by line; but, as always, company rate filings will continue to adhere to the actuarial standards prescribed by state law.

AIA and PCI urge you to carefully consider the complexity of the tax law and the significant differences in potential impact across insurance products and lines of business before responding to the CEJ-CFA letter.

Respectfully yours,



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