# HOUSE BILL REPORT
# HB 1076

**As Reported by House Committee On:**
Business & Financial Services

**Title**:  An act relating to modernizing life insurance reserve requirements.

**Brief Description**:  Modernizing life insurance reserve requirements.

**Sponsors**:  Representatives Kirby, Vick, Ryu, McBride and Stanford; by request of Insurance Commissioner.

**Brief History:**
**Committee Activity:**
Business & Financial Services:  1/16/15, 1/20/15 [DPS].

**Brief Summary of Substitute Bill**

- Amends and updates the model acts for the Standard Valuation Law and Standard Nonforfeiture Law.

## HOUSE COMMITTEE ON BUSINESS & FINANCIAL SERVICES

**Majority Report**:  The substitute bill be substituted therefor and the substitute bill do pass. Signed by 11 members:  Representatives Kirby, Chair; Ryu, Vice Chair; Vick, Ranking Minority Member; Parker, Assistant Ranking Minority Member; Blake, G. Hunt, Hurst, Kochmar, McCabe, Santos and Stanford.

**Staff**:  Linda Merelle (786-7092).

**Background**:

In 1982 the Legislature enacted two model acts of the National Association of Insurance Commissioners (NAIC):  the Standard Valuation Law and the Standard Nonforfeiture Law. They have not been amended since that time.

Standard Valuation.

*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

The Office of the Insurance Commissioner (Commissioner) must annually value the reserve liabilities (Reserves) for outstanding life insurance policies, annuity, and pure endowment contracts of every life insurance company doing business in this state. Life insurance is a payment to a beneficiary upon the death of the insured. An "annuity" is an insurance contract that pays a periodic income benefit to one or more persons while they are living. An "endowment" contract is one where the face value of the policy is payable only if the insured lives to the end of a stated endowment period. Life insurers set aside Reserves to ensure they will be able to pay all expected claims.

Life insurance companies must annually submit the opinion of a qualified actuary regarding whether the required reserve amounts have been appropriately determined. The insurance companies must rely on standard mortality tables to determine the minimum standard valuation of the policies and contracts issued.

Nonforfeiture Standard.

Nonforfeiture provisions entitle an insured to relinquish a life insurance policy for its cash surrender value, to take a "reduced paid-up" policy, to take an "extended term" policy, or to borrow from the company using the cash value as collateral. A "paid-up" policy is one in which the premiums have already been paid. Under the option of the "extended term" policy, the cash value of the policy being relinquished may be used to purchase term life insurance in the amount of the original policy.

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**Summary of Substitute Bill**:

The Standard Valuation and Standard Nonforfeiture Laws are amended.

Standard Valuation.

Principle-based reserves is an approach to calculating Reserves that requires life insurance companies to determine appropriate amounts based upon factors such as mortality, policy holder behavior, and expenses, under various economic conditions.

*Valuation Manual.*

The NAIC Valuation Manual (Manual), once operative, will be the basis upon which Reserves are calculated. The operative date of the Manual is January 1 of the calendar year following July 1 of the year that the Manual has been adopted. The Manual is adopted when: it has been adopted by the NAIC by an affirmative vote of at least three-fourths of the voting members; the standard valuation law has been enacted by states representing greater than 75 percent of the direct premiums written; and the standard valuation law has been enacted by at least 42 of the 55 members of the NAIC, which includes the 50 states, American Samoa, the American Virgin Islands, the District of Columbia, Guam, and Puerto Rico.

A company must establish reserves using a principle-based valuation that meets the conditions specified in the Manual. The company must also establish procedures for corporate governance and oversight of the actuarial valuation function and provide the Commissioner and the Board of Directors with an annual certification of the effectiveness of the internal controls with respect to the principle-based valuation. The controls must be designed to assure that all material risks inherent in the liabilities and associated assets are included in the valuation.

*Valuation of Reserve Liabilities.*

The Commissioner must annually value the Reserves for all outstanding life insurance, annuity and endowment, disability, and deposit-type contracts of every company, where those contracts were issued on or after the operative date of the Manual. A deposit term policy is one where a premium (the deposit) is paid in the first policy year, in addition to regular premiums. The deposit is left to accumulate at an interest rate for a specified number of years. After that time, the policy owner may receive the deposit plus interest or may renew the policy without having to furnish evidence of insurability. Under a disability contract, income is paid under a policy that is not covered under worker's compensation benefits, usually as a percentage of the insured's income prior to the disability.

The Commissioner may accept a valuation made by the insurance supervisory official of any state, or other jurisdiction when the valuation complies with the minimum standards required under Washington law.

*Opinion of Appointed Actuary and Memorandum.*

Insurance companies subject to regulation by the Commissioner and that have life insurance, accident and health, or deposit-type contracts must annually submit the opinion of the appointed actuary whether reserves and other actuarial items in support of those contracts are computed appropriately, based on assumptions that satisfy contractual provisions, are consistent with prior reported amounts, and comply with law. A memorandum must also be submitted in support of the opinion.

Unless exempt from the requirements of the Manual, the annual opinion must include whether the reserves made adequate provision for the company's obligations under the policies and contracts. If an insurance company fails to provide an opinion that meets the required standards, the Commissioner may engage a qualified actuary at the expense of the company to review the opinion and prepare the supporting memorandum required.

*Principle-Based Valuation Report.*

A company must also develop a principle-based valuation report that complies with the standards in the Manual. Upon request, the company must file the report with the Commissioner.

*Confidentiality.*

With certain exceptions, the memorandum in support of the opinion submitted to the Commissioner and any other material provided by the insurance company in connection with the memorandum is confidential and privileged, not subject to the Public Records Act, not subject to subpoena or discovery, and not admissible as evidence in any private civil action.

The Commissioner may use the documents, material or other information submitted (Documents) in the furtherance of any regulatory or legal action brought as part of the Commissioner's official duties. However, neither the Commissioner nor any other person who received the Documents is permitted or required to testify in any private civil action concerning the Documents.

The Commissioner may enter into agreements to share the Documents with other state, federal, and international regulatory agencies; with the NAIC and its affiliates and subsidiaries; and with law enforcement authorities. The recipient of the Documents must agree to maintain their confidentiality and privileged status. Sharing of the Documents pursuant to the authority of these statutory provisions does not result in the waiver of confidentiality or privilege.

*Exceptions to Confidentiality.*

The memorandum and other materials provided in support of the opinion of the actuary may be subject to subpoena for the purpose of defending an action seeking damages from the actuary submitting the memorandum. A memorandum and its attendant materials may be released by the Commissioner with the written consent of the company or to the American Academy of Actuaries upon a request for the purpose of professional disciplinary proceedings and on the condition that procedures are set forth to preserve confidentiality.

All portions of a memorandum will no longer be confidential if: the company cites any portion in its marketing, if it is cited before a governmental agency other than the Commissioner, or if it is released to the news media by the company.

Standard Nonforfeiture.

For policies issued after the operative date of the Manual, the Manual must provide the Commissioner's standard mortality for use in determining the minimum nonforfeiture standard to replace existing mortality tables. The Commissioner may, by rule, adopt a Commissioner's standard mortality table adopted by the NAIC after 1980, and that standard would supersede the standard provided by the Manual.

*Operative Date of Valuation Manual.*

The Commissioner must provide notice to the Office of the Code Reviser regarding the date the Manual becomes operative.

**Substitute Bill Compared to Original Bill**:

A provision was added to the substitute bill to require the Commissioner to notify the Office of the Code Reviser regarding the operative date of the Manual.

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**Appropriation**: None.

**Fiscal Note**: Available.

**Effective Date of Substitute Bill**: The bill takes effect on January 1, 2016, except for section 20 relating to amendments to the Public Records Act, which takes effect July 1, 2017.

**Staff Summary of Public Testimony**:

(In support) The current system for determining reserves is substantially out-of-date and needs to be updated. The principle-based reserves approach takes into account more accurate factors for predicting costs and for determining what kind of reserves should be on hand. It changes the "up-and-down" reserving pattern that has plagued the Commissioner. This approach has been fully vetted. It will be a great benefit to consumers and regulators, and it will help to ensure that consumers are paying the appropriate price. It becomes fully enacted when at least 43 states enact the legislation, and it only applies to new insurance contracts. Last year 20 states enacted the model legislation, and this year 23 states have committed to enact the provisions. It is important that Washington join the other states in moving forward. The approach of principle-based reserves is already being used in the areas of property and casualty and health insurance. This is extremely important to military members, and it will give regulators the enhanced reporting and tools to make sure that companies are meeting the required standard. The nonforfeiture law is included in the same bill so that the two model acts come as a packet, and the mortality and interest rates are coordinated for both. This is more predictable, and it is a better model.

(Opposed) None.

**Persons Testifying**: Mel Sorensen, American Council of Life Insurance, Allstate, and American Family Insurance; Carrie Tellefson and Mike Mattoch, United Services Automobile Association; and Lonnie Johns-Brown, Office of the Insurance Commissioner.

**Persons Signed In To Testify But Not Testifying**: None.