Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Business & Financial Services Committee

SB 5180

Brief Description: Modernizing life insurance reserve requirements.

Sponsors: Senators Benton, Mullet, Angel, Hobbs, Hargrove, Keiser and Darneille; by request of Insurance Commissioner.

Brief Summary of Bill

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

Hearing Date: 2/2/16

Staff: Peter Clodfelter (786-7127)

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. The two model acts have not been amended since that time.

Standard Valuation Law.
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 Washington 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 the person(s) are living. An endowment contract is an insurance contract 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

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companies must rely on standard mortality tables to determine the minimum standard valuation of the policies and contracts issued.

The NAIC adopted a revised model Standard Valuation Law in 2009, which introduced Principle Based Reserving (PBR). PBR is an approach to calculating Reserves that requires life insurance companies to determine appropriate Reserve amounts based upon factors such as mortality, policy holder behavior, and expenses, under various economic conditions. The NAIC has developed and maintains a Valuation Manual (Manual), which contains the reserve calculation requirements. This new method of calculating Reserves would apply only to policies issued after the Standard Valuation Law is adopted and not to existing policies.

Standard Nonforfeiture Law.
The Standard Nonforfeiture Law established minimum benefit values for when a life insurance policy is surrendered or lapses. Currently, standard mortality tables are used to value minimum benefits. In 2009 the NAIC also adopted a new Standard Nonforfeiture Law model act that uses the Manual as the source for mortality and interest rates used in nonforfeiture calculations.

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.

Operative Date of the Valuation Manual.
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 the Standard Valuation Law revisions are adopted by at least 42 states representing 75 percent of total U.S. premiums. As of January 29, 2016, 39 states representing 71.2% of total U.S. premiums, have adopted the revised model laws.

Summary of Bill:

The Standard Valuation and Standard Nonforfeiture Laws are amended.

Standard Valuation Law.
The Valuation Manual. The NAIC Valuation Manual (Manual), once operative, will be the basis upon which Reserves are calculated for policies issued on or after the effective date of the Manual. A company must establish reserves using a principle-based valuation that meets the conditions specified in the Manual. Additionally, a company must 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 insurance company, where those contracts were issued on or after the operative date of the Manual. 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, disability, or deposit-type contracts must annually submit the opinion of the appointed actuary as to 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 the Documents' 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 lose their confidential status if the company cites any portion in its marketing, before a governmental agency other than the Commissioner, or if it is released to the news media by the company.

Standard Nonforfeiture Law.
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.

Appropriation: None.

Fiscal Note: Available.

Effective Date: Sections 1 through 19 take effect January 1, 2016. Section 19, regarding amendments to the Public Records Act, expires July 1, 2017. Section 20, regarding amendments to the Public Records Act, takes effect July 1, 2017.