

HOUSE BILL REPORT

SB 5180

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

Brief History:

Committee Activity:

Business & Financial Services: 3/13/15, 3/17/15 [DP], 2/2/16, 2/3/16 [DP].

Brief Summary of Bill

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

HOUSE COMMITTEE ON BUSINESS & FINANCIAL SERVICES

Majority Report: Do pass. Signed by 10 members: Representatives Kirby, Chair; Stanford, Vice Chair; Vick, Ranking Minority Member; McCabe, Assistant Ranking Minority Member; Blake, Dye, Hurst, Kochmar, Ryu and Santos.

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 for outstanding life insurance policies, annuity, and pure endowment contracts of every life insurance company doing business in Washington state. Life insurance is a

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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 liability 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.

The NAIC adopted a revised model Standard Valuation Law in 2009, which introduced Principle Based Reserving (PBR). The PBR is an approach to calculating reserve liabilities that requires life insurance companies to establish 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, which contains the reserve calculation requirements. This new method of calculating reserve liabilities would apply only to policies issued after the Standard Valuation Law is adopted and the Valuation Manual is operative and not to existing policies.

Standard Nonforfeiture Law.

The Standard Nonforfeiture Law establishes minimum benefit values for when a life insurance policy is surrendered or lapses. 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. 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 Valuation Manual as the source for mortality and interest rates used in nonforfeiture calculations.

Operative Date of the Valuation Manual.

The operative date of the Valuation Manual is January 1 of the calendar year following July 1 of the year that the Valuation Manual has been adopted. The Valuation Manual is adopted when the Standard Valuation Law revisions are adopted by at least 42 states representing 75 percent of total U.S. premiums.

Summary of Bill:

The Standard Valuation and Standard Nonforfeiture Laws are amended.

Standard Valuation Law.

The Valuation Manual. The NAIC Valuation Manual, once operative, will be the basis upon which reserve liabilities are calculated for policies issued on or after the effective date of the Valuation 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 reserve liabilities 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 Valuation 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 with outstanding life insurance contracts, accident and health insurance contracts, or deposit-type contracts in Washington subject to regulation by the Commissioner must annually submit the opinion of an appointed actuary as to whether reserves and other actuarial items held in support of insurance companies' policies and 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 Valuation Manual, the annual opinion must include whether the reserves make 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 Valuation 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, and 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 Valuation Manual, the Valuation 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 Valuation Manual.

Appropriation: None.

Fiscal Note: Available.

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

Staff Summary of Public Testimony:

(In support) Both the insurance industry and the Office of the Insurance Commissioner are in support. The language in the bill is based on the National Association of Insurance Commissioner's (NAIC) model acts. The language has been fully vetted by regulators, the industry, and consumers. To date, 39 states representing about 72 percent of total U.S. premiums have adopted the updates to the Standard Valuation Law and the NAIC is already assisting states in preparing to make the transition. This will be an NAIC accreditation standard, likely in 2017. The existing method of calculating reserve requirements is archaic and it is appropriate to update the method to be more flexible. Mortality figures are getting better, not worse, so it is appropriate to modernize life insurance reserve requirements so that reserving can more closely align with the true risk and liability. The new method of calculating reserve requirements would also allow insurance companies to more easily create and offer consumers new products. It is difficult to develop new products under the current system. Principle based reserving is already used for certain property and casualty insurance products and health insurance products.

(Opposed) None.

Persons Testifying: Lonnie Johns-Brown, Legislative Director, Office of the Insurance Commissioner; Carry Tellefson, United Services Automobile Association; Mel Sorenson,

American Council of Life Insurers, National Association of Insurance and Financial Advisors.

Persons Signed In To Testify But Not Testifying: None.