

Life Insurance—Principle-Based Valuation; Standard Nonforfeiture Law; SB 47

SB 47 amends provisions in the Insurance Code pertaining to the methodology for determining future minimum life insurance policy reserves by adopting “Principle-Based Reserving” (PBR) contained in the National Association of Insurance Commissioners’ (NAIC) Model Standard Valuation Law. In updating to this new methodology, the bill amends provisions in both the Standard Valuation Law and the Standard Nonforfeiture Law. Under former law, the calculation of reserves was made using a rules-based formulaic approach.

Definitions and general provisions relating to insurance policies and contracts subject to the PBR requirements will be applicable on and after the operative date of the Valuation Manual. (The operative date of the Valuation Manual will be January 1 of the first calendar year the Valuation Manual is effective.)

Standard Valuation Law—Incorporating PBR Requirements

Definitions. The bill establishes definitions for several terms, including these:

- **Company** – An entity which has written, issued or reinsured life insurance contracts, accident and health insurance contracts, or deposit-type contracts in this state and has at least one such policy in force or on claim; or has written, issued, or reinsured life insurance contracts, accident and health insurance contracts, or deposit-type contracts in any state and is required to hold a certificate of authority to write life insurance, accident and health insurance, or deposit-type contracts in this state;
- **Deposit-type contract** – Contracts that do not incorporate mortality or morbidity risks and may be specified in the Valuation Manual;
- **Principle-based valuation** – A reserve valuation that uses one or more methods or one or more assumptions determined by the insurer and is required to comply with principle-based valuation requirements in the bill, as specified in the Valuation Manual; and
- **Valuation Manual** – The manual of valuation instructions adopted by the NAIC.

Insurance Products Subject to Minimum Reserve Requirements—Continuing Law and New Law

The bill clarifies the annual reporting of certified valuation of the policies of life insurance companies to the Insurance Commissioner will continue for the policies and contracts issued prior to the operative date of the Valuation Manual. The bill delineates which requirements will be applicable for policies and contracts based on the timing of their issuance relative to the operative date of the Valuation Manual:

- Policies and contracts issued prior to the operative date of the Valuation Manual and prior to the operative date of the Standard Nonforfeiture Law; and
- Policies and contracts issued prior to the operative date of the Valuation Manual but after the operative date of the Standard Nonforfeiture Law.

In both instances described above, the formulaic reserve calculation methodology specified in law will remain unchanged.

The bill then provides a new methodology for policies and contracts issued on or after the effective date of the Valuation Manual. The bill requires the Commissioner to annually value the reserve liabilities (referred to in the PBR amendments as “reserves”) for all outstanding life insurance contracts, annuity and pure endowment contracts, accident and health contracts, and deposit-type contracts. The Commissioner is allowed to accept, in the case of a foreign or alien company, a valuation made by the supervisory official of that state or other jurisdiction.

PBR Products Subject to Review—Documentation Requirements

Each life insurance company annually files an actuarial opinion of reserve liabilities which must include support information for review (e.g., investment earnings on assets, consideration of and provision for the company’s obligations under its policies and contracts). Each insurer subject to the PBR requirements of the bill also must file an actuarial opinion of reserves in a manner similar to former law. The bill creates provisions to accommodate additional standards specified in the Valuation Manual. The bill requires companies, unless otherwise exempted in the Valuation Manual, to file the actuarial opinion of an appointed actuary on reserves, including support information. The opinion must be submitted in the form and substance specified in the Valuation Manual and acceptable to the Commissioner. Additionally, if the Commissioner determined the insurance company failed to provide a supporting memorandum or the filed supporting memorandum failed to meet certain standards, the Commissioner is permitted to engage a qualified actuary at the expense of the company to review the opinion and prepare the memorandum. The bill also provides that disciplinary action by the Commissioner against a company or the appointed actuary must be defined in rules and regulations adopted by the Commissioner.

Accident and health insurance contracts. The bill specifies the standard of valuation applicable to accident and health insurance contracts based on the timing of the operative date of the Valuation Manual. For those contracts issued prior to this date, the Commissioner must adopt rules and regulations establishing the minimum standard of valuation. (The Commissioner has been required to adopt rules and regulations relating to the minimum standards applicable to the valuation of accident and sickness insurance.) For those contracts issued on or after the operative date of the Valuation Manual, the standard prescribed in the Valuation Manual will be the minimum standard of valuation required.

Standard of Valuation and Operative Date of the Valuation Manual

The bill specifies, for life insurance policies and contracts issued on or after the operative date of the Valuation Manual, the standard prescribed in the Valuation Manual will be the minimum standard of valuation required. The bill specifies the operative date of the Valuation

Manual will be January 1 of the first calendar year following the first July 1 in which the following have occurred:

- The Valuation Manual has been adopted by the NAIC by an affirmative vote of at least 42 members, or three-fourths of the members voting, whichever is greater;
- The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by states representing greater than 75 percent of the direct premiums as reported in certain annual statements submitted for 2008; and
- The Standard Valuation Law, as described above, has been enacted by at least 42 of the 55 jurisdictions.

The bill also provides for determination of effective dates of future changes to the Valuation Manual.

Valuation Manual requirements. The bill outlines specifications associated with the Valuation Manual. Among the requirements, the Valuation Manual must specify:

- Minimum valuation standards for and definitions of the policies and contracts issued on and after the operative date of the Valuation Manual, including:
 - The Commissioner's reserve valuation method for life insurance contracts, other than annuity contracts;
 - The Commissioner's annuity reserve valuation method for annuity contracts; and
 - Minimum reserves for all other policies or contracts subject to the PBR requirements.
- Which policies or contracts are subject to the requirements of principle-based valuation and the minimum valuation standards consistent with those requirements;
- Requirements for the format of reports including the information necessary to determine if the valuation is appropriate and in compliance (limited to those companies subject to PBR);
- Other requirements, including reserve methods and risk measurement; and
- The data and form of data required and other specifications regarding data analyses and reporting of analyses.

The bill permits the Commissioner to employ or contract a qualified actuary, at the expense of the company, to perform an actuarial examination on the company and provide an opinion on the appropriateness of any reserve assumption or methodology used. The

Commissioner also is authorized to require a company to change any assumption or methodology that is necessary to meet the required standard for reserves.

Requirements of principle-based valuation. The bill also sets forth conditions on policies and contracts issued by a company subject to principle-based valuation requirements. Among the conditions for companies establishing reserves using the PBR the requirements are:

- Quantifying the benefits and guarantees, and the fund, associated with the contracts and their risks at a level of conservatism reflecting conditions that include unfavorable events having a reasonable probability of occurring during the lifetime of the contracts; and
- Providing margins for uncertainty including adverse deviation and estimation error, such that the greater the uncertainty, the larger the margin and resulting reserve.

The bill also requires companies using principle-based valuation to establish procedures for corporate governance and oversight of the actual valuation function, provide the Commissioner an annual certification of the effectiveness of its internal controls with respect to principle-based valuation, and develop and file with the Commissioner, upon request, a principle-based valuation report that complies with the standards prescribed in the Valuation Manual. Companies will be required to submit mortality, morbidity, policyholder behavior or expense experience, and other data as prescribed in the Valuation Manual.

Confidentiality. The bill provides a definition of “confidential information” to include the memorandums in support of actuarial opinions and related documentation and documents, materials, and working papers created, produced, or obtained by or disclosed to the Commissioner or others in the course of an examination. Additionally, the bill creates provisions outlining the privilege for, and confidentiality of, confidential information. The bill states a company’s confidential information is confidential by law and privileged (exceptions are noted), and not subject to the Kansas Open Records Act, not subject to subpoena, and not subject to discovery or admissible in evidence in any private civil action. The exception allows the Commissioner to use the confidential information in the furtherance of regulatory or legal action brought against the company. The bill then specifies how the Commissioner is permitted to share confidential information with certain regulators, law enforcement officials, and the NAIC.

Exemption for certain products and lines. The Commissioner is permitted to exempt specific product forms or product lines of a domestic insurance company that is licensed and doing business only in Kansas.

Standard Nonforfeiture Law—Amendments

The bill specifies, for policies issued on and after the effective date of the Valuation Manual, the Valuation Manual will provide the Commissioners’ standard mortality table for use in determining the minimum nonforfeiture standard. For those policies issued on or after the operative date of the Valuation Manual, the nonforfeiture interest rate per annum for any policy issued in a particular calendar year will be provided by the Valuation Manual.