*SESSION OF 2015*

# SUPPLEMENTAL NOTE ON SENATE BILL NO. 47

As Recommended by Senate Committee on Financial Institutions and Insurance

## Brief*

SB 47 would amend 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. The bill, in updating to this new methodology, would amend provisions in both the Standard Valuation Law and the Standard Nonforfeiture Law. Under current law, the calculation of reserves is made using a rules-based formulaic approach.

Definitions and general provisions relating to insurance policies and contracts subject to the PBR requirements would 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 would establish definitions for several terms, including:

- Company – An entity which: has written, issued or reinsured life insurance contracts, accident and health insurance contracts or deposit-type

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*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at http://www.kslegislature.org 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 (subsection h), 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—Existing Law and New Law**

The bill would clarify the annual reporting of certified valuation of the policies of life insurance companies to the Insurance Commissioner would continue for the policies and contracts issued prior to the operative date of the Valuation Manual. The bill would then delineate which requirements would 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 existing law would remain unchanged.

The bill would then provide a new methodology for policies and contracts issued on or after the effective date of the Valuation Manual. The bill would require 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 would be 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**

Under current law, life insurance companies annually file 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.) Insurers subject to the PBR requirements of the bill also must file an actuarial opinion of reserves in a manner similar to current law. The bill would create provisions to accommodate additional standards specified in the Valuation Manual. The bill would require 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, as 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 would be permitted to engage a qualified actuary at the expense of the company to review the opinion and prepare the memorandum. The bill also would provide 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 would specify standard of valuation applicable to accident 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 currently is 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 would specify 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 would specify 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 statement 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 would provide for when future changes to the Valuation Manual would become effective.

*Valuation Manual Requirements.* The bill would outline 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 would permit 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 would be 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 would set 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 life time 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 would require 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 would be required to submit mortality, morbidity, policyholder behavior or expense experience, and other data as prescribed in the Valuation Manual.

*Confidentiality*. The bill would provide a definition of "confidential information" which would 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 would create provisions outlining the privilege for, and confidentiality of, confidential information. The bill would state 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 would allow the Commissioner to use the confidential information in the furtherance of regulatory or legal action brought against the company. The bill would then specify 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 would be permitted to exempt specific product forms or product lines of a domestic insurance company that is licensed and only doing business in Kansas.

**Standard Nonforfeiture Law—Amendments**

The bill would specify, 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.

The bill also would make technical amendments.

**Background**

The bill was introduced by the Senate Committee on Financial Institutions and Insurance at the request of the American Council of Life Insurers (ACLI). In the Senate Committee, the ACLI representative indicated the current method of life insurer reserving dates back more than 100 years and involves a formulaic "one size fits all" approach that now results in some products being under-reserved and others, over-reserved. PBR, the conferee noted, would help ensure consumers are paying the appropriate price for the risk coverage being provided. In addition, PBR would allow life insurance companies to develop and reserve for new products and product features that the current outdated and inflexible system inhibits. A representative of the Kansas Insurance Department appeared in support of the bill at the Senate Committee hearing. Written proponent testimony was submitted by a representative of Prudential Financial, Inc. There were no opposition or neutral testimony presented at the hearing.

The fiscal note prepared by the Division of the Budget states the Department indicates the use of the PBR method would only become effective when at least 42 states approve the change (adoption of model act; change in methodology for calculation of reserves.) At the time of the Senate Committee hearing on the bill, the ACLI representative indicated 20 states have enacted PBR legislation and 24 states have either committed to or are in the process of introducing this legislation in 2015.

In addition, the Department indicates there would be a three-year transition period before the method would be fully utilized. The Department estimates enactment of the bill would require additional expenses of approximately $50,000 for salaries and wages expenses for an additional 1.00 FTE Financial Examiner position. However, the note indicates, because of the three-year transition period, FY 2018 would be the earliest the Department would incur these additional expenses. Any fiscal effect associated with the bill is not reflected in *The FY 2016 Governor's Budget Report*.