ARIZONA STATE SENATE

Fifty-First Legislature, First Regular Session

FACT SHEET FOR S.B. 1149

insurance; principle-based valuation; reserves

Purpose

Allows the Director of the Department of Insurance (Director) to implement reserve methods and requirements to calculate and report reserve liabilities.

Background

Life insurance is a contract between the policy owner and the insurer, by which the insurer agrees to pay a sum of money upon the occurrence of the insured individual's death or other event, such as terminal illness or critical illness. In return, the policy owner agrees to pay a stipulated amount called a premium, paid at regular intervals.

Life insurers set aside assets, or reserves, to ensure they will be able to pay all expected claims. State insurance regulators closely monitor reserves and take action if a company's reserve levels jeopardize policyholders' interests. Currently, life insurance reserves are calculated based on fixed formulas prescribed by state insurance laws and regulations.

The principle-based reserves (PBR) method was designed to enhance regulatory to assist regulators properly monitor reserve levels. Under PBR, life insurers are required to compare a formulaic reserve calculation with a calculation based on actual experience factors, such as mortality, policyholder behavior and expense, under a variety of economic conditions. Companies would then hold the higher of the two reserve levels. Policy assumptions that were locked in under the formulaic approach will be updated annually under PBR to account for future changes.

There is no anticipated impact to the General Fund associated with this legislation.

Provisions

Reserve Valuation for Policies and Contracts Issued Before the Operative Date of the Manual of Valuation Instructions (Valuation Manual)

1. Requires the Director to annually value, or cause to be valued, the reserves for all outstanding life insurance policies and annuity and pure endowment contracts of every life insurance company doing business in the state that were issued before the operative date of the valuation manual.

2. Allows the Director, for calculating reserves, to use group methods and approximate averages for fractions of a year.

3. Specifies that the minimum standard for the valuation of policies and contracts issued before January 1, 1956, is the standard provided by law in effect immediately before that date.

Reserve Valuation for Policies and Contracts Issued On or After the Operative Date of the Valuation Manual

4. Requires the Director to annually value, or cause to be valued, the reserves for all outstanding life insurance contracts, annuity and pure endowment contracts, accident and health contracts and deposit-type contracts of every company issued on or after the operative date of the valuation manual.

5. Allows the Director, in lieu of the valuation of the reserves required of a foreign or alien company, to accept, or caused to be made, by the insurance supervisory official of any state or other jurisdiction if the valuation complies with the provided minimum standard.

Actuarial Opinion of Reserves Before the Operative Date of the Valuation Manual

6. Stipulates that, with certain exceptions, documents, materials or other information in the possession or control of the Department that are a memorandum in support of an actuarial opinion, and any other material provided to the Director, are confidential and not subject to public records requests, subpoenas, discovery or admissible in evidence in any private civil action.

7. Authorizes the Director to use documents, materials or other information in the furtherance of any regulatory or legal action brought as part of the Director's official duties.

8. Prohibits the Director or any person who received documents, materials or other information while acting under the authority of the Director from testifying in any private civil action concerning any confidential documents, materials or information.

9. Allows the Director, in order to assist in the performance of its duties, to:
   a) share documents, materials or other information, including confidential and privileged documents and materials with:
      i. other state, federal and international regulatory agencies with the National Association of Insurance Commissioners (NAIC) and its affiliates and subsidiaries; and
      ii. state, federal and international law enforcement authorities, if the recipient agrees to maintain the confidentiality and privileged status of the document or other material.
   b) receive documents, material or information, including confidential and privileged documents and materials, from the NAIC and its affiliates and subsidiaries, and regulatory and law enforcement officials or other foreign or domestic jurisdictions; and
   c) enter into agreements governing sharing and use of confidential information.

10. Prohibits the waiver of any applicable privilege or claim of confidentiality in the documents, materials or information from occurring as a result of disclosure.

11. Allows a memorandum in support of the actuarial opinion, and any other material provided by the company to the Director in connection with the memorandum, to be subpoenaed for the purpose of defending an action seeking damages from the actuary submitting the memorandum by reason of a required action.

12. Allows a memorandum or other material to be released by the Director with the written consent of the company or to the American Academy of Actuaries on request stating that the memorandum or other material is required for the purpose of professional disciplinary proceedings and setting forth procedures satisfactory to the Director for preserving confidentiality.

13. Specifies that all portions of the confidential memorandum are no longer confidential once any portion is cited by the company in its marketing, cited before a governmental agency other the Department, or is released to the news media.

Actuarial Opinion of Reserves After the Operative Date of the Valuation Manual

14. Requires every company with outstanding life insurance contracts, accident and health insurance contracts or deposit-type contracts in the state and subject to regulation by the Director to annually submit the actuarial opinion of the appointed actuary as to whether the reserves and related actuarial items held in support of the policies and contracts are:
    a) computed appropriately;
    b) based on assumptions that satisfy contractual provisions;
    c) consistent with prior reported amounts; and
    d) comply with applicable state laws.

15. Specifies that the valuation manual will prescribe the specifics of the actuarial opinion including any items deemed to be necessary to its scope.

16. Requires every company with outstanding life insurance contracts, accident and health insurance contracts or deposit-type contracts in the state and subject to regulation by the Director, except as prescribed in the valuation manual, to annually include in the required actuarial opinion of the same appointed actuary as to whether the reserves and related actuarial items held in support of the policies and contracts specified in the valuation manual, when considered in light of the assets held by the company with respect to the reserves and related actuarial items, including investment earning on the assets and considerations anticipated to be received and retained, make adequate provision for the company's obligations under the policies and contracts, including benefits and expenses.

17. Requires a supporting memorandum, in form and substance specified in the valuation manual, and acceptable to the Director, to be prepared to support each actuarial opinion.

18. Allows the Director to engage a qualified actuary at the expense of the insurance company to review the actuarial opinion and the basis for the opinion and prepare the supporting memorandum if the company fails to provide a supporting memorandum within a period specified in the valuation manual or the Director determines that the supporting

memorandum fails to meet the standards prescribed by the valuation manual or is otherwise unacceptable.

Actuarial Opinion Requirements

19. Requires actuarial opinions to be in the form and substance as specified in the valuation manual and acceptable to the Director.

20. Requires actuarial opinions to be submitted with the annual statement reflecting the valuation of the reserves for each year ending on or after the operative date of the valuation manual.

21. Requires actuarial opinions to apply to all policies and contracts plus other actuarial liabilities as may be specified by the valuation manual.

22. Requires actuarial opinions to be bas on standards adopted from time to time by the Actuarial Standards Board or its successor and on any additional standards that may be prescribed in the valuation manual.

23. Allows the Director, in the case of any actuarial opinion required by a foreign or alien company, to accept the actuarial opinion filed by that company with the insurance supervisory official of another state if the Director determines that the actuarial opinion reasonably meets the requirement applicable to a company domiciled in the state.

24. Stipulates that, except in cases of fraud or willful misconduct, the appointed actuary is not liable for damages to any person, other than the insurance company and the Director, for any act, error, omission, decision or conduct with respect to the appointed actuary's opinion.

25. Requires disciplinary action by the Director to be defined in rule.

Accident and Health Insurance Contracts Issued On or After the Operative Date of the Valuation Manual

26. Specifies that the standard prescribed in the valuation manual is the required minimum standard of valuation.

27. Stipulates that the standard of valuation for disability insurance contracts issued on or after January 1, 1956, and before the operative date of the valuation manual is the standard adopted by the Director by rule.

Valuation Manual for Policies Issued On or After the Operative Date

28. Specifies that for policies issued on or after the operative date of the valuation manual, the standard prescribed in the manual is the minimum standard of valuation required, except as provided in statute.

29. Stipulates that the operative date of the valuation manual is January 1 of the first calendar year following the first July 1 as of which all the following have occurred:

   a) 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.
   b) 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 written as reported in the life, accident and health, health or fraternal annual statements submitted for 2008.
   c) the standard valuation law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by at least 42 of the following 55 jurisdictions:
      i. United States;
      ii. American Samoa;
      iii. United States Virgin Islands;
      iv. District of Columbia;
      v. Guam; and
      vi. Puerto Rico.

30. Specifies that, unless a change in the valuation manual specifies a later effective date, changes to the valuation manual must be effective on January 1 following the date when all of the following have occurred:
   a) the change to the valuation manual has been adopted by the NAIC by an affirmative vote representing the following:
      i. at least three-fourths of the members of the NAIC voting, but not less than a majority of the total membership; and
      ii. members of the NAIC representing jurisdictions totaling greater than 75 percent of the direct premiums written as reported in the life accident and health, health or fraternal annual statements most recently available before the vote of the NAIC membership; and
   b) the valuation manual becomes effective pursuant to an order of the Director.

31. Specifies that the valuation manual must specify all of the following:
   a) minimum valuations standards for and definitions of policies and contracts and must include all of the following:
      i. the Director's reserve valuation method for life insurance contracts, other than annuity contracts;
      ii. the Director's annuity reserve valuation method for annuity contracts; and
      iii. minimum reserves for all other policies or contracts.
   b) which policies or contracts or types of policies or contracts that are subject to the requirements of a principle-based valuation and the minimum valuation standards consistent with those requirements;
   c) for policies and contracts subject to a principle-based valuation:
      i. requirements for format of reports to the Director which must include information necessary to determine if the valuation is appropriate and in compliance;
      ii. assumptions must be prescribed for risks over which the company does not have significant control or influence; and
      iii. procedures for corporate governance and oversight of the actuarial function and a process for appropriate waiver or modification of the procedures;

d) for policies for policies not subject to a principle-based valuation the minimum valuation standard must be either:
   i. be consistent with the minimum standard of valuation before the operative date of the valuation manual; or
   ii. develop reserves that quantify the benefits and guarantees, and the funding, associated with the contracts and their risks at a level of conservatism that reflects conditions that include unfavorable events that have a reasonable probability of occurring;
e) other requirements, including those relating to reserve methods, models for measuring risk, generation of economic scenarios, assumptions, margins, use of company experience, risk measurement, disclosure, certifications, reports, actuarial opinions and memorandums, transition rules and internal controls; and
f) the data and required form of the data with whom the data must be submitted, and other requirements including data analyses and reporting analyses.

32. Requires the company, with respect to the requirements, in the absence of a specific valuation requirement or if a specific valuation requirement in the valuation is not in compliance, to comply with minimum valuation standards prescribed by rule.

33. Allows the Director to engage a qualified actuary, at the expense of the company, to perform an actuarial examination of the company and opine on the appropriateness of any reserve assumption or method used by the company, or to review and opine on company's compliance with any requirement.

34. Permits the Director to rely on opinion of a qualified actuary engaged by the Director of another state, district or territory of the United States.

35. Allows the Director to require a company to change any assumption or method that is necessary in order to comply with the requirements of the valuation manual or other parts of statute.

36. Requires the company to adjust the reserves as required by the Director.

37. Permits the Director to take other disciplinary action as allowed by law.

Companies Using Principle-Based Valuation for Policies or Contracts as Specified in the Valuation Manual

38. Requires a company to establish reserves using principle-based valuation that meets the following conditions for policies or contracts as specified in the valuation manual:
   a) quantify the benefits and guarantees, and the funding, associated with the contracts and their risks at a level of conservatism that reflects conditions that include unfavorable events that have a reasonable probability of occurring during the lifetime of the contracts, and for policies or contracts with significant tail risk, that reflects conditions appropriately adverse to quantify the tail risk;
   b) incorporate assumptions, risk analysis methods and financial models and management techniques that are consistent with, but not necessarily identical to, those utilized within

the company's overall risk assessment process, while recognizing potential differences in financial reporting structures and any prescribed assumptions or methods;

c) incorporate assumptions that are derived in one of the following manners:
   i. the assumption is prescribed in the valuation manual;
   ii. for assumptions not prescribed, the assumptions must be established utilizing the company's available experience to the extent it is credible or established utilizing other relevant, statistically credible experience, to the extent that company data is not available; and

d) provide margins for uncertainty including adverse deviation and estimation error, such that the greater the uncertainty the larger the margin and resulting reserve.

Companies Using Principle-Based Valuation for One or More Policies

39. Specifies that a company using principle-based valuation for one or more policies or contracts as specified in the valuation manual must:
   a) establish procedures for corporate governance and oversight of the actuarial valuation function consistent with those described in the valuation manual;
   b) provide an annual certification of the effectiveness of the internal controls with respect to the principle-based valuation to the Director and the Board of Directors; and
   c) develop, and file with the Director on request, a principle-based valuation report that complies with standards prescribed in the valuation manual.

Single State Exemption

40. Permits the Director to exempt specific product forms or product lines of a domestic company that is licensed and doing business only in Arizona from certain requirements if:
   a) the Director has issued an exemption in writing to the company and has not subsequently revoked the exemption in writing; and
   b) the company computes reserves using assumptions and methods used before the operative date of the valuation manual in addition to any requirements established by the Director and adopted by rule.

Standard Nonforfeiture Law for Life Insurance

41. Stipulates that for policies issued on or after the operative date of the valuation manual, the valuation manual must provide the Commissioners Standard Mortality Table for use in determining the minimum nonforfeiture standard that can be substituted for:
   a) the Commissioners 1980 Standard Ordinary Mortality table with or without 10 year select mortality factors:
   b) the Commissioners 1980 Extended Term Insurance Table;
   c) the Commissioners 1961 Standard Industrial Mortality Table; or
   d) the Commissioners 1961 Industrial Extended Term Insurance Table.

42. Specifies that if the Director approves any NAIC adopted Commissioners Standard Ordinary Mortality or Standard Industrial Mortality Table, the minimum nonforfeiture standard supersedes the minimum nonforfeiture standard provided by the valuation manual.

43. States that for policies issued on or after the operative date of the valuation manual, the nonforfeiture interest rate per annum for any policy issued on a particular calendar year must be provided by the valuation manual.

Miscellaneous

44. Requires a company to submit mortality, morbidity, policyholder behavior or expense experience and other data as prescribed by the valuation manual.

45. Defines *confidentiality*.

46. Specifies information that applies as *confidential*.

47. Cites this section as the Standard Valuation Law.

48. Defines terms.

49. Makes technical and conforming changes.

50. Becomes effective on the general effective date.

<u>Amendment Adopted by Committee of the Whole</u>

1. Outlines the method for determining minimum nonforfeiture standards.

2. Provides the nonforfeiture interest rate.

3. Defines terms.

4. Makes technical changes.

<u>Senate Action</u>

FIN	2/20/13	DPA/SE	7-0-0
3rd Read	2/28/13		28-0-2

Prepared by Senate Research
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BR/ly