STATE OF CONNECTICUT

INSURANCE DEPARTMENT

Testimony of Thomas B. Leonardi, Insurance Commissioner
to
Insurance and Real Estate Committee

February 25, 2014

Raised Bill 185 AN ACT CONCERNING CHANGES TO THE STANDARD VALUATION AND NONFORFEITURE LAWS, AND THE USE OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS' VALUATION MANUAL

Senator Crisco, Representative Megna, and members of the Insurance and Real Estate Committee, The Insurance Department thanks the Committee for raising S.B. 185, An Act Concerning Changes To The Standard Valuation And Nonforfeiture Laws, And The Use Of The National Association Of Insurance Commissioners' Valuation Manual, at the Department's request, and appreciates the opportunity to provide written testimony.

Senate Bill 185 is being introduced to bring life insurance and annuity reserving techniques from the 19th Century to the 21st Century.

These amendments to the Standard Valuation Law enable the introduction of a concept known as Principle Based Reserving ("PBR") of life insurance companies' actuarial liabilities. That concept has been developed by state insurance regulators working through the National Association of Insurance Commissioners, and is being introduced in state legislatures throughout the nation. It will ultimately replace a formulaic system of insurance reserves that has been in use since at least 1885 and possibly much earlier.

The formulaic reserve approach worked well for over a century as insurers sold similar life and annuity products with relatively standard basic features. That approach has become overly static, however, as insurance companies have developed increasingly sophisticated life and annuity products. Those formulas do not always work without modification or clarification as new product designs and innovations are introduced. Regulators and insurers now find that use of those formulaic reserves can result in reserves being redundant in some cases and inadequate in others.

Principle based reserving uses risk analysis techniques such as modeling and simulation to better capture and evaluate various risks inherent in modern life insurance policies and annuity contracts. It sets up a regulatory system so that these reserves can be established to be consistent with the unique characteristics of the different products of different companies. The purpose is to establish reserves at a better level so they are neither under reserved -- with a risk to solvency -- nor over reserved -- which can lead to unnecessarily expensive policies and contracts. It is based on company-specific and product-specific actuarial data.

The bill requires life insurance companies to submit to regulators mortality, morbidity, policyholder behavior experience and other data as prescribed in the Valuation Manual. It also protects confidentiality of sensitive financial and actuarial data provided to the Insurance Department so that the Department can have uninhibited access to this data. This makes for effective monitoring of reserves, and ultimately solvency.

The SVL revisions under consideration provide for life and health reserve requirements to be consolidated in a Valuation Manual to support state uniformity along with the PBR method for determining life insurance reserves. The initial version of the Valuation Manual was recently adopted by the NAIC. However, the manual will not go into effect until a supermajority of states enacts both the manual and revisions to state Standard Valuation Laws. Specifically the supermajority calls for approval of the SVL amendments or substantially similar legislation by legislative approval in 42 jurisdictions and in states representing greater than 75% of direct written premium for life, accident and health business. As mentioned, one trigger has already been met, namely approval of the Valuation Manual by a supermajority of jurisdictions at the NAIC. This is an admittedly unusual provision, but it is intended to allow a uniform transition to PBR and to prevent differing reserving practices and standards being used in different states. Reserving standards in life insurance and annuity products is one of those regulatory functions where national uniformity is critically important to the state-based system of insurance regulation and the maintenance of a financially sound life insurance industry. The reserving requirements for life insurance and annuity business written before the effective date of the Valuation Manual will remain unchanged.

The changes to the Standard Nonforfeiture Law establish minimum benefit values if policies are surrendered or lapsed and for consistency, would align the Nonforfeiture Law with the SVL and Valuation Manual as the source for mortality and interest rates used in nonforfeiture calculations.

While uniformity is important to establish uniform reserve methodologies, the amendments to the SVL and Nonforfeiture Law preserve my authority and the authority of individual insurance commissioners to require companies to change any assumption or method as appropriate and to engage a qualified actuary at the expense of the company to review compliance with Valuation Manual requirements.

The Valuation Manual is intended to be dynamic to allow consideration of ongoing changes of products offered in the marketplace, much as the NAIC Accounting and Procedures Manual -- which sets out the details of statutory accounting -- works now. Future changes in the manual will require approval by a supermajority of 42 NAIC jurisdictions so that they will be implanted uniformly and with appropriate controls.

The SVL proposal is a product of more than a year's collaboration with the insurance industry. Connecticut is the number one state in the country for life insurance premium, making our adoption of SVL a show of leadership in the oversight of the industry. As you consider the legislative proposal, regulators and the industry are working to develop outreach and training programs to assist in the implementation of principle based reserving, including the use of pilot studies to test and resolve issues that may arise during rollout.

The Department appreciates the opportunity to submit these comments today. We strongly urge passage of Raised Bill 185. Thank you.

About the Connecticut Insurance Department: The mission of the Connecticut Insurance Department is to protect consumers through regulation of the industry, outreach, education and advocacy. The Department recovers an average of more than $4 million yearly on behalf of consumers and regulates the industry by ensuring carriers adhere to state insurance laws and regulations and are financially solvent to pay claims. The Department's annual budget is funded through assessments from the insurance industry. Each year, the Department returns an average of $100 million a year to the state General Fund in license fees, premium taxes, fines and other revenue sources to support various state programs, including childhood immunization.