

OFFICE OF LEGISLATIVE RESEARCH
PUBLIC ACT SUMMARY



PA 14-195—SB 185

Insurance and Real Estate Committee

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

SUMMARY: This act modifies and expands, in two stages, the scope of the laws governing reserve requirements for insurance companies. By law, the insurance commissioner must annually value, or cause to be valued, the reserves of life insurance companies. The act expands (1) requirements for an actuary's opinion and memorandum on the sufficiency of the reserves, (2) confidentiality provisions regarding information submitted under these requirements, and (3) the commissioner's powers in using this information.

These provisions run until the National Association of Insurance Commissioners' (NAIC) Valuation Manual goes into effect in Connecticut. At that point, they are superseded by similar provisions that apply to a broader range of insurers. The act specifies (1) the issues the manual must address and (2) when the manual and its changes take effect in Connecticut.

Once the manual goes into effect in Connecticut, the act requires each company issuing life, accident, and health insurance and deposit-type contracts (those that do not account for the risks of death or sickness) to establish reserves using a "principle-based valuation" for policies or contracts as the manual requires. The act specifies the requirements for this valuation approach and sets valuation standards if the manual does not require companies to use this approach. It requires the commissioner to value, or cause to be valued, the reserves for all outstanding contracts in these lines for all companies that write such contracts in Connecticut or have the authority to do so.

The act makes minor and technical changes in the statutory minimum standards for valuing the reserves of life insurance plans until the manual goes into effect in Connecticut.

The act extends requirements for an actuary's opinion and memorandum on the sufficiency of the reserves to the contracts the act covers. It broadens, once the manual goes into effect, the types of information considered confidential.

The provisions that apply once the manual goes into effect govern policies and contracts issued on or after the manual's effective date. Several of these provisions do not apply to a fraternal benefit society unless it chooses to use the valuation standards that apply to other types of insurers.

The act makes related minor, conforming, and technical changes (§§ 3-5).

EFFECTIVE DATE: Upon passage

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§ 1 — MODIFICATIONS OF RESERVE REQUIREMENTS FOR LIFE INSURANCE COMPANIES BEFORE MANUAL TAKES EFFECT

§ 1(a)(1) — *Commissioner's Duties and Powers*

By law, the insurance commissioner must annually value, or cause to be valued, the reserves for all outstanding life insurance policies and annuity and pure endowment contracts of life insurance companies doing business in Connecticut. For alien (non-U.S.) companies, the valuation is limited to the company's U.S. business.

The act eliminates the commissioner's power to certify the amount of the reserves and specify the mortality table or tables, rate or rates of interest, and methods used to calculate them.

The act expands the commissioner's authority to accept a valuation made by or caused to be made by the insurance regulatory official of another state or country. It does so by eliminating the requirement that the other jurisdiction grant reciprocity in valuations made by the commissioner.

§ 1(b)(2-4) — *Actuary's Opinion and Memorandum*

By law, each life insurance company doing business in Connecticut must annually submit a qualified actuary's opinion and a supporting memorandum on whether the reserves and related actuarial items held to support its policies and contracts meet statutory requirements. The act provides that, if other provisions of insurance law conflict with the requirements of the act or existing law, the other provisions govern.

By law, the commissioner can engage an actuary, at the company's expense, if the memorandum is not prepared or is deficient. The act specifies that the commissioner can do so either by employing or contracting with the actuary.

The act specifically requires the commissioner to adopt regulations to specify:

1. the standards for the supporting memorandum and
2. how soon the company must provide a memorandum after the commissioner requests one.

§ 1(b)(8) & 1(c) — *Confidentiality*

The act broadens the confidentiality provisions related to an actuary's opinion and memorandum.

By law, the commissioner must keep confidential any memorandum in support of the opinion and any other material the company provides him. This material may not be made public and is not subject to subpoena, other than to defend an action seeking damages by reason of any act required by law.

But the commissioner may release the material:

1. with the company's written consent or
2. if the American Academy of Actuaries requests it for disciplinary proceedings and establishes procedures satisfactory to the commissioner to preserve its confidentiality.

In addition, once the company refers to any part of the memorandum in its marketing or releases the information to the news media, or the information is

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referred to before a governmental agency other than a state insurance department, the entire memorandum is no longer confidential.

Under the act, any information in the department's possession or control relating to the memorandum is (1) confidential and privileged, except as provided above; (2) exempt from disclosure under the Freedom of Information Act; (3) not subject to subpoena, except to defend an action for damages by the actuary; and (4) not subject to discovery or admissible in evidence in any civil action in this state. Also, the commissioner or anyone who receives the information relating to the memorandum while acting under his authority may not be permitted or required to testify in any civil action concerning it.

§ 1(b)(8 & 9) — Commissioner's Powers

The act allows the commissioner to use information in or related to the memorandum to further any regulatory or legal action brought as part of his official duties. It allows the commissioner to:

1. share information, including information deemed confidential and privileged, with (a) other state, federal, and international regulatory officials, (b) NAIC, its affiliates, and subsidiaries, and (c) state, federal, and international law enforcement officials, provided the recipient agrees in writing to maintain its confidentiality and privileged status;
2. receive information, including confidential and privileged information, from (a) NAIC, its affiliates, or subsidiaries and (b) regulatory and law enforcement officials of other jurisdictions; and
3. enter into written agreements governing the sharing and use of the information consistent with these confidentiality provisions.

The commissioner must maintain the confidentiality and privileged status of any information he receives when notified, or with the understanding, that it is confidential and privileged under the laws of the source jurisdiction. Disclosure to the commissioner or sharing authorized under the act does not waive any applicable privilege or claims.

§ 2 — VALUATION MANUAL

The act requires accident and health and life insurers and those that write or have authority to write deposit-type contracts to use the NAIC Valuation Manual for determining the value of their reserves once specified triggering events occur.

§ 2(c)(1) — Issues Addressed in the Manual

The act requires the manual to specify:

1. the minimum valuation standards for the policies or contracts it covers, including that the (a) commissioner's annuity reserve valuation method must be the standard for annuity contracts, (b) commissioner's reserve valuation method must be the standard for other life insurance contracts, and (c) manual must specify minimum reserves for all other affected policies or contracts;
2. the policies or contracts or types of policies or contracts that must

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- establish reserves using a principle-based valuation (see below) and the minimum valuation standards consistent with these requirements;
3. for policies or contracts subject to principle-based valuation, the (a) requirements for formatting reports submitted to the commissioner, including the information required to determine if the valuation is appropriate and complies with the act, (b) assumptions prescribed for risks beyond the company's significant control or influence, and (c) procedures for the corporate governance and oversight of the actuarial function and a process for appropriate waiver or modification of these procedures;
 4. for policies or contracts not subject to principle-based valuation, the minimum valuation standard, which must (a) be consistent with the standard in effect before the manual goes into effect or (b) develop reserves that quantify the benefits, guarantees, and funding associated with the policies or contracts and their risks, at a level of conservatism reflecting conditions that include unfavorable events that have a reasonable probability of occurring;
 5. other requirements, including reserve methods, models for measuring risk, generating economic scenarios, assumptions, margins, use of company experience, risk measurement, disclosures, certifications, reports, actuarial opinions and memoranda, transition rules, and internal controls; and
 6. the data companies must submit, its form, who gets it, and other information that may be required, including data analyses and reporting.

If (1) there is no specific valuation requirement or (2) the commissioner believes that a specific requirement in the manual does not comply with the act, he must direct a company to comply with the minimum valuation standards prescribed by department regulations.

Under the act, "principle-based valuation" uses one or more assumptions or methods determined by a company to value reserves.

§ 2(a) — EFFECTIVE DATE OF THE MANUAL

Initial Adoption of the Manual

Under the act, the manual goes into effect January 1 of the first calendar year following the first July 1 when all of the following have occurred:

1. NAIC, by an affirmative vote of at least 42 of its members or three-quarters of the members voting, whichever is greater, has adopted the manual;
2. the Standard Valuation Law, as amended by NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by states representing more than 75% of the direct written premiums as reported in the following types of annual statements submitted to NAIC for 2008: life insurance, accident and health insurance, health insurance, and fraternal benefit societies; and
3. at least 42 of the 50 specified U.S. jurisdictions have enacted the Standard Valuation Law, as amended by NAIC in 2009, or legislation including substantially similar terms and provisions.

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After all of these events occur, the insurance commissioner must certify they occurred and notify affected companies of the certification and the manual's effective date.

Changes to the Manual

Under the act, unless a later effective date is specified, a change to the manual applies on January 1 of the first calendar year after:

1. NAIC adopts the change by an affirmative vote of at least three-quarters of its members voting but not less than a majority of its total membership and
2. the change has been adopted by NAIC members representing jurisdictions totaling more than 75% of the direct written premiums for life insurance, accident and health insurance, health insurance, or fraternal benefit society annual statements, as reported in the most recent annual statement submitted to NAIC.

After both have occurred, the commissioner must certify they occurred and notify companies of the certification, the change to the manual, and the change's effective date.

§ 1(m) & (n) — ESTABLISHING RESERVES AFTER THE MANUAL TAKES EFFECT

Once the manual goes into effect, the act requires each company issuing life insurance, accident and health insurance, and deposit-type contracts to establish reserves using a principle-based valuation for policies or contracts as required by the manual. But the requirement does not apply to fraternal benefit societies, unless they choose to use the valuation standards that apply to other types of insurers.

The valuation must:

1. quantify the benefits, guarantees, and funding associated with the policies or contracts and their risks, at a level of conservatism reflecting conditions that include unfavorable events that have a reasonable probability of occurring during the lifetime of the policies or contracts;
2. incorporate assumptions, risk analysis methods, financial models, and management techniques generally consistent with those the company uses in its overall risk assessment process, while recognizing potential differences in financial reporting structures and any prescribed assumptions or methods;
3. incorporate assumptions prescribed in the manual or, if an assumption is not prescribed, make the assumption using the company's available experience, to the extent it is relevant and statistically credible, or establish assumptions using other relevant and statistically credible experience when its own experience data is not available; and
4. provide margins for uncertainty including adverse deviation and estimation error, so that the greater the uncertainty, the larger the margin and resulting reserves.

For policies or contracts with significant "tail risk" (unlikely but potentially

very expensive risks), the valuation must reflect appropriately adverse conditions to quantify the tail risk.

Governance and Internal Controls

A company using principle-based valuation for one or more policies or contracts must:

1. establish a procedure for corporate governance and oversight of the actuarial valuation function consistent with those described in the manual;
2. annually certify to the commissioner and the company's board of directors the effectiveness of the internal controls with respect to the principle-based valuation; and
3. develop and file with the commissioner, upon request, a principle-based valuation report that complies with standards prescribed in the manual.

The controls must be designed to ensure that:

1. all material risks inherent in the liabilities and associated assets subject to the valuation are included in the valuation and
2. the valuations are made according to the manual.

The certification must be based on the internal controls in place as of the end of the preceding calendar year.

The company must also submit, presumably to the commissioner, mortality, morbidity, policyholder behavior, or expense experience and other data in accordance with the manual's requirements. Under the act, "policyholder behavior" is any action a policyholder, contract holder, certificate holder, or other person who may elect options may take under a policy or contract. Policyholder behavior includes such things as withdrawals, premium payments, and benefit elections prescribed by the policy or contract. But it does not include deaths or illnesses that result in benefits (e.g., a life insurance policyholder dying and his beneficiaries being paid).

§ 2(c) — VALUATION OF RESERVES AFTER THE MANUAL TAKES EFFECT

The act requires the commissioner, once the manual takes effect, to annually value the reserves for all outstanding life insurance, accident and health insurance, and deposit-type contracts of every company. For out-of-state companies, he may accept a valuation made by the insurance regulatory official of another jurisdiction if it complies with the act's standards. This requirement does not apply to a fraternal benefit society, unless it chooses to use the valuation standards that apply to other types of insurers.

§ 1(b) — ACTUARY'S OPINION

Under the act, every company with outstanding contracts in Connecticut must annually submit the opinion of an actuary as to whether the reserves and related actuarial items held in support of the policies and contracts:

1. are computed appropriately,
2. are based on assumptions that satisfy contractual provisions,

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3. are consistent with prior reported amounts, and
4. comply with applicable state laws.

In addition to the qualifications required under existing law, the act requires the actuary to be appointed in accordance with the manual.

Unless exempted by the manual, the same actuary must give an opinion as to whether the reserves and related actuarial items adequately provide for the company's obligations under the policies and contracts, including the benefits under and expenses associated with them.

The actuary must prepare a memorandum that supports the opinion and give it to the company. If (1) a company fails to provide a memorandum at the commissioner's request within the time period specified in the manual or (2) the commissioner determines that the memorandum fails to meet the manual's standards or is unacceptable, he may engage another actuary, at the company's expense, to review the opinion and its basis and prepare the memorandum.

Each opinion must:

1. be submitted to the commissioner with the annual statement reflecting the valuation of the reserves for each year ending on or after December 31 of the year the manual goes into effect,
2. apply to all of the affected policies and contracts and any other actuarial liabilities the manual specifies, and
3. be based on standards adopted periodically by the Actuarial Standards Board or its successor and any additional standards prescribed in the manual.

The commissioner may hire or contract with a qualified actuary, at a company's expense, to (1) perform an actuarial examination of the company and (2) (a) provide an opinion on the appropriateness of any reserve assumption or method the company used or (b) review and provide an opinion on the company's compliance with any of the act's requirements. The act allows the commissioner to rely on the opinion, regarding these requirements, of a qualified actuary engaged by the insurance regulatory official of another U.S. jurisdiction.

The commissioner may require a company to change any assumption or method that he deems necessary to comply with the requirements of the act or the manual, and the company must adjust its reserves as the commissioner requires.

§ 2(g) — CONFIDENTIALITY

Once the manual goes into effect, the act broadens the types of information considered confidential. At that point, the following information is generally considered confidential:

1. the memorandum supporting an actuary's opinion and related documents;
2. all reports, documents, materials, and other information a company develops in support of or in connection with the annual certification of the effectiveness of its internal controls;
3. any valuation report developed under the act; and
4. all submitted information regarding mortality, morbidity, policyholder behavior, or expense experience and any related information that includes any potentially company-identifying or personally identifiable information

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obtained by or provided to the commissioner.

The act also treats as confidential all documents, materials, and other information and their copies created, produced, or obtained by or disclosed to the commissioner or any other person in the course of an examination conducted under the act or in connection with the memorandum, certification, report, or information submitted concerning policyholder behavior or expense experience.

Under the act, a company's confidential information is generally subject to the same confidentiality protections that applied to submissions by life insurance companies under prior law, as modified by the act (see above).

§ 2(g)(3) — Commissioner's Powers

To help him perform his duties, the commissioner may share confidential information:

1. with other state, federal, and international regulatory agencies and NAIC, its affiliates, and its subsidiaries and
2. concerning the supporting memorandum or principle-based valuation report or related documents with (a) the Actuarial Board for Counseling and Discipline or its successor upon its request when it needs the information for professional disciplinary proceedings and (b) state, federal, and international law enforcement officials.

The recipient must agree, in writing, and have the legal authority to agree, to maintain the information's confidentiality and privileged status in the same way and to the same extent as required for the commissioner.

The act allows the commissioner to receive documents, materials, data, and other information, including those that are confidential and privileged, from the same entities with which he can share such information. He must maintain the confidentiality of any documents, materials, data, or other information received with notice or the understanding that they are confidential and privileged under the laws of the jurisdiction that is their source.

The act allows the commissioner to enter into written agreements governing the sharing and use of documents, materials, data, and other information, if they are consistent with its provisions.

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