

BILL ANALYSIS

S.B. 1654
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Insurance
Committee Report (Unamended)

BACKGROUND AND PURPOSE

It is noted that life insurers set aside reserves that are used to pay future expected claims. There are concerns about the current reserve framework for life insurers, which has been in place and fundamentally unchanged for a significant period of time. Interested parties contend that the current system relies on a one-size-fits-all system dependent on a formula that primarily draws information from annual statement data and, since the differences in company experience, mortality, and expense levels are not reflected, efficiency in underwriting, pricing, and expense control is not rewarded.

Interested parties further contend that principle-based reserves allow reserves to be tailor-made for every company to match its unique risks. To implement principle-based reserves, state legislatures must adopt both the Standard Model Valuation Law that was approved by the National Association of Insurance Commissioners (NAIC) and recent revisions to the NAIC Standard Nonforfeiture Law.

S.B. 1654 seeks to apply the statutory framework developed by the NAIC to enhance the current system for calculating policy reserves, provide regulators with tools to properly monitor a life insurer's reserve levels through annual reporting and review, and help reserve requirements keep pace with new product designs from life insurers to meet consumer needs.

CRIMINAL JUSTICE IMPACT

It is the committee's opinion that this bill does not expressly create a criminal offense, increase the punishment for an existing criminal offense or category of offenses, or change the eligibility of a person for community supervision, parole, or mandatory supervision.

RULEMAKING AUTHORITY

It is the committee's opinion that rulemaking authority is expressly granted to the commissioner of insurance in SECTION 15 of this bill.

ANALYSIS

S.B. 1654 amends the Insurance Code to require the commissioner of insurance to adopt by rule a valuation manual substantially similar to the valuation manual approved by the National Association of Insurance Commissioners (NAIC) for the purpose of setting reserves for life insurance policies, accident and health insurance policies, and certain deposit-type contracts and to determine the operative date of the valuation manual. The bill establishes that the minimum standard of valuation for disability, accident and sickness, and accident and health insurance contracts issued before the valuation manual's operative date is the valuation standard in existence before the valuation manual's operative date in addition to any requirements established by the commissioner and adopted by rule. The bill makes the standard prescribed by the valuation manual the minimum standard of valuation for policies and contracts issued on or after the valuation manual's operative date, including the minimum standard for accident and health insurance.

Valuation Manual Adoption Procedures and Content

S.B. 1654 requires the valuation manual's operative date to be January 1 of the first calendar year immediately following a year in which, on or before July 1, the commissioner determines that the valuation manual has been adopted by a specified minimum threshold of members of the NAIC and that the NAIC Standard Model Valuation Law or legislation including substantially similar terms and provisions has been enacted by a specified minimum threshold of states and jurisdictions, as applicable. The bill requires the commissioner to determine whether the NAIC and a sufficient number of states and other jurisdictions have adopted a valuation manual. The bill requires the commissioner, as soon as practicable after making that determination, to adopt rules as required by the bill's provisions.

S.B. 1654 requires any changes to the valuation manual made after the commissioner's adoption to be adopted by rule and to be substantially similar to changes adopted by the NAIC. The bill prohibits an effective date for changes to the valuation manual from being earlier than January 1 of the year immediately following the date on which the commissioner determines that the changes to the valuation manual have been adopted in the manner specified by the bill by an affirmative vote of a specified minimum threshold of the NAIC, unless a change in the valuation specifies a later effective date.

S.B. 1654 sets out the required content of the valuation manual, including the specification of certain minimum valuation standards, provisions governing the application of principle-based valuation, and an exemption that allows certain small companies to value reserves based on an exception from certain requirements. The bill prescribes the valuation manual's required minimum valuation standard for policies not subject to a principle-based valuation standard. The bill requires a company to comply with minimum valuation standards prescribed by commissioner rule in the absence of a specific valuation requirement or if such a requirement in the valuation manual does not in the commissioner's opinion comply with state standard valuation law.

S.B. 1654 authorizes the commissioner to employ or contract with a qualified actuary at the company's expense to perform an actuarial examination of a company and provide an opinion concerning the appropriateness of any reserve assumption or method used by the company or to review and provide an opinion on a company's compliance with any requirement of state standard valuation law. The bill authorizes the commissioner to rely on the opinion in regards to provisions contained within state standard valuation law of a qualified actuary engaged by the insurance supervisory official of another state. The bill authorizes the commissioner to require a company to change an assumption or method as necessary in the commissioner's opinion to comply with a requirement of the valuation manual or state standard valuation law and authorizes the commissioner to take other disciplinary action as permitted under statutory provisions prescribing the imposition of sanctions.

Principle-Based Valuation and Experience Reporting

S.B. 1654 requires a company to establish reserves using a principle-based valuation that meets the conditions for policies or contracts provided by the valuation manual and sets out the minimum criteria for a principle-based valuation. The bill requires a company using a principle-based valuation for one or more of those policies or contracts to establish procedures for corporate governance and oversight of the actuarial valuation function consistent with procedures specified by the valuation manual; to provide to the commissioner and the company's board of directors an annual certification of the effectiveness of the internal controls with respect to the principle-based valuation; and to develop, and file with the commissioner on request, a principle-based valuation report that complies with standards prescribed in the valuation manual.

S.B. 1654 requires a company's internal controls with respect to the principle-based valuation to be designed to ensure that all material risks inherent in the liabilities and associated assets subject to the valuation are included in the valuation and that valuations are made in accordance with the valuation manual. The bill requires the annual certification to be based on the controls in

place as of the end of the preceding calendar year and authorizes a principle-based valuation to include a prescribed formulaic reserve component.

S.B. 1654 requires a company to submit mortality, morbidity, policyholder behavior, or expense experience and other data as prescribed in the valuation manual.

Provisions Relating to Policies and Contracts Issued Before Operative Date of Valuation Manual

S.B. 1654 limits the applicability of established state standard valuation law provisions requiring the annual valuation of reserves for all outstanding life insurance policies and annuity and pure endowment contracts of each life insurance company engaged in business in Texas to policies and contracts issued before the valuation manual's operative date and removes the authority of the Texas Department of Insurance (TDI) to certify the amount of such reserves. The bill specifies that the minimum standards for the valuation of policies and contracts issued before the valuation manual's operative date are as provided by the law in effect immediately before that date and exempts such policies and contracts from the bill's provisions regarding the minimum standard for valuation, valuation manual, and principle-based valuation requirements for policies or contracts issued on or after the valuation manual's operative date.

S.B. 1654 provides that any document or other information in the possession or control of TDI that is a memorandum in support of the actuarial opinion or other material provided by the company to the commissioner in connection with a memorandum is confidential and privileged and is not subject to disclosure under state public information law, subpoena, discovery, or admissibility as evidence in a private civil action. The bill prohibits the commissioner or any person who receives such a document or other information while acting under the commissioner's authority from testifying or being compelled to testify in a private civil action concerning the document or other information.

S.B. 1654 authorizes the commissioner to share information, including such confidential and privileged documents or information, with another state, federal, or international regulatory agency; with the NAIC and its affiliates and subsidiaries; and with state, federal, and international law enforcement authorities, provided that the recipient agrees to maintain the confidentiality of the information. The bill authorizes the commissioner to receive such information from the NAIC and its affiliates and subsidiaries, and from regulatory and law enforcement officials of other foreign or domestic jurisdictions, provided that the commissioner maintains as confidential or privileged any information received with notice or understanding that it is confidential or privileged under the laws of the jurisdiction that is the source of the information.

S.B. 1654 establishes that disclosing information or providing a document to the commissioner, or sharing information as authorized, does not result in a waiver of any applicable privilege or claim of confidentiality that may apply to the document or information. The bill establishes that a memorandum in support of the opinion, and any other material provided by the company to the commissioner in connection with the memorandum, may be subject to subpoena for the purpose of defending an action seeking damages from the actuary submitting the memorandum by reason of an action required by the bill's provisions regarding actuarial opinions of reserves required before the operative date of the valuation manual or rules adopted under such provisions.

S.B. 1654 establishes that the supporting memorandum or other material provided by the company to the commissioner may otherwise be released by the commissioner with the written consent of the company, or to the Actuarial Board for Counseling and Discipline or its successor, on receipt of a request stating that the memorandum or other material is required for the purpose of professional disciplinary proceedings and setting forth procedures satisfactory to the commissioner for preserving the confidentiality and privileged status of the memorandum or other material. The bill sets out the circumstances under which the memorandum ceases to be confidential and privileged. The bill establishes that its provisions regarding actuarial opinions of reserves required before the operative date of the valuation manual do not prohibit the

commissioner from using the acquired information in the furtherance of a legal or regulatory action relating to the administration of the Insurance Code.

Provisions Relating to Policies and Contracts Issued on or After Operative Date of Valuation Manual

S.B. 1654 defines "company," for the purposes of state standard valuation law on and after the valuation manual's operative date, as an entity that has written, issued, or reinsured life insurance contracts, accident and health insurance contracts, or deposit-type contracts in Texas and has at least one such policy in force or on claim or an entity that 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 Texas.

S.B. 1654 requires the commissioner 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 each company issued on or after the valuation manual's operative date. The bill authorizes the commissioner, in lieu of the valuation of the reserves required of a foreign or alien company, to accept a valuation made or caused to be made by the insurance supervisory official of another state if the valuation complies with the provided minimum standards prescribed by state standard valuation law. The bill applies its provisions regarding the minimum standard of valuation for accident and health insurance contracts and other policies issued on or after the valuation manual's operative date and principle-based valuation requirements to all policies and contracts issued on or after the operative date of the valuation manual.

S.B. 1654 requires a company that has outstanding life insurance contracts, accident and health insurance contracts, or deposit-type contracts in Texas that is subject to TDI regulation to annually submit the appointed actuary's opinion as to whether the reserves and related actuarial items held in support of the policies and contracts are computed appropriately, are based on assumptions that satisfy contractual provisions, are consistent with prior reported amounts, and are in compliance with applicable state laws. The bill requires an actuarial opinion of reserves made after the valuation manual's operative date to comply with provisions of the valuation manual, including in regard to any items necessary to its scope. The bill requires such a company, unless exempted by the valuation manual, to include with the required actuarial opinion an opinion of the same appointed actuary concerning whether the reserves and related actuarial items held in support of the policies and contracts specified in the valuation manual make adequate provision for the company's obligations under the policies and contracts when considered in light of the assets held by the company with respect to the reserves and related actuarial items.

S.B. 1654 sets out the requirements for an actuarial opinion of reserves required after the valuation manual's operative date. The bill authorizes the commissioner, in the case of an actuarial opinion required to be submitted by a foreign or alien company, to accept the opinion filed by the company with the insurance supervisory official of another state if the commissioner determines that the opinion reasonably meets the requirements applicable to a company domiciled in Texas.

S.B. 1654 requires a supporting memorandum to be prepared for each actuarial opinion of reserves made after the valuation manual's operative date and requires the form and substance of a supporting memorandum to comply with the valuation manual. The bill limits the liability of a person who certifies an actuarial opinion made after the valuation manual's operative date and subjects a company or person who makes such a certification to disciplinary action for violating state standard valuation law provisions governing actuarial opinions of reserves and supporting memorandum for those opinions.

S.B. 1654 designates as "confidential information" a memorandum in support of an actuarial opinion of reserves made after the valuation manual's operative date; information provided in the

course of an actuarial examination, subject to certain conditions; information developed by a company for an annual certification evaluating the effectiveness of the company's internal controls; any principle-based valuation report; and experience materials and other information, as applicable, that are created, produced, obtained by, or disclosed to the commissioner or other person in connection with such experience materials.

S.B. 1654 establishes that a company's confidential information is confidential by law, privileged, and not subject to state public information law, subpoena, or discovery, or admissibility in evidence in a private civil action provided that the commissioner is authorized to use such confidential information in the furtherance of any legal or regulatory action brought against the company as a part of the commissioner's official duties. The bill prohibits the commissioner or any person who received confidential information while acting under the commissioner's authority from testifying and from being required to testify in any private civil action concerning any confidential information.

S.B. 1654 authorizes the commissioner, in order to assist in the performance of the commissioner's duties, to share the specified confidential information with other state, federal, and international regulatory agencies; the NAIC and its affiliates and subsidiaries; in certain cases, the Actuarial Board for Counseling and Discipline or its successor upon a request stating that the confidential information is required for the purpose of professional disciplinary proceedings; and with state, federal, and international law enforcement officials, provided that the recipient agrees and has the legal authority to agree to maintain the confidentiality and privileged status of such information in the same manner and to the same extent as required for the commissioner.

S.B. 1654 authorizes the commissioner to receive documents, materials, data, and other information, including otherwise confidential or privileged documents, material, data, and information, from the NAIC and its affiliates and subsidiaries; from regulatory or law enforcement officials of other foreign or domestic jurisdictions; and from the Actuarial Board for Counseling and Discipline or its successor. The bill requires the commissioner to maintain as confidential or privileged any document, material, data, or other information received with notice or the understanding that it is confidential or privileged under the laws of the jurisdiction that is the source of the document or other information.

S.B. 1654 authorizes the commissioner to enter into agreements governing the sharing and use of information consistent with certain bill provisions relating to confidentiality and establishes that disclosing documents, material, data, or other confidential information to the commissioner, or sharing such confidential information as authorized, does not result in a waiver of any applicable privilege or claim of confidentiality. The bill makes a privilege established under the law of any state or jurisdiction that is substantially similar to the privilege established under the bill's provisions regarding confidentiality available and enforceable in any proceeding in, and in any court of, the state. The bill specifies that a reference to a regulatory agency, law enforcement agency, or the NAIC includes an entity's employee, agent, consultant, or contractor, as applicable, with regard to the bill's provisions governing the sharing and use of certain confidential information.

S.B. 1654 establishes that any of the confidential information specified in relation to a supporting memorandum or principle-based valuation report may be subject to subpoena for the purpose of defending an action seeking damages from an appointed actuary submitting the related memorandum in support of an actuarial opinion of reserves after the valuation manual's operative date or a principle-based valuation report by reason of an action required by state standard valuation law or rules adopted under state standard valuation law and may be released by the commissioner with the written consent of the company. The bill sets out the circumstances under which any portion of a memorandum in support of an actuarial opinion or a principle-based valuation report ceases to be confidential and privileged.

S.B. 1654 authorizes the commissioner to exempt specific product forms or product lines of a domestic company licensed and doing business only in Texas from the bill's requirements

regarding policies issued on or after the valuation manual's operative date if the commissioner has issued an exemption in writing to the company and has not subsequently revoked the exemption in writing and if the company computes reserves using assumptions and methods used before the valuation manual's operative date in addition to any requirements established by the commissioner and adopted by rule.

Standard Nonforfeiture Law For Life Insurance

S.B. 1654 requires the valuation manual, with regard to a life insurance policy in which any ordinary mortality table adopted by the NAIC after 1980 that is approved by rules adopted by the commissioner for use in determining the minimum nonforfeiture standard may be substituted for the Commissioners 1980 Standard Ordinary Mortality Table with or without Ten-Year Select Mortality Factors or the Commissioners 1980 Extended Term Insurance Table issued on or after the valuation manual's operative date, to provide the commissioner's standard ordinary mortality table for use in determining the minimum nonforfeiture standard that may be substituted for the aforementioned 1980 tables. The bill establishes that, if the commissioner by rule adopts a commissioner's standard ordinary mortality table adopted by the NAIC for use in determining the minimum nonforfeiture standard for policies issued on or after the operative date of the valuation manual, the minimum nonforfeiture standard determined in accordance with that table supersedes the standard provided by the valuation manual.

S.B. 1654 requires the valuation manual, with regard to a life insurance policy in which any industrial mortality table adopted by the NAIC after 1980 that is approved by rules adopted by the commissioner for use in determining the minimum nonforfeiture standard may be substituted for the Commissioners 1961 Standard Industrial Mortality Table or the Commissioners 1961 Industrial Extended Term Insurance Table issued on or after the valuation manual's operative date, to include the commissioner's standard industrial mortality table for use in determining the minimum nonforfeiture standard that may be substituted for the aforementioned 1961 tables. The bill establishes that, if the commissioner by rule adopts a commissioner's standard industrial mortality table adopted by the NAIC for use in determining the minimum nonforfeiture standard for policies issued on or after the operative date of the valuation manual, the minimum nonforfeiture standard determined in accordance with that table supersedes the standard provided by the valuation manual.

S.B. 1654 prohibits the annual nonforfeiture interest rate for a life insurance policy issued in a particular calendar year before the valuation manual's operative date from being less than four percent. The bill specifies that the annual nonforfeiture interest rate for any life insurance policy issued in a particular calendar year on or after the valuation manual's operative date is provided by the valuation manual.

EFFECTIVE DATE

September 1, 2015.