2015 HOUSE INDUSTRY, BUSINESS AND LABOR

HB 1142

2015 HOUSE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee
Peace Garden Room, State Capitol

HB 1142
2/3/2015
23047
☐ Subcommittee
☐ Conference Committee

Donna Whetham

Explanation or reason for introduction of bill/resolution:

Relating to the standard valuation law for life insurance policies and annuities; to amend relating to the standard valuation law for life insurance; and to provide a contingent effective date

Minutes: Attachment 1-6.

Vice *Chairman Sukut*: Opens the hearing on HB 1142.

Chairman Keiser~District 47. (Attachment 1 & 2). We are going to take the two bills together. Introduces HB 1142 & 1143-Principle -Based Reserving (PBR). I have two amendments. Adam Hamm will explain the bill.

0:19

Adam Hamm~Commissioner for the North Dakota Insurance Department: (Attachment 3, 4 & 5). Principal-Based Reserving (PBR) includes two law changes in order to make this happen in North Dakota as well as the rest of the country. An evaluation manual NESC adopted a revised SVL or Standard Valuation Law back in 2009 and the Revised Standard Non-forfeiture law in 2012 as well as the Evaluation manual in 2012. Once 42 states representing a total of 75% of written premium adopt the revisions to the SVL, which for us is HB 1142 and HB 1143. Then PBR will be implemented and will only apply to new life insurance business. As of today 20 states has passed this package of laws. We are close to half way there. It is likely by the end of 2015 the 42 states will have adopted this package of laws. Once the 42 states super majority is met, it will be a three year ramp up where companies can implement PBR anytime in the 3 years. Valuation manual will be updated annually as part of the maintenance process. This will smooth out the bumps so as we are completely transitioning to PBR nothing falls through the cracks. (See Attachment #3, 4, 5).

11:20

Representative Becker: It would be good for the insurance companies to have the appropriate level of reserves. Knowing that there are new approaches that developed over these last decades, why do we mandate that we should all go to this type of system?

Hamm: The most important function of an insurance regulator is to make sure that the promises that insurances companies are making to policy holders are promises they can keep. The most fundamental way to make sure they are making good on that promise is that there is enough money on reserve to handle to any claims when they come due. The most important thing we do as insurance regulators is to test that and make sure on a year to year basis that there is enough money to take care of the policy holders.

Representative Becker: This is not a new level of regulation it is a different regulation. We are not increasing regulation?

Hamm: Correct.

Representative Becker: Chairman Kaiser said the word subjective. In what manner in the insurance industry can you evenly apply something that's subjective? It brings to mind that the team players may be looked at slightly different than the non team players because subjective means that there is discretion from whichever regulator is looking at whichever product?

Hamm: We have had an objective system, this formula approach which was simply here's your product here's the formula that applies to the product and here is the reserves you have to hold. Often what that resulted in redundant reserves which tied up capital which impacted consumers and impacted the company in terms of what they could do as a business. We had to transition to a way to make sure on a company to company basis there were appropriate reserves. That's what PBR is. It will move us from this objective system to a little bit more subjectivity. The way this is going to work is once PBR is effective in all the states, on a year to year basis each company through their own actuary will have to certify, through the insurance regulator in that state, that the reserves that they are holding for all the products they are selling is appropriate. The initial beginning stage here is the company applying these risk metrics in PBR to make sure they are holding the appropriate reserves and then through and actuary they certify to the regulator that yes they in fact met the PBR requirements. After that it allows the regulator on a year to year basis if they need to, to test that to make sure that the certification the company is making is accurate and they are holding the correct amount of reserves.

Representative Becker: Do you think that there is any possibility that something that as undesirable as a company which donated to a campaign heavily and has operatives of that particular party and good positions would be viewed differently and regulated differently or because there reserves are a little bit easier than the company who is from the other party and didn't donate?

Hamm: That would not happen. Regardless what political affiliation the head of the insurance department is, in America you are either elected or appointed. The day to day work on these issues is done by a professional staff of the insurance department. In ND

the chief financial officer would be primarily responsible for making sure once we get the PBR that once a company certified we are holding the right amount of reserves. He would be primarily responsible for testing that. Step two is because we work on a national system, at the end of the day it has to be accepted by the rest of the insurance regulators in the country. There are 49 other sets of eyes on this .

Representative Lefor: This would not require any more FTE. Is there a conversion process or just a different way of doing the job for your actuarials?

Hamm: Once we get the PBR, the companies that we have domesticated in North Dakota, there is 4 on the life insurance side. So they will be submitting on a yearly basis these certifications that they have complied with PBR and they have the correct amount of reserves. Because there is only 4 companies we believe it will not substantially add more work and that we should be able to address this with our current staffing.

Representative Ruby: You mentioned complicated insurance products, what do you mean?

Hamm: There all sorts of products in the annuities base or life insurance. Insurance companies have developed products to meet that need.

Representative Ruby: Page 29, on HB 1142, requirements of principal based evaluation and it is some benchmarks, do the formulas come to you and you review them or do you predetermine what their benchmarks will be for them?

Hamm: The old was pick a product, term life. Term life had a specific formula you plug the numbers in and get a number and that is the reserve you had to have for that product. Over time that didn't work. When you do the PBR it is a very complicated risk metrics that is designed for each individual product. The package of laws 1142 and 1143 set the base line and allow us to move to PBR and I mentioned the Evaluation Manual will be updated annually and is right now being worked on to further hone down the every risk base for each individual product is in there. That's a collaborative process between the regulators, the industry and consumer advocate groups to make sure it is up to date as possible.

Representative Ruby: In existing law there were some waiting factors?

Hamm: Those will also be part of PBR. PBR is the formulaic approach and then some. PBR takes into account not just the risk metrics of each product but the risk characteristics of the company. The whole point of PBR is if you pick a product out of the air. PBR wants to right size that product reserve and get as close to possible as would be appropriate for that product.

Vice Chairman Sukut: The evaluation manual is kind of like the bible apparently?

Hamm: I would say the SVL and the standard non-forfeiture law which is 1142 and 1143 in front of you would be the old testament and the evaluation will be the new testament, the

good news. It is not the bible but you can't get to the evaluation manual (the new testament) until you have the (old testament) the SVL and non-forfeiture.

Vice Chairman Sukut: Currently we don't use the evaluation manual?

Hamm: That correct.

Vice Chairman Sukut: The evaluation manual is consistently updated?

Hamm: Every year correct. This is a collaborative process with industry and consumer advocate groups to make sure that the evaluation manual updated correctly. We realize what a huge change this is and no one is taking this lightly.

Representative Hanson: Your saying 20 states has this and this is looking likely more will adopt, has this been adopted by uniform laws commission or is that out of their jurisdiction?

Hamm: They don't have any jurisdiction on this. What happened is the National Association of Insurance Commissioners passed these model laws in 2009 and 2012, which means the states are responsible for bringing it to their legislature to attempt to get it passed. States started introducing this in 2013. Representative Kaiser and I thought this wasn't ready yet in 2013 but we feel it is ready now.

Representative Hanson: What is the worst case scenario if this isn't passed?

Hamm: This will probably become an accreditation standard in the 2017 time frame so we can still come back in 2017 and pass it. The concern is by then we might be to the point where it is beyond 42 states and 75%. We want to be in earlier so we are not left with crumbs.

Representative M Nelson: Basically the manual is going to be an expert system to keep everyone on the same page. Really what is happening now is there are experts on the regulator level , experts on the insurance level that you run through the formulas and you see, that is not quite right. So what you are going to do to the manual is add the things to where everyone feels comfortable and you keep fine tuning the manual as you go along.

Hamm: That correct. One of the things that the formulaic approach produced those work arounds. So you had some regulators around the country giving companies relief from the formulaic approach independent of what the rest of the regulators were authorizing. This is a part of why we are here today. We have to move away from that.

Representative Kasper: Not wanting to be the last, would it be a fair statement is the possibility that insurance companies that are developing new products all along might use the fact we have not adopted this legislation as a reason to not introduce those products in the state because it is too difficult for them to have two sets of reserve calculation?

Hamm: One hundred percent correct.

Chairman Keiser: Let's talk about the exemption for small and specialty companies?

Hamm: One of the difficult parts is the small company exemption. Some small companies will ask can we get an exemption for PBR? That has been a tough road to go down because it can be tricky. We are at the point, it sounds like their might be an agreement that has been reached by all groups. There is a vote scheduled for the PBR Implementation Task Force on February 11. They will vote on the small company exemption. It will apply to few companies in ND. You could be exempted but you might not want to be.

Chairman Keiser: Do these bills accommodate that? Or would that be a change that would have to be made on the Senate side if you wanted it made?

Hamm: No. It is possible it could be made on that side. I talked to a co-chair of the task force. She would prefer states would not incorporate into bills like 1142 and 1143 a small company exemption because they would want to put that in the evaluation manual which is reviewed annually.

Representative Ruby: Our current system, is it unified across the country or is it state by state?

Hamm: It's uniform. All 50 states is using this formulaic approach.

Representative Ruby: With the new system, if there is changes and adjustments from here on out, what's our leverage?

Hamm: The flexibility would exist within that evaluation manual with the year to year basis. If we as as state believe that PBR as it is being implemented across ND or other states is producing results we don't want. That evaluation manual will be where we would band together and push for changes to the evaluation manual to accomplish what we want to accomplish.

Levi Andrist~Vogel Law Firm, American Council Life Insurers. I have the pleasure of introducing Bruce Ferguson.

Bruce Ferguson~Senior Vice President-State Relations with the American Council of Life insurers: Strongly supports HB 1142 and HB 1143. Explained written testimony. (See Attachment # 6).

49:50

Representative Kasper: If we fail to pass these bills what do you see as the potential for some of the insurance companies that are currently doing business in our state to change their method of business or not be so excited about being here?

Ferguson: If you look at the eyes of the world, and what they are thinking our state based system of insurance regulation. Clearly they wonder if the states can act in a uniform and efficient manner. The solvency over lay in place since the accreditation program was instituted is the crown jewel of state insurance regulation. It proves that the states can act collectively in a way that insures uniform oversight in the area that matters most, financial regulation. The extent to which states have a hodge podge system of reserving regulation doesn't bode well. The NAIC when it had its financial sector assessment done in 2010 one of the weakness was the lack of principal based methodology. That lead to where we are today. As far as on the state level what companies decide to do in ND with respect to product availability and the extent with which reserving standards are more or less static, less dynamic and more fixed acts as a disincentive for companies to come. At the micro level it doesn't help when it comes to product availability and innovation here in North Dakota.

Chairman Keiser: Is there anyone here to testify in support of HB 1142 or HB 1143? Seeing none. Is there any opposition to HB 1142 or HB 1143? Is there anyone in the neutral position? Seeing none we will closed the hearing on HB 1142 and HB 1143.

Representative Kasper: You had some amendments?

Chairman Keiser: Yes, on both bills. They are technical in nature and should be adopted. (See Attachment 1-2). The insurance department worked with Legislative council on this set of amendments. So, yes we are comfortable with the amendments. We have to take each bill separately for our records.

Representative Kasper: moved adoption of the amendment 15.0402.02001 to HB 1142.

Representative Boschee: seconded.

Voice Vote: All Ayes. Motion carried to adopt amendment.

Representative Laning: Moved a Do Pass as Amended for HB 1142.

Representative Sukut: seconded.

A Roll Call Vote was taken. Yes: 13 No: 0 Absent: 2. Motion Carried.

Representative Sukut: will carry the bill.

15.0402.02001
Title.03000

Prepared by the Legislative Council staff for
Representative Keiser
February 2, 2015

2/3/15

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1142

Page 2, line 13, replace "26.1-35-00.2" with "26.1-35-12"

Page 2, line 28, replace "5" with "4"

Page 2, line 28, replace "7" with "6"

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Page 2, line 30, replace "1" with "2"

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Page 12, line 29, remove the overstrike over "~~sections 26.1-35-03~~"

Page 12, line 29, after "~~and~~" insert an underscored comma

Page 12, line 30, remove the overstrike over "~~26.1-35-04~~"

Page 12, line 30, replace "subsections 1 and 2" with an underscored comma

Page 12, line 30, remove "section"

Page 31, line 6, replace "6" with "5"

Page 31, line 6, replace "26.1-35-12" with "26.1-35-00.2"

Page 31, line 10, replace "6" with "5"

Page 31, line 10, replace "26.1-35-12" with "26.1-35-00.2"

Page 31, line 27, replace "26.1-35-12" with "26.1-35-13"

Page 32, line 23, remove "; in the case of subdivisions a and b"

Renumber accordingly

Date: Feb 3, 2015

Roll Call Vote: 1

2015 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1142

House Industry, Business & Labor Committee

☐ Subcommittee ☐ Conference Committee

Amendment LC# or Description: 15.0402.02001

Recommendation: ☒ Adopt Amendment
☐ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations

Other Actions: ☐ Reconsider ☐

Motion Made By Rep Kasper Seconded By Rep Boschee

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser			Representative Lefor		
Vice Chairman Sukut			Representative Louser		
Representative Beadle			Representative Ruby		
Representative Becker			Represenative Amerman		
Representative Devlin			Representative Boschee		
Representative Frantsvog			Representative Hanson		
Representative Kasper			Representative M Nelson		
Representative Laning					
		Voice Vote			

Total (Yes) _____ No _____

Absent _____

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

voice vote -
motion carried

Date: Feb 3, 2015

Roll Call Vote: 2

2015 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1142

House Industry, Business & Labor Committee

☐ Subcommittee ☐ Conference Committee

Amendment LC# or Description: 15.0402.02001

Recommendation: ☐ Adopt Amendment
☒ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☒ As Amended ☐ Rerefer to Appropriations

Other Actions: ☐ Reconsider ☐

Motion Made By Rep Laning Seconded By Rep Sukut

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser	X		Representative Lefor	X	
Vice Chairman Sukut	X		Representative Louser	X	
Representative Beadle	X		Representative Ruby	X	
Representative Becker	X		Represenative Amerman	X	
Representative Devlin	X		Representative Boschee	X	
Representative Frantsvog	Ab		Representative Hanson	Ab	
Representative Kasper	X		Representative M Nelson	X	
Representative Laning	X				

Total (Yes) 13 No 0

Absent 2

Floor Assignment Rep Sukut

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1142: Industry, Business and Labor Committee (Rep. Keiser, Chairman) recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** (13 YEAS, 0 NAYS, 2 ABSENT AND NOT VOTING). HB 1142 was placed on the Sixth order on the calendar.

Page 2, line 13, replace "26.1-35-00.2" with "26.1-35-12"

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Renumber accordingly

2015 SENATE INDUSTRY, BUSINESS AND LABOR

HB 1142

2015 SENATE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee
Roosevelt Park Room, State Capitol

HB 1142 Engrossed
3/10/2015
Job Number 24545

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature	Era Lickelt

Explanation or reason for introduction of bill/resolution:

Relating to the standard valuation law for life insurance policies and annuities

Minutes: Attachments

Chairman Klein: Opened the hearing.

Representative Keiser: Said he was here on behalf of 1142 and also 1143 but he will not be covering them both. Principle-Based Reserving is an insurance term. It is a standard through this legislation that we are transitioning to. What these bills will do is move the life insurance segment of the insurance industry into a principle-based reserving position relative to the regulations of the reserves that are required for companies to carry in order to protect the consumer. The reason for the transition from a formulaic approach, which we have had from day one, although it is good and it works but in today's economies the products available through life insurance today the annuities and all the variations of the different kinds of products that are now under the life insurance sector are really extensive and complicated in some cases or different from the traditional term insurance or whole life insurance products. With the transition the regulators do need a more sophisticated methodology for evaluating the reserves that companies carry. (1:07-6:25)

Senator Campbell: Asked why we need this bill. Why can't we just let capitalism succeed and if someone wants to be over capitalized and let their premiums go up it is their business or if someone is leveraged and undercapitalized they probably give lower premiums and the consumer could decide what level they wanted to take?

Representative Keiser: That is really the critical question. For a long time I was very concerned, the formulaic approach has worked forever why in the world we would want to change it because the last thing anyone wants in their state is insolvency. It does occur occasionally and when it does it is catastrophic. By capitalizing at the appropriate level you are going to allow the companies to have the opportunity with what would have been excess capital to develop products to introduce and aggressively move into different markets. They will be able to serve the consumer better. (7:14-9:00)

Adam Hamm, Commissioner of the North Dakota Insurance Department: He said he would like to approach 1142 and 1143 together, they are intimately tied and you can't have one without the other. For example if the State passed 1142 but didn't pass 1143 we wouldn't have PBR. So you have to do both or none. This bill and its sister bill, HB 1143, which deals with the standard non forfeiture requirements of life insurance products, are both part of Principle-Based Reserving. He went over his second attachment, legislative brief first. Life insurance policy reserves are the money an insurance company must set aside today to pay expected future life insurance claims. Written Testimony Attached (1) and Legislative Brief Attachment (2). (9:15-16:24)

Senator Murphy: That formulaic approach is that essentially, you having to have a standard percentage in reserve?

Adam Hamm: It is a fairly complicated formula, pick a product, a plus b equals c. It is literally like that, it is a mathematical formula for each individual product that kicks out a number and says here is the reserve that has to be in place for that product. There is no flexibility for the industry or for the regulators. (16:40-17:04)

Senator Murphy: So then with the PBR are you running more complex algorithms?

Adam Hamm: Yes it is actuarially based. The starting point might be a formula and it might not, depending on the product. What it really is doing is looking at the individual risks of that product, running it actuarially to figure on a timeline of a hundred yeas what the practical reserves need to be for that product. As opposed to a formula where you are looking at the specific risk of each one of those products to determine what is the appropriate reserve and the key that is not a static conclusion. Every year on an ongoing bases as there becomes more data for that product you are going to figure out what would be the approach. (17:15-18:27) He begins again going over the Legislative Brief @ (18:30-18:56) At 18:58 he refers to the fifth bullet, Non Forfeiture Law in regards to HB 1143. He states that 1143 is attended as a package with Standard Valuation Law 1142 so mortality and interest rate assumptions are coordinated. This is a package deal you cannot have one without the other. To highlight a couple of things on my testimony on 1142 the second paragraph on page one of the written testimony 1142 along with its sister bill 1143 are both part of the PBR package if you move to page two the second full paragraph on page two, 1142 will conform North Dakota law, it is a pretty extensive bill that you see with respect to 1142 and 1143, with the recent changes to the model standard valuation law from 2009. He continues with his written testimony.

Chairman Klein: As we move beyond our borders this is a big deal as to how the world is globally transitioning into reserves?

Adam Hamm: Yes I touched on that a little bit but will expand on it some more. He said PBR in the life insurance space it is used in Europe and it is used in Asia and they look at America and see that we are still using this formulaic approach that has been around for a century that is producing these awkward results. It would help us substantially to update our reserve methodology so we are on par of where the rest of the world is heading. (23:35-24:55)

Levi Andrist, Vogel Law Firm Representing the ACLI: He introduced Bruce Ferguson.

Bruce Ferguson, Senior Vice President, State Relations with the American Council of Life Insurers: PBR is designed to be more elastic, more dynamic and more reflective of the types of products that are sold today. He referred to the attachment (4) as a grid that shows where we are. Written Testimony Attached (3), PBR Implementation Snapshot (4), and Public Policy Issue Brief (5). (35:14-42:35)

Chairman Klein: Asked about the states that stay outside of PBR if they will continue their formulas or will they be drawn in.

Bruce Ferguson: They will have to be drawn in. It will become the prevailing standard from the tax standpoint and from a regulatory standpoint. (45:40-46:46)

Senator Campbell: Asked him to summarize of what 1142 and 1143 do separately.

Bruce Ferguson: Said House Bill 1142 is the Standard Evaluation Law, the version found in every state law that deals with evaluation of reserves. It is the old methodology for establishing the right reserve level for companies that they have to hold under the law in order to pay claims down the road. The other House Bill 1143 is the Standard Non Forfeiture Law that is the provision of the code that calculates the cash value for cash value policies the benefit to the consumer when the consumer pays premiums into that policy over time. There are incidences where an individual may lapse the policy, may choose not to continue paying premiums on it and so for a cash value policy, what is the minimum non forfeiture benefit? The cash value that builds up in that policy that is owed to the consumer if that person surrenders the policy or chooses not to continue the payments on the policy. That is the non-forfeiture law. The two go hand and glove. In order to establish reserves you also have to be mindful of the cash value in the policy you would have to pay out in the event of surrender of the policy. The two do work hand and glove. There were discussions on why New York has not chosen to go into PBR. (47:25-53:48)

Chairman Klein: We spoke a bit about bankruptcies or defaults in your industry how is it doing overall?

Bruce Ferguson: It is doing very well and did quite well during the financial crisis. He addressed that issue. (54:10-56:34)

2015 SENATE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee
Roosevelt Park Room, State Capitol

HB 1142 Engrossed
3/10/2015
Job Number 24557

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature	Eva Liebelt

Explanation or reason for introduction of bill/resolution:

Relating to the standard valuation law for life insurance policies and annuities

Minutes: No Attachment

Chairman Klein: We are going to vote on these individually.

Senator Sinner: Moved a do pass.

Senator Poolman: Seconded the motion.

Roll Call Vote: Yes-7 No-0 Absent-0

Senator Poolman will carry the bill.

Date: 3/10/2015
Roll Call Vote #: 1

2015 SENATE STANDING COMMITTEE
ROLL CALL VOTES
HB 1142 Engrossed

Senate Industry, Business and Labor Committee

☐ Subcommittee

Amendment LC# or Description: _____

Recommendation: ☐ Adopt Amendment
☒ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions: ☐ Reconsider ☐ _____

Motion Made By Senator Sinner Seconded By Senator Poolman

Senators	Yes	No	Senators	Yes	No
Chairman Klein	x		Senator Murphy	x	
Vice Chairman Campbell	x		Senator Sinner	x	
Senator Burckhard	x				
Senator Miller	x				
Senator Poolman	x				

Total (Yes) 7 No 0

Absent 0

Floor Assignment Senator Poolman

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1142, as engrossed: Industry, Business and Labor Committee (Sen. Klein, Chairman) recommends **DO PASS** (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). Engrossed HB 1142 was placed on the Fourteenth order on the calendar.

2015 TESTIMONY

HB 1142

#1 HB 1142 2/3/15

15.0402.02001
Title.

Prepared by the Legislative Council staff for
Representative Keiser
February 02, 2015

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1142

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#2

HB 1142
2/3/15

15.0398.03001
Title.

Prepared by the Legislative Council staff for
Representative Keiser
January 30, 2015

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1143

Page 13, line 27, after "percent" insert ", but the nonforfeiture interest rate may not be less than four percent"

Renumber accordingly

#3 HB 1142
2/3/15

LEGISLATIVE BRIEF

NAIC National Association of Insurance Commissioners & The Center for Insurance Policy and Research

Principle-Based Reserving

- *Life insurance policy reserves are the money an insurance company must set aside today to pay expected future life insurance claims.*
- *Life insurance policy reserves are currently calculated (or "valued") using pre-set formulas. Principle-Based Reserving, or PBR, would use more advanced methodologies to better reflect and measure the risks of the new innovative insurance policies.*
- *PBR includes two law changes and a new Valuation Manual. The NAIC adopted a revised Standard Valuation Law in 2009, a revised Standard Nonforfeiture Law in 2012, and a Valuation Manual in 2012.*
- *PBR will be effective only after a supermajority of states, representing 75% of written premium, adopts the revised laws and will apply only to new life insurance business.*

Background

Innovation in life insurance products provides consumers with products they want, but can also make it more difficult to capture the value of the life insurance promise with a simple formula. The result is a constant need for modification of formulas and the laws containing those formulas. In 2009, the NAIC adopted a revised model Standard Valuation Law (SVL) which introduced a new method for calculating life insurance policy reserves to more easily adapt requirements for changing products. This new method is referred to as Principle-Based Reserving, or PBR. Once adopted by legislatures, PBR would replace the current formulaic approach to determining policy reserves with an approach that more closely reflects the risks of the highly complex products. The improved calculation is expected to "right-size reserves," reducing reserves that are too high for some products and increasing reserves that are too low for other products. While the impact on each company could vary widely, it is expected that the effect on total reserves would be a small decrease, especially in the initial years.[1] However, the increase or decrease in reserves is much less important than the "right-sizing" of reserves. This new method will help reduce the incentive for company "workarounds" designed to reduce reserves. The revised SVL would authorize creation of a Valuation Manual that contains reserving requirements. The Valuation Manual was adopted by a supermajority of NAIC members in December 2012, paving the way for states to begin adopting revisions to the SVL in their legislative sessions. Once at least 42 states (a supermajority) representing 75% of total U.S. premium adopt the revisions to the SVL, PBR will be implemented.

Key Points

- States may adopt revisions to the Standard Valuation Law (SVL) beginning in the 2013 legislative sessions.
- PBR will be effective only after the law revisions are adopted by at least 42 states representing 75% of total U.S. premium and then, after a three-year transition period. (Companies can implement PBR anytime in the 3 years.)
- The Valuation Manual will continue to be updated annually as part of an ongoing maintenance process.
- The NAIC and state insurance departments must assess their needs for additional staffing, as PBR requires a greater degree of actuarial expertise. Already, the NAIC plans to hire additional actuarial staff to assist states.
- Change to the Standard Non-Forfeiture Law for Life Insurance is intended as a package with the SVL changes so that mortality and interest rate assumptions are coordinated.
- The Valuation Manual provides exclusion criteria which allow simpler products, with fewer guarantees and therefore less risk, to be subject to simpler reserving requirements.

Kris DeFrain, Director, Research and Actuarial Services kdefrain@naic.org **Reggie Mazyck** Life Actuary rmazyck@naic.org

[1] Additional discussion of the impact on reserves can be found in the NAIC PBR Educational Brief.

Adopted by the PBR Implementation (EX) Task Force: 6/21/13

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HB 1142
2/3/15

HOUSE BILL NO. 1142

Presented by: **Adam Hamm**
Commissioner
North Dakota Insurance Department

Before: **House Industry, Business and Labor Committee**
Representative George Keiser, Chairman

Date: **February 3, 2015**

TESTIMONY

Good morning, Chairman Keiser and committee members. For the record, my name is Adam Hamm and I am the Commissioner of the North Dakota Insurance Department.

You have before you House Bill No. 1142 which amends the existing standard valuation section of the life insurance act. This bill and its sister bill, House Bill No. 1143, which deals with standard nonforfeiture requirements of life insurance products, are both part of Principle-Based Reserving or as it is more commonly known, PBR.

In 2009, the National Association of Insurance Commissioners (NAIC) membership introduced a new method for calculating life insurance policy reserves and nonforfeiture benefits to more easily adapt reserving requirements for changes in life insurance products. This new method is referred to as Principle-Based Reserving, or PBR. PBR would replace the current formulaic approach to determining policy reserves and nonforfeiture benefits with an approach that more closely reflects the risks of today's highly complex products. This new method will help reduce the incentive for company "workarounds" (captives and "special purpose vehicles") designed to reduce reserves. PBR includes two law changes and a new Valuation Manual.

Over a three-year period from 2009 to 2012, the NAIC worked closely with life insurers and consumer groups to develop and adopt a revised standard valuation law and

standard nonforfeiture law and a new Valuation Manual. This bill addresses the revisions to the standard valuation law. Policy reserves under life insurance policies will be determined using principles specified in the Valuation Manual rather than based on the formulas currently specified in the Century Code.

Current law already specifies how policy reserves must be calculated. The switch to principles-based determination of policy reserves will not become effective until at least 42 states (a supermajority) representing 75 percent of total U.S. written premium adopt the revisions to the standard valuation law. PBR will then be phased in over the three years following adoption. To date, 20 states have enacted legislation to implement PBR.

The amendments in House Bill No. 1142 will conform North Dakota law with the recent changes to the model standard valuation law. This law is not yet included in the NAIC accreditation program, but it is expected this will occur sometime after 2017. North Dakota's accreditation status is critical to maintain if we want to remain relevant in the U.S. and international regulatory system.

Most importantly, the impact to consumers purchasing life insurance products should be positive overall. The "right-sizing" of reserves based on the risks found in each individual insurer will allow companies to better price products. Appropriate reserve levels also reflect the differences in insurer's management of risks; therefore, more protection is available for policyholders when needed.

As companies adopt these practices, our financial examiners will be working closely with them to monitor their progress and ensure accurate implementation.

The fiscal note on this bill indicates no fiscal impact.

Mr. Chairman, members of the committee, I am happy to answer any questions and urge a vote of "do pass" on House Bill No. 1142. Thank you.

#5
HB 1142
2/3/15

HOUSE BILL NO. 1143

Presented by: **Adam Hamm**
Commissioner
North Dakota Insurance Department

Before: **House Industry, Business and Labor Committee**
Representative George Keiser, Chairman

Date: **February 3, 2015**

TESTIMONY

Good morning, Chairman Keiser and committee members. For the record, my name is Adam Hamm and I am the Commissioner of the North Dakota Insurance Department. .

You have before you House Bill No. 1143 which amends the existing nonforfeiture section of the life insurance act (nonforfeiture). This bill and its sister bill, House Bill No. 1142, which deals with standard valuation requirements of life insurance products, are both part of Principle-Based Reserving, or commonly known as PBR.

Nonforfeiture benefits under life insurance policies refer to the policy's cash surrender value, extended term insurance or reduced paid-up insurance.

- Cash surrender value is the amount entitled to the owner at the time of surrender before maturity.

- Extended term allows the policy owner to use the policy's cash value accumulation as a single premium to purchase paid-up term life insurance in an amount equal to the original policy face amount. The length of the term life insurance depends on the net cash value. Typically, the extended term nonforfeiture option goes into effect automatically if the owner is not available to make a choice of simply fails to exercise an option.

- Reduced paid-up allows the policy owner to use the cash value of the policy to purchase a single premium insurance policy at attained age rates for a reduced face amount.

In 2009, the National Association of Insurance Commissioners (NAIC) membership introduced a new method for calculating life insurance policy reserves and nonforfeiture benefits to more easily adapt reserving requirements for changes in life insurance products. This new method is referred to as Principle-Based Reserving, or PBR. PBR would replace the current formulaic approach to determining policy reserves and nonforfeiture benefits with an approach that more closely reflects the risks of today's highly complex products. This new method will help reduce the incentive for company "workarounds" (captives and "special purpose vehicles") designed to reduce reserves. PBR includes two law changes and a new Valuation Manual.

Over a three-year period from 2009 to 2012, the NAIC worked closely with life insurers and consumer groups to develop and adopt a revised standard valuation law and standard nonforfeiture law and a new Valuation Manual. This bill addresses the revisions to the standard valuation law. Policy reserves under life insurance policies will be determined using principles specified in the Valuation Manual rather than based on the formulas currently specified in the Century Code.

Current law already specifies how policy reserves must be calculated. The switch to principle-based determination of policy reserves will not become effective until at least 42 states (a supermajority) representing 75 percent of total U.S. written premium adopt the revisions to the standard valuation law. PBR will then be phased in over the three years following adoption. To date, 20 states have enacted legislation to implement PBR.

If passed, House Bill No. 1143 will conform North Dakota law with the recent changes to the model standard nonforfeiture law. This law is not yet included in the NAIC accreditation program but it is expected this will occur sometime after 2017. North

Dakota's accreditation status is critical to maintain if we want to remain relevant in the U.S. and international regulatory system.

As companies adopt these practices, our financial examiners will be working closely with them to monitor their progress and ensure accurate implementation.

The fiscal note on this bill indicates no fiscal impact.

Mr. Chairman, members of the committee, I am happy to answer any questions and urge a vote of "do pass" on House Bill No. 1143. Thank you.

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HB 1142
2/3/15

TESTIMONY OF THE AMERICAN COUNCIL OF LIFE INSURERS

BEFORE THE HOUSE INDUSTRY, BUSINESS AND LABOR COMMITTEE

IN SUPPORT OF

HOUSE BILLS 1142 AND 1143

J. Bruce Ferguson
Senior Vice President, State Relations
February 3, 2015

Good morning, Chairman Keiser and members of the House IBL Committee, my name is Bruce Ferguson, and I am Senior Vice President, State Relations with the American Council of Life insurers. ACLI is a national trade association representing the life insurance industry. ACLI has nearly 300 member companies who hold more than 90% of the life insurance in force in America today. There are 251 life insurance companies licensed to do business in North Dakota accounting for 93 percent of the total life insurance coverage on North Dakota residents.

ACLI strongly supports House Bill 1142 and House Bill 1143. If enacted, these bills would adopt National Association of Insurance Commissioners Model amendments to modernize the state's insurance code to allow life insurance companies to conduct "principle-based reserving."

Life insurance companies are required to hold financial reserves in order to support payment of policy owner claims. However, the current method of life insurer reserving dates back more than one hundred years and involves a formulaic, "one size fits all" approach. This outdated reserving method now results in some products being under-reserved and other products being over-reserved. The new, principle-based reserving method modernizes the reserving method and "right sizes" the reserve to ensure that it matches the risk that is actually being assumed by the insurance company.

Principle-based reserving will help ensure that consumers are paying the appropriate price for the risk coverage being provided. In addition, principle-based reserving will allow life insurance companies to develop and reserve for new products and product features that the current outdated and inflexible system inhibits.

Principle-based reserving is not a new concept. The property/casualty insurance industry has been utilizing principle-based reserving for some time. In addition, principle-based reserving is already in place for life insurers in a number of other countries, including Australia, Canada and the United Kingdom. These bills and the same NAIC Model amendments in other states will simply allow life insurers in the United States to use that modern reserving method on their new business.

Principle-based reserving will enhance regulatory oversight of a life insurer's solvency. This is achieved in three ways: 1) Principle-based reserving retains certain elements of the existing reserving system that provides "floors" for the minimum amount of reserves required; 2) Principle-based reserving is "self-correcting" in the sense that each year the insurance company must demonstrate that its assumptions underlying its reserve calculations are correct; and 3) To the extent those underlying assumptions are not correct, the principle-based reserving system allows the company and the state insurance regulator to identify any concerns and take appropriate corrective action in a more timely manner.

The principle-based reserving initiative has been in the works for nearly ten years. Life insurers, actuaries and state insurance regulators have worked to develop the principle-based reserving methodology through a thoughtful and deliberative approach. The American Academy of Actuaries supports principle-based reserving. The principle-based reserving amendments are National Association of Insurance Commissioners Model language.

Currently, twenty states have enacted principle-based reserving legislation. In 2015, twenty-four states have either committed to or are now in the process of introducing principle-based reserving legislation.

In summary, enactment of House Bills 1142 and 1143 will benefit consumers, life insurers and regulators. Consumers will benefit from having the price of the products more closely aligned with the risk being assumed by the company. Life insurers will benefit by being able to more accurately reserve for risks and by gaining the flexibility to develop new products and new product features. Regulators will benefit from the enhanced solvency oversight that principle-based reserving provides.

ACLI strongly supports enactment of this important legislation and we urge the Committee's do pass recommendation of these bills.

Respectfully,

J. Bruce Ferguson
Senior Vice President, State Relations

PBR Implementation Snapshot

As of January 23, 2015

2013-2014 Enacted	2015 Committed*	2015 Pending	Remaining States	Opposes
20 states	**25** states	**1** states**	**8** states	**1** states
AZ, CT, FL, HI, IN, IA, LA, ME, MI, MS, NE, NH, NJ, NM, OH, OK, RI, TN, VA, WV	AL, AK, AR, CA, CO, DE, GA, IL, KS, KY, MD MA, MO, MT, NV, NC, ND, OR, PA, SC, SD, TX, VT, WA, WI **COI support or no objection to legislation*	PR **Outreach in progress to confirm no objection to move forward in 2015	DC, ID, MN, UT, WY, GU, AS, VI	NY
35.67% gross premium	**50.31%** gross premium	**.75%** gross premium	**4.08%** gross premium	**9.20%** gross premium

45 states, 85.98% gross premium (THRESHOLD MET & EXCEEDED)

46 states, 86.73% gross premium (threshold exceeded)

GOAL: 42 states, 75% gross premium (PBR becomes effective on January 1 of the first calendar year following the first July 1 as of which the 42 state/75% gross Life and Health premium threshold has been met).

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ACLI
Financial Security...for Life.

Public Policy Issue Brief

PRINCIPLE-BASED RESERVES (PBR)

BACKGROUND

Life insurers set aside capital—called reserves—to ensure they will be able to pay all future expected claims. State insurance regulators closely monitor reserves and take action if a company's reserve levels jeopardize policyholders' interests.

The current system to calculate reserves dates back to Civil War times and utilizes a formulaic, one-size-fits-all approach to determine those reserves. Many regulators and life insurance companies believe that reserve requirements need to evolve in order to keep pace with new product designs. For nearly a decade, state regulators, with the support of life insurers and actuaries, have developed a new method for calculating life insurance policy reserves. This proposal replaces that system with a principle-based reserving (PBR) approach that "right sizes" the reserve to ensure that it matches the actual risk being assumed. The new PBR approach will enhance the current system for calculating policy reserves, resulting in reserve levels that more accurately reflect risks assumed by life insurers for the policies they underwrite. This new system will provide regulators with tools to properly monitor a life insurer's reserve levels through annual reporting and review.

To implement PBR, state legislatures must adopt both the Standard Valuation Model Law that was approved by the National Association of Insurance Commissioners (NAIC) in 2009, and the 2012 revisions to the NAIC Standard Nonforfeiture Law. PBR will only be operational once it has been adopted in at least 42 U.S. jurisdictions, accounting for 75 percent of U.S. life insurance premiums combined.

PBR legislation benefits consumers in three distinct ways:

- PBR helps to ensure that consumers are paying the appropriate price for the insurance coverage being provided.
- PBR helps insurance companies develop and reserve for new products and product features that the current system inhibits.
- PBR strengthens the solvency oversight authority of regulators to help ensure that companies will be able to fulfill their promises.

STATUS

To date, 20 states have enacted legislation to implement principle-based reserving: Arizona, Connecticut, Florida, Hawaii, Iowa, Indiana, Louisiana, Maine, Michigan, Mississippi, Nebraska, New Hampshire, New Jersey, New Mexico, Ohio, Oklahoma, Rhode Island, Tennessee, Virginia, and West Virginia. Texas has enacted the amendments to the Standard Nonforfeiture Law required for PBR implementation, but will still need to adopt the Standard Valuation Model Law before becoming fully operational.

ACLI POSITION

ACLI supports the implementation of PBR and encourages state legislatures to adopt the revisions to the Standard Valuation Model Law and the revisions to the NAIC Standard Nonforfeiture Law. PBR has been designed to enhance regulatory oversight, not to weaken it. It is in the interest of the entire industry and its policyholders that companies are well capitalized.

AT A GLANCE

- Life insurers are heavily regulated at the state level to protect consumers. The state-based regulatory system enforces strict solvency oversight to ensure the industry fulfills its promises to policyholders.
- PBR has been under development for close to a decade. During that time, it has been subject to actuarial modeling, testing, and refinement.
- PBR will help reserve requirements keep pace with new product designs from life insurers to meet consumer needs.
- Under PBR, regulators will have access to more tools to properly monitor reserve levels and ensure that companies are able to meet their commitments to policyholders.
- PBR allows reserves to be tailor-made for every company to match its unique risks, instead of taking a regulatory one-size-fits-all approach.
- PBR is supported by the NAIC, the American Academy of Actuaries, and ACLI.
- PBR is not a new concept—it is currently used by property casualty and health insurance companies in the states and in international insurance markets.
- Life insurers' reserves allow companies to provide affordable products with long-term guarantees that protect families' financial security and allow for a dignified, independent and secure retirement.
- Life insurers provide long-term financial protection to 75 million American families and thus companies must manage their assets with these long-term risks in mind.
- In 2012, U.S. life insurers provided payments in excess of $544 billion, helping families guarantee long-term financial security now and in retirement.

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LAST REVIEW DATE: JANUARY 2015
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#1

HOUSE BILL NO. 1142

Presented by: **Adam Hamm**
Commissioner
North Dakota Insurance Department

Before: **Senate Industry, Business and Labor Committee**
Senator Jerry Klein, Chairman

Date: **March 10, 2015**

TESTIMONY

Good morning, Chairman Klein and committee members. For the record, my name is Adam Hamm and I am the Commissioner of the North Dakota Insurance Department.

You have before you House Bill No. 1142 which amends the existing standard valuation section of the life insurance act. This bill and its sister bill, House Bill No. 1143, which deals with standard nonforfeiture requirements of life insurance products, are both part of Principle-Based Reserving or as it is more commonly known, PBR.

In 2009, the National Association of Insurance Commissioners (NAIC) membership introduced a new method for calculating life insurance policy reserves and nonforfeiture benefits to more easily adapt reserving requirements for changes in life insurance products. This new method is referred to as Principle-Based Reserving, or PBR. PBR would replace the current formulaic approach to determining policy reserves and nonforfeiture benefits with an approach that more closely reflects the risks of today's highly complex products. This new method will help reduce the incentive for company "workarounds" (captives and "special purpose vehicles") designed to reduce reserves. PBR includes two law changes and a new Valuation Manual.

Over a three-year period from 2009 to 2012, the NAIC worked closely with life insurers and consumer groups to develop and adopt a revised standard valuation law and

standard nonforfeiture law and a new Valuation Manual. This bill addresses the revisions to the standard valuation law. Policy reserves under life insurance policies will be determined using principles specified in the Valuation Manual rather than based on the formulas currently specified in the Century Code.

Current law already specifies how policy reserves must be calculated. The switch to principles-based determination of policy reserves will not become effective until at least 42 states (a supermajority) representing 75 percent of total U.S. written premium adopt the revisions to the standard valuation law. PBR will then be phased in over the three years following adoption. To date, 20 states have enacted legislation to implement PBR.

The amendments in House Bill No. 1142 will conform North Dakota law with the recent changes to the model standard valuation law. This law is not yet included in the NAIC accreditation program, but it is expected this will occur sometime after 2017. North Dakota's accreditation status is critical to maintain if we want to remain relevant in the U.S. and international regulatory system.

Most importantly, the impact to consumers purchasing life insurance products should be positive overall. The "right-sizing" of reserves based on the risks found in each individual insurer will allow companies to better price products. Appropriate reserve levels also reflect the differences in insurer's management of risks; therefore, more protection is available for policyholders when needed.

As companies adopt these practices, our financial examiners will be working closely with them to monitor their progress and ensure accurate implementation.

The fiscal note on this bill indicates no fiscal impact.

Mr. Chairman, members of the committee, I am happy to answer any questions and urge a vote of "do pass" on House Bill No. 1142. Thank you.

3/10/15 HB 1142 #2

LEGISLATIVE BRIEF

NAIC National Association of Insurance Commissioners

The Center for Insurance Policy and Research

Principle-Based Reserving

- *Life insurance policy reserves are the money an insurance company must set aside today to pay expected future life insurance claims.*
- *Life insurance policy reserves are currently calculated (or "valued") using pre-set formulas. Principle-Based Reserving, or PBR, would use more advanced methodologies to better reflect and measure the risks of the new innovative insurance policies.*
- *PBR includes two law changes and a new Valuation Manual. The NAIC adopted a revised Standard Valuation Law in 2009, a revised Standard Nonforfeiture Law in 2012, and a Valuation Manual in 2012.*
- *PBR will be effective only after a supermajority of states, representing 75% of written premium, adopts the revised laws and will apply only to new life insurance business.*

Background

Innovation in life insurance products provides consumers with products they want, but can also make it more difficult to capture the value of the life insurance promise with a simple formula. The result is a constant need for modification of formulas and the laws containing those formulas. In 2009, the NAIC adopted a revised model Standard Valuation Law (SVL) which introduced a new method for calculating life insurance policy reserves to more easily adapt requirements for changing products. This new method is referred to as Principle-Based Reserving, or PBR. Once adopted by legislatures, PBR would replace the current formulaic approach to determining policy reserves with an approach that more closely reflects the risks of the highly complex products. The improved calculation is expected to "right-size reserves," reducing reserves that are too high for some products and increasing reserves that are too low for other products. While the impact on each company could vary widely, it is expected that the effect on total reserves would be a small decrease, especially in the initial years.[1] However, the increase or decrease in reserves is much less important than the "right-sizing" of reserves. This new method will help reduce the incentive for company "workarounds" designed to reduce reserves. The revised SVL would authorize creation of a Valuation Manual that contains reserving requirements. The Valuation Manual was adopted by a supermajority of NAIC members in December 2012, paving the way for states to begin adopting revisions to the SVL in their legislative sessions. Once at least 42 states (a supermajority) representing 75% of total U.S. premium adopt the revisions to the SVL, PBR will be implemented.

Key Points

- States may adopt revisions to the Standard Valuation Law (SVL) beginning in the 2013 legislative sessions.
- PBR will be effective only after the law revisions are adopted by at least 42 states representing 75% of total U.S. premium and then, after a three-year transition period. (Companies can implement PBR anytime in the 3 years.)
- The Valuation Manual will continue to be updated annually as part of an ongoing maintenance process.
- The NAIC and state insurance departments must assess their needs for additional staffing, as PBR requires a greater degree of actuarial expertise. Already, the NAIC plans to hire additional actuarial staff to assist states.
- Change to the Standard Non-Forfeiture Law for Life Insurance is intended as a package with the SVL changes so that mortality and interest rate assumptions are coordinated.
- The Valuation Manual provides exclusion criteria which allow simpler products, with fewer guarantees and therefore less risk, to be subject to simpler reserving requirements.

Kris DeFrain, Director, Research and Actuarial Services kdefrain@naic.org **Reggie Mazyck** Life Actuary rmazyck@naic.org

[1] Additional discussion of the impact on reserves can be found in the NAIC PBR Educational Brief.

Adopted by the PBR Implementation (EX) Task Force: 6/21/13

#3

TESTIMONY OF THE AMERICAN COUNCIL OF LIFE INSURERS

BEFORE THE SENATE INDUSTRY, BUSINESS AND LABOR COMMITTEE

IN SUPPORT OF

HOUSE BILLS 1142 AND 1143

J. Bruce Ferguson
Senior Vice President, State Relations
March 10, 2015

Good morning, Chairman Klein and members of the Senate IBL Committee, my name is Bruce Ferguson, and I am Senior Vice President, State Relations with the American Council of Life insurers. ACLI is a national trade association representing the life insurance industry. ACLI has nearly 300 member companies who hold more than 90% of the life insurance in force in America today. There are 251 life insurance companies licensed to do business in North Dakota accounting for 93 percent of the total life insurance coverage on North Dakota residents.

ACLI strongly supports House Bill 1142 and House Bill 1143. If enacted, these bills would adopt National Association of Insurance Commissioners Model amendments to modernize the state's insurance code to allow life insurance companies to conduct "principle-based reserving."

Life insurance companies are required to hold financial reserves in order to support payment of policy owner claims. However, the current method of life insurer reserving dates back more than one hundred years and involves a formulaic, "one size fits all" approach. This outdated reserving method now results in some products being under-reserved and other products being over-reserved. The new, principle-based reserving method modernizes the reserving method and "right sizes" the reserve to ensure that it matches the risk that is actually being assumed by the insurance company.

Principle-based reserving will help ensure that consumers are paying the appropriate price for the risk coverage being provided. In addition, principle-based reserving will allow life insurance companies to develop and reserve for new products and product features that the current outdated and inflexible system inhibits.

Principle-based reserving is not a new concept. The property/casualty insurance industry has been utilizing principle-based reserving for some time. In addition, principle-based reserving is already in place for life insurers in a number of other countries, including Australia, Canada and the United Kingdom. These bills and the same NAIC Model amendments in other states will simply allow life insurers in the United States to use that modern reserving method on their new business.

Principle-based reserving will enhance regulatory oversight of a life insurer's solvency. This is achieved in three ways: 1) Principle-based reserving retains certain elements of the existing reserving system that provides "floors" for the minimum amount of reserves required; 2) Principle-based reserving is "self-correcting" in the sense that each year the insurance company must demonstrate that its assumptions underlying its reserve calculations are correct; and 3) To the extent those underlying assumptions are not correct, the principle-based reserving system allows the company and the state insurance regulator to identify any concerns and take appropriate corrective action in a more timely manner.

The principle-based reserving initiative has been in the works for nearly ten years. Life insurers, actuaries and state insurance regulators have worked to develop the principle-based reserving methodology through a thoughtful and deliberative approach. The American Academy of Actuaries supports principle-based reserving. The principle-based reserving amendments are National Association of Insurance Commissioners Model language.

Currently, twenty states have enacted principle-based reserving legislation. In 2015, twenty-four states have either committed to or are now in the process of considering principle-based reserving legislation.

In summary, enactment of House Bills 1142 and 1143 will benefit consumers, life insurers and regulators. Consumers will benefit from having the price of the products more closely aligned with the risk being assumed by the company. Life insurers will benefit by being able to more accurately reserve for risks and by gaining the flexibility to develop new products and new product features. Regulators will benefit from the enhanced solvency oversight that principle-based reserving provides.

During the deliberations on these bills in the House, several technical amendments were adopted to these bills to conform them to NAIC model language. ACLI strongly supports enactment of House Bills 1142 and 1143 as amended and we urge the Committee's do pass recommendation of these bills.

Respectfully,

J. Bruce Ferguson
Senior Vice President, State Relations

ACLI
Financial Security. For Life

PBR Implementation Snapshot

As of March 6, 2015

2013-2014 Enacted	2015 Introduced	2015 Committed*	Remaining States	Opposes
20 states	**16** states	**9** states*	**9** states	**1** states
AZ, CT, FL, HI, IN, IA, LA, ME, MI, MS, NE, NH, NJ, NM, OH, OK, RI, TN, VA, WV	CA, CO, GA, IL, KS, KY, MD MA, MO, MT, NV, ND, OR, SD, TX, WA	AL, AK, AR, DE, NC, PA, SC, VT, WI	DC, ID, MN, PR, UT, WY, GU, AS, VI	NY
35.67% gross premium	**35.36%** gross premium	**14.94%** gross premium	**4.83%** gross premium	**9.20%** gross premium

**COI support or no objection to legislation*

36 states, 71.03% gross premium

(need 6 more states and 3.97% more premium)

45 states, 85.97% gross premium (threshold exceeded)

GOAL: 42 states, 75% gross premium (PBR becomes effective on January 1 of the first calendar year following the first July 1 as of which the 42 state/75% gross Life and Health premium threshold has been met).

3/10/15 HB1142 #4

3/10/15 HB 1142 #5

ACLI
Financial Security...for Life.

Public Policy Issue Brief

PRINCIPLE-BASED RESERVES (PBR)

BACKGROUND

Life insurers set aside capital—called reserves—to ensure they will be able to pay all future expected claims. State insurance regulators closely monitor reserves and take action if a company's reserve levels jeopardize policyholders' interests.

The current system to calculate reserves dates back to Civil War times and utilizes a formulaic, one-size-fits-all approach to determine those reserves. Many regulators and life insurance companies believe that reserve requirements need to evolve in order to keep pace with new product designs. For nearly a decade, state regulators, with the support of life insurers and actuaries, have developed a new method for calculating life insurance policy reserves. This proposal replaces that system with a principle-based reserving (PBR) approach that "right sizes" the reserve to ensure that it matches the actual risk being assumed. The new PBR approach will enhance the current system for calculating policy reserves, resulting in reserve levels that more accurately reflect risks assumed by life insurers for the policies they underwrite. This new system will provide regulators with tools to properly monitor a life insurer's reserve levels through annual reporting and review.

To implement PBR, state legislatures must adopt both the Standard Valuation Model Law that was approved by the National Association of Insurance Commissioners (NAIC) in 2009, and the 2012 revisions to the NAIC Standard Nonforfeiture Law. PBR will only be operational once it has been adopted in at least 42 U.S. jurisdictions, accounting for 75 percent of U.S. life insurance premiums combined.

PBR legislation benefits consumers in three distinct ways:

- PBR helps to ensure that consumers are paying the appropriate price for the insurance coverage being provided.
- PBR helps insurance companies develop and reserve for new products and product features that the current system inhibits.
- PBR strengthens the solvency oversight authority of regulators to help ensure that companies will be able to fulfill their promises.

STATUS

To date, 20 states have enacted legislation to implement principle-based reserving: Arizona, Connecticut, Florida, Hawaii, Iowa, Indiana, Louisiana, Maine, Michigan, Mississippi, Nebraska, New Hampshire, New Jersey, New Mexico, Ohio, Oklahoma, Rhode Island, Tennessee, Virginia, and West Virginia. Texas has enacted the amendments to the Standard Nonforfeiture Law required for PBR implementation, but will still need to adopt the Standard Valuation Model Law before becoming fully operational.

ACLI POSITION

ACLI supports the implementation of PBR and encourages state legislatures to adopt th revisions to the Standard Valuation Model Law and the revisions to the NAIC Standard Nonforfeiture Law. PBR has been designed to enhance regulatory oversight, not to weaken it. It is in the interest of the entire industry and its policyholders that companies are well capitalized.

AT A GLANCE

- Life insurers are heavily regulated at the state level to protect consumers. The state-based regulatory system enforces strict solvency oversight to ensure the industry fulfills its promises to policyholders.
- PBR has been under development for close to a decade. During that time, it has been subject to actuarial modeling, testing, and refinement.
- PBR will help reserve requirements keep pace with new product designs from life insurers to meet consumer needs.
- Under PBR, regulators will have access to more tools to properly monitor reserve levels and ensure that companies are able to meet their commitments to policyholders.
- PBR allows reserves to be tailor-made for every company to match its unique risks, instead of taking a regulatory one-size-fits-all approach.
- PBR is supported by the NAIC, the American Academy of Actuaries, and ACLI.
- PBR is not a new concept—it is currently used by property casualty and health insuranc companies in the states and in international insurance markets.
- Life insurers' reserves allow companies to provide affordable products with long-term guarantees that protect families' financial security and allow for a dignified, independent and secure retirement.
- Life insurers provide long-term financial protection to 75 million American families and thus companies must manage their assets with these long-term risks in mind.
- In 2012, U.S. life insurers provided payments in excess of $544 billion, helping families guarantee long-term financial security now and in retirement.

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