SB 573

Department of Legislative Services

Maryland General Assembly
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FISCAL AND POLICY NOTE
Revised

Senate Bill 573 (Senator Kelley)
Finance Health and Government Operations

Insurance - Standard Valuation Law and Reserve and Nonforfeiture Requirements

This bill requires insurance companies, on or after the operative date of a valuation manual adopted by the National Association of Insurance Commissioners (NAIC), to value their reserves for life insurance policies, accident and health insurance contracts, and deposit-type contracts using principle-based reserving (PBR) that is established by the valuation manual. In the event that there is a conflict between Maryland law and the valuation manual, the conflict must be resolved in favor of Maryland law. The bill also makes conforming changes.

The bill is contingent on the adoption of the valuation manual and the occurrence of other events specified by the bill. If notice of the satisfaction of the contingencies is not received by the Department of Legislative Services by January 1, 2017, the bill is null and void.

Fiscal Summary

State Effect: Maryland Insurance Administration (MIA) special fund expenditures increase by $289,400 in FY 2017 to (1) train existing employees concerning the PBR system established by the valuation manual and (2) hire one permanent full-time actuary. Expenditures related to the actuary are fully or partially offset by special fund revenues to the extent that MIA charges fees to insurers as the actuary reviews the insurer filings required by the bill. General fund revenues likely increase minimally beginning in FY 2018 due to the 2% tax collected on all insurance premiums paid in the State.

(in dollars)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
GF Revenue	$0	$0	-	-	-
SF Revenue	$0	$0	-	-	-
SF Expenditure	$0	$289,400	$177,900	$186,000	$194,500
Net Effect	$0	($289,400)	($177,900)	($186,000)	($194,500)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: The bill does not directly affect local governmental finances or operations.

Small Business Effect: Minimal.

Analysis

Bill Summary/Current Law:

Operative Date of the Valuation Manual

Under the bill, the operative date of the valuation manual is January 1 of the first calendar year following the first July 1 in which all of the following have occurred:

- The valuation manual has been adopted by NAIC by an affirmative vote of the greater of at least 42 members or 75% of members voting.
- The Standard Valuation Law (SVL) or similar legislation has been enacted by states representing greater than 75% of direct premiums written.
- The SVL or similar legislation has been enacted by at least 42 of 55 specified jurisdictions.

The bill also establishes the effective date for any changes that are made to the valuation manual.

Reserve Requirements and Opinions for Policies and Contracts

Under current law, life insurers, nonprofit health service plans, and fraternal benefit societies must annually submit to the Insurance Commissioner the opinion of a qualified actuary discussing whether the reserves and related actuarial items held in support of the policies, contracts, and benefit agreements are (1) computed appropriately; (2) based on assumptions that satisfy contractual provisions; (3) consistent with prior reported amounts; and (4) in compliance with applicable laws of the State. *Under the bill*, this requirement continues to apply to each insurance company that, **on or after** the operative date of the valuation manual, has outstanding life insurance policies, accident and health insurance contracts, or deposit-type contracts in the State and is subject to regulation by the Commissioner. Furthermore, the valuation manual must prescribe the contents of the opinion and any other items considered necessary to the scope of the opinion.

Additionally, *under current law*, the qualified actuary must include an opinion stating whether the reserves and related actuarial items are adequate to meet the obligations under the policies, contracts, and benefit agreements, in light of the assets held with respect to the reserves and related actuarial items. A memorandum that is acceptable to the Commissioner must be prepared to support each opinion. The Commissioner is authorized to engage a qualified actuary (at the expense of the insurer) to review each opinion and prepare a supporting memorandum in specified situations. Each opinion must meet specified criteria. The memorandum or other material submitted to the Commissioner is generally confidential but may be disclosed in specified situations. An appointed actuary generally is not liable for damages for acts related to the opinion. *Under the bill,* these requirements and provisions also apply for insurance companies **on or after** the operative date of the valuation manual, and the bill requires the Commissioner to adopt regulations to establish disciplinary action against an insurance company or an appointed actuary that violates these requirements.

Valuations On or After the Operative Date of the Valuation Manual

Under current law, the Commissioner must value or cause to be valued the reserves for all outstanding life insurance policies of each insurance company doing business in the State. *Under the bill,* the Commissioner must continue to do so for policies issued or renewed **on or after** the operative date of the valuation manual.

Current law sets forth the minimum standard for the valuation of life insurance policies. *Under the bill,* life insurance policies issued **on or after** the operative date of the valuation manual must follow the standard prescribed in the valuation manual as the minimum standard of valuation. The bill requires an insurance company to comply with the minimum valuation standard prescribed by the Commissioner by regulation in the absence of valuation requirements in the valuation manual.

The bill requires the valuation manual to specify (1) minimum valuation standards for policies and contracts issued by an insurance company **on or after** the operative date of the valuation manual; (2) the policies and contracts that are subject to a principle-based valuation; (3) for those policies and contracts, requirements for the format of reports, required assumptions for specified risks, and procedures for corporate governance and oversight of the actuarial function; (4) any other requirements; and (5) requirements for data that must be submitted as prescribed in the valuation manual. The bill also establishes the minimum valuation standard for policies and contracts not subject to a principle-based valuation.

Under the bill, the Commissioner may engage a qualified actuary, at the expense of the insurance company to perform an actuarial examination. In addition, the Commissioner may require the insurance company to change any assumption or method used in the analysis if the Commissioner considers it necessary. An insurance company must adjust its reserves as required by the Commissioner.

Requirements of a Principle-based Valuation

Under the bill, for policies and contracts specified in the valuation manual, insurance companies must establish reserves using a principle-based valuation. An insurance company that uses a principle-based valuation must (1) establish procedures for corporate governance and oversight of the actuarial valuation function consistent with the valuation manual; (2) provide an annual certification of the effectiveness of the insurance company's internal controls with respect to the principle-based valuation; and (3) develop, and file with the Commissioner on request, a principle-based valuation report that complies with the valuation manual.

Under the bill, insurance companies are required to submit the mortality data, morbidity data, policyholder behavior, expense experience, and other data as prescribed in the valuation manual.

Confidential Information

The bill specifies that an insurance company's confidential information (1) is confidential and privileged; (2) is not subject to the Maryland Public Information Act; and (3) is not subject to subpoena or discovery or admissible in evidence in any private civil action. The Commissioner is authorized to use, share, and receive confidential information under specified circumstances and to enter into agreements governing the sharing and use of confidential information.

Exemptions

Under the bill, the Insurance Commissioner is authorized to grant exemptions from the requirements of using the valuation manual under specified circumstances.

Minimum Nonforfeiture Standard – Policies of Life Insurance

The bill establishes the minimum nonforfeiture standard for life insurance policies issued **before** the operative date of the valuation manual and for policies issued **on or after** the effective date of the valuation manual.

Background: 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.

In 2009, NAIC adopted a revised model SVL which introduced a new method for calculating life insurance policy reserves to more easily adapt requirements for changing life insurance products. This new method is referred to as PBR. Once adopted by legislatures, PBR will replace the current formulaic approach to determining policy reserves with an approach that more closely reflects the risks of highly complex life insurance 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. The revised SVL authorizes creation of a valuation manual that contains reserving requirements.

A supermajority of NAIC members adopted the valuation manual in December 2012, paving the way for states to begin adopting the SVL in their 2013 legislative sessions. Once at least 42 states (a supermajority) representing 75% of the total U.S. premium adopt the revisions to the SVL, PBR will be implemented. All policies issued on or after the operative date of the valuation manual will be subject to the PBR standard.

As the industry moves to PBR, there will be challenges, including substantial initial expense of implementing a PBR system for some insurance companies. Regulators and governmental entities also need to obtain the training and experienced staff necessary to review the insurance company submissions and conduct audits.

To allow insurance companies time to identify and address these challenges, the valuation manual provides a three-year transition period beginning on the operative date of the manual before insurers are required to comply with PBR standards; however, insurance companies may begin to use the valuation manual before the three-year transition period has concluded. It is anticipated to take from three to five years to obtain the 42 state adoptions of the SVL necessary to make the valuation manual operative. Given that timeframe and the three-year transition period required by the valuation manual, most insurance companies will not use the PBR system until 2018 at the earliest.

State Fiscal Effect:

Assumptions

The bill specifies that the operative date of the valuation manual is January 1 of the first calendar year following the first July 1 in which the SVL or similar legislation has been enacted by enough states and in enough other jurisdictions. As such, the year in which the valuation manual will become operative cannot be reliably estimated at this time; however, in June 2013, NAIC expected the process to take between three and five years. Therefore, this estimate assumes that the operative date of the valuation manual is January 1, 2017.

Furthermore, although the valuation manual does not require insurance companies to use the PBR system until three years after its operative date, it does authorize insurance companies to begin using it prior to that date. This estimate assumes that some insurance companies will begin to use the PBR system no sooner than six months after the operative date of the valuation manual. MIA needs its staff trained and ready to meet the review and oversight requirements established by the bill no later than July 1, 2017. Thus, this estimate assumes that expenditures related to training and staffing begin January 1, 2017.

Required Staff and Staff Training for MIA

To implement the bill's provisions and suitably and accurately oversee insurance companies who begin to use the PBR system established by the valuation manual, MIA requires additional staff and training for existing staff. Therefore, MIA special fund expenditures increase by $200,000 in fiscal 2017 to provide training related to the valuation manual and PBR for existing staff. Expenditures further increase to hire one permanent full-time actuary to review the filings required of insurance companies by the bill.

	FY 2017	**FY 2018**
Position	1	0
Salary and Fringe Benefits	$84,817	$177,346
Operating Expenses	296	597
Start-up Costs	4,285	0
Staff Training	200,000	0
Total Expenditures	**$289,398**	**$177,943**

Future year expenditures reflect a full salary with annual increases, inflation, and the elimination of one-time costs. Costs related to the actuary are fully or partially offset to the extent that MIA charges insurance companies to review filings because the bill authorizes the Commissioner to engage a qualified actuary at the expense of the insurance company to perform certain actuarial examinations and reviews.

Insurance Premium Tax

Title 6 of the Insurance Article imposes a 2% premium tax on each authorized insurance company, surplus lines broker, or unauthorized insurance company that sells, or an individual who independently procures, any type of insurance coverage upon a risk that is located in the State. Revenues generally accrue to the general fund.

The process for insurance companies to transition to the new PBR valuation system required by the valuation manual is likely costly in the short term, and insurance companies may pass some of these increased costs onto consumers by increasing premiums. Therefore, general fund revenues increase minimally due to the premium tax. In future years, NAIC believes that the PBR model could result in lower premiums for consumers, thus decreasing general fund revenues minimally in those years; however, such an impact cannot be reliably estimated at this time.

Additional Information

Prior Introductions: None.

Cross File: HB 770 (Delegate Davis) - Health and Government Operations.

Information Source(s): Maryland Insurance Administration, National Association of Insurance Commissioners, Center for Insurance Policy and Research, Department of Health and Mental Hygiene, Department of Legislative Services

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