

## BILL ANALYSIS

Senate Research Center  
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S.B. 1386  
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### AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

In order to sell life insurance policies, insurers must maintain and incorporate statutory reserves with respect to their future obligations. The current process for setting life insurance reserves has remained essentially the same for over 150 years. Interested parties contend that the current law relies on a one-size-fits-all approach that does not appropriately take into account differences in companies and the life insurance products they write. For example, mortality experience and other assumptions used to set current reserves are mostly proscribed by statute, even if individual company experience is materially different. Further, differences in the design of two products can affect the level of statutory reserves, even if the underlying risks to a company are the same. Interested parties contend that the resulting statutory reserves, when compared to the amount reasonably necessary to pay future obligations, are much too high in some cases, and too low in others. Because of these inefficiencies, some life insurers have been forced to utilize reinsurance, or alternative mechanisms such as captive insurance programs, to mitigate the impact of unnecessarily high reserves. Interested parties further contend that the reserve requirements, coupled with the tactics being utilized to mitigate the impact of unnecessarily high reserves, create numerous issues including counterparty risk and the possible need to limit future term insurance sales.

After more than seven years of debate and study, the National Association of Insurance Commissioners adopted a revised Standard Valuation Law Model in 2009 for passage by state legislatures. S.B. 1379, 83rd Legislature, Regular Session, 2013, if passed, will allow the commissioner of the Texas Department of Insurance to implement a rule to allow companies to set life insurance reserves using a principles-based reserving (PBR) approach.

PBR uses revised methods and assumptions for setting reserves that better reflect the features and risks in modern products. In addition, it requires companies to model various economic scenarios to ensure the right level of reserves to meet the future obligations of life insurance companies to their policyholders. Once PBR is implemented, statutory life insurance reserves will more accurately reflect the insurance risks of individual companies and products.

PBR also provides the commissioner with added tools with which to appropriately regulate companies and the reserves they hold. Companies will have to prepare a PBR report certifying compliance with reserve requirements and submit an annual certification to the commissioner regarding the effectiveness of internal controls related to PBR. Companies will also submit actual experience data, which will provide much needed transparency into the assumptions companies use to set life insurance reserves.

Once implemented, PBR in S.B. 1379 will enable insurance companies to set reserves that appropriately match the products they sell and will provide the commissioner with the tools needed to properly regulate the life insurance reserves companies hold.

PBR will be operational once it is adopted in 42 jurisdictions that account for at least 75 percent of United States life insurance premiums combined. This is to ensure that all PBR states are applying the approach at the same time. In order to implement the standard valuation model law, states also must update their standard nonforfeiture laws. S.B. 1386 provides these updates. Standard nonforfeiture laws provide requirements for minimum benefit values for certain policies that are surrendered or lapse. The updates refer to the standard valuation law and the new valuation manual as the source for mortality and interest rates used in nonforfeiture

calculations. The updates in S.B. 1386 do not affect the current calculation of nonforfeiture values.

As proposed, S.B. 1386 amends current law relating to the nonforfeiture requirements of certain life insurance policies.

### **RULEMAKING AUTHORITY**

Rulemaking authority is expressly granted to the commissioner of insurance in SECTION 2 (Section 1105.055, Insurance Code) of this bill.

### **SECTION BY SECTION ANALYSIS**

SECTION 1. Amends Subchapter A, Chapter 1105, Insurance Code, by adding Section 1105.0015, to define "operative date of the valuation manual" for this section.

SECTION 2. Amends Section 1105.055, Insurance Code, by amending Subsections (h) and (i) and adding Subsections (j), (k), (l), and (m), as follows:

(h) Authorizes any ordinary mortality table adopted after 1980 by the National Association of Insurance Commissioners that is approved by rules adopted by the commissioner of insurance (commissioner) for use in determining the minimum nonforfeiture standard, for a policy issued before the operative date of the valuation manual, to be substituted for specific tables.

(i) Authorizes any industrial mortality table adopted after 1980 by the National Association of Insurance Commissioners that is approved by rules adopted by the commissioner for use in determining the minimum nonforfeiture standard, for a policy issued before the operative date of the valuation manual, to be substituted for specific tables.

(j) Requires that the valuation manual, except as provided by Subsection (k), for a policy described by Subsection (h), on or after the operative date of the valuation manual, provide the commissioners' standard ordinary mortality table for use in determining the minimum nonforfeiture standard that is authorized to be substituted for the Commissioners 1980 Standard Ordinary Mortality Table with or without Ten-Year Mortality Factors or the Commissioners 1980 Extended Term Insurance Table.

(k) Provides that if the commissioner by rule adopts a commissioners' standard ordinary mortality table adopted by the National Association of Insurance Commissioners 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.

(l) Requires that the valuation manual, except as provided by Subsection (m), for a policy described by Subsection (i), on or after the operative date of the valuation manual, include the commissioners' standard industrial mortality table for use in determining the minimum nonforfeiture standard that is authorized to be substituted for the 1961 Standard Industrial Mortality Table or the Commissioners 1961 Industrial Extended Term Insurance Table.

(m) Provides that if the commissioner by rule adopts a commissioners' standard industrial mortality table adopted by the National Association of Insurance Commissioners 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.

SECTION 3. Amends Section 1105.056, Insurance Code, as follows:

Sec. 1105.056. NONFORFEITURE INTEREST RATE. (a) Creates this subsection from existing text. Provides that, for a policy issued before the operative date of the valuation manual, the annual nonforfeiture interest rate for a policy issued in a particular calendar year is equal to 125 percent of the calendar year statutory valuation interest rate for that policy as defined by Subchapter B (Standard Valuation Law), Chapter 425, rounded to the nearest one-fourth of one percent.

(b) Provides that, for a policy issued on or after the operative date of the valuation manual, the nonforfeiture per year for any policy issued in a particular calendar year is provided by the valuation manual.

SECTION 4. Prohibits the commissioner from implementing this Act before the operative date of the valuation manual described by Section 1105.0015, Insurance Code, as added by this Act.

SECTION 5. Provides that this Act is contingent upon the passage of an Act of the 83rd Legislature, Regular Session, 2013, that amends Chapter 425, Insurance Code.

SECTION 6. Effective date: January 1, 2014.