

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** CS/CS/HB 1271 Insurer Solvency

**SPONSOR(S):** Regulatory Affairs Committee; Insurance & Banking Subcommittee; Ingram and others

**TIED BILLS:** CS/CS/HB 1273 **IDEN./SIM. BILLS:** CS/CS/SB 1308

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	13 Y, 0 N, As CS	Bauer	Cooper
2) Regulatory Affairs Committee	18 Y, 0 N, As CS	Bauer	Hamon

### SUMMARY ANALYSIS

The Office of Insurance Regulation (OIR) is a member of the National Association of Insurance Commissioners (NAIC), an organization consisting of state insurance regulators. As a member of the NAIC, the OIR is required to participate in the organization's accreditation program. NAIC accreditation is a certification that legal, regulatory, and organizational oversight standards and practices are being fulfilled by a state insurance department. The NAIC also periodically reviews its solvency standards as set forth in its model acts, and revises accreditation requirements to adapt to evolving industry standards and practices.

The OIR has identified several model act components that are not in the current Insurance Code and must be implemented in order for the OIR to maintain its accreditation. The bill implements the following NAIC components:

- Requires insurers to file actuarial opinion summaries and supporting workpapers annually;
- Requires acquirers of controlling interests to disclose "enterprise risk" and for ultimate controlling persons to file an annual enterprise risk report;
- Requires insurance holding companies to file an annual registration statement;
- Allows the OIR to examine any insurer and its affiliates to ascertain enterprise risk;
- Provides a privilege to the OIR for memoranda supporting actuarial opinions on reserves, actuarial opinion summaries and related information, and acquisition-related filings and documents;
- Requires health maintenance organizations and prepaid limited health service organizations to file risk-based capital filings;
- Incorporates a risk-based capital trend test for life and health and property and casualty insurers; which expands the scenarios in which a company may be required to take corrective action;
- Allows the OIR to initiate the establishment of, and to participate in, supervisory colleges with other state insurance regulators and authorizes the OIR to act as a group-wide supervisor for international insurance groups;
- Authorizes the OIR to implement principle-based reserving for life insurers,
- Authorizes the OIR to impose sanctions for violations of acquisition, enterprise risk reporting, and holding company registration requirements; and
- Updates the Financial Services Commission's rulemaking authority to reflect these new NAIC requirements.

The bill does not have a fiscal impact on local government, and the OIR does not anticipate a fiscal impact to state government. The bill has a positive but indeterminate impact on the private sector.

Except as otherwise expressly provided, the bill provides a contingent effective date of October 1, 2014, if the linked public records bill (HB 1273) or similar legislation is adopted in the same legislative session or an extension thereof and becomes law.

# FULL ANALYSIS

## I. SUBSTANTIVE ANALYSIS

### A. EFFECT OF PROPOSED CHANGES:

#### **Background: Insurer Solvency Regulation**

The National Association of Insurance Commissioners (NAIC) is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance departments that regulate the conduct and solvency of insurers in their respective states or territories.<sup>1</sup> The Florida Office of Insurance Regulation (OIR) is responsible for all activities concerning insurers and other risk bearing entities, including licensing, rates, policy forms, market conduct, claims, issuance of certificates of authority, solvency, viatical settlements, premium financing, and administrative supervision, as provided under the insurance code or chapter 636, F.S.<sup>2</sup>

As a member of the NAIC, the OIR is required to participate in the organization's Financial Regulation Standards and Accreditation Program.<sup>3</sup> NAIC accreditation is a certification that legal, regulatory, and organizational oversight standards and practices are being fulfilled by a state insurance department. The accreditation program is designed to allow for interstate cooperation and reduces regulatory redundancies. For example, the OIR's examinations may be recognized by other member states, thereby avoiding the need to have a Florida domestic insurer examined by multiple states. All fifty states, the District of Columbia, and Puerto Rico are accredited by the NAIC. Once accredited, a state is subject to a full accreditation review every five years, as well as interim reviews. The OIR's most recent full accreditation review occurred in the fall of 2013, and the OIR retained its accredited status.<sup>4</sup>

NAIC accreditation standards are grouped into four major areas, with laws and regulations being one of these areas. These standards include, but are not limited to, the NAIC Risk-Based Capital (RBC) for Insurers Model Act, Model Holding Company Regulatory Act, Standard Valuation Law, and Actuarial Opinion and Memorandum Regulation or substantially similar provisions.<sup>5</sup> The NAIC also periodically reviews these model solvency standards,<sup>6</sup> and revises accreditation requirements to adapt to evolving industry practices, particularly in the wake of the recent economic crisis.

The OIR has identified new elements of these NAIC model acts that must be implemented in the Insurance Code in order for the OIR to maintain its accreditation. In addition, the bill adopts the 2009 NAIC revisions to the Standard Valuation Law (which Florida adopted in s. 625.121, F.S.), including the adoption of a new manual for valuing life insurer reserves and a principle-based approach to determining reserve levels and a group-wide supervision standard for international insurance companies.

#### **Effect of the Bill**

This bill implements these model act elements, to be discussed in further detail below:

- *Model Holding Company Act & Regulations*
  - NAIC accreditation effective date January 1, 2016
  - Acquisition and controlling stock reporting
  - Registration and regulation of insurance holding companies
  - Enterprise risk reporting
  - Supervisory colleges

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<sup>1</sup> About the NAIC, [http://www.naic.org/index\\_about.htm](http://www.naic.org/index_about.htm) (last accessed March 4, 2014).

<sup>2</sup> Section 20.121(3)(a), F.S. The OIR's agency head for purposes of final agency action is the commissioner, and its rulemaking body is the Financial Services Commission (the Governor and the Cabinet).

<sup>3</sup> NAIC Financial Regulation Standards and Accreditation Committee: [http://www.naic.org/committees\\_f.htm](http://www.naic.org/committees_f.htm) (last accessed March 7, 2014).

<sup>4</sup> OIR bill analysis of HB 1271 (received March 7, 2014), on file with the Insurance & Banking Subcommittee staff.

<sup>5</sup> All NAIC Model Laws, Regulations and Guidelines are available at: [http://www.naic.org/store\\_model\\_laws.htm](http://www.naic.org/store_model_laws.htm) (last accessed March 7, 2014).

- *Risk-Based Capital for Insurers & Health Organizations*
  - Risk-based capital standards for health organizations – NAIC accreditation effective date: January 1, 2015
  - Risk-based capital trend test for property and casualty insurers
    - NAIC accreditation effective date: January 1, 2012
  - Risk-based capital trend test for life and health insurers
    - NAIC accreditation effective date: January 1, 2017
- *Property & Casualty Actuarial Opinion Model Law*
  - NAIC accreditation effective date: January 1, 2010
  - Actuarial opinion summary
  - Confidentiality<sup>7</sup> and privilege
- *Standard Valuation Law*
  - Confidentiality<sup>8</sup> and privilege

## **1. NAIC Model Holding Company Act and Regulations**

For years, the OIR’s financial oversight authority has included a review of transactions among affiliates and members of insurance holding companies by adopting the NAIC’s Model Insurance Holding Company Act and Regulation.<sup>9</sup>

However, in response to the recent financial crisis, the NAIC studied key group supervision issues for insurance holding company systems. In light of the 2008 liquidity crisis and collapse of American International Group, Inc., the NAIC’s efforts focused on the risks and activities of non-insurance entities within insurance holding companies and concluded there was a corresponding regulatory need to obtain affiliates’ financial information, such as enterprise risk, in order to ensure that the overall solvency of the holding company (whose main business is insurance) is not jeopardized. The NAIC model act defines “enterprise risk” as:

[A]ny activity, circumstance, event, or series of events involving one or more affiliates of an insurer that, if not remedied promptly, is likely to have a material adverse effect upon the financial condition or liquidity of the insurer or its insurance company as a whole, including, but not limited to, anything that would cause the insurer’s risk-based capital as set forth in [state requirement] or would cause the insurer to be in a hazardous financial condition.<sup>10</sup>

As a result, the NAIC adopted revisions to its *Model Insurance Holding Company System Regulatory Act and Regulations* in December 2010, which states must adopt as an accreditation component by January 1, 2016. These revisions include:

- expansions to regulators’ ability to evaluate any entity within an insurance holding company system;
- enhancements to the regulator’s rights to access books and records and to compel production of information;
- establishment of expectation of funding with regard to regulator participation in supervisory colleges;
- enhancements in corporate governance, such as board of directors and senior management responsibilities;
- the inclusion of financial statements as part of an affiliate’s registration requirements; and
- enterprise risk reporting requirements.<sup>11</sup>

### *Definitions*

- **Section 1** of the bill amends s. 624.10, F.S., to define “affiliate,” “affiliated person,” and “control” for purposes of reporting acquisition of controlling stock.

<sup>7</sup> See the linked public records exemption bill, CS/CS/HB 1273.

<sup>8</sup> *Id.*

<sup>9</sup> The NAIC model act numbers for the Model Holding Company Act and Regulations are #440 and #450, respectively.

<sup>10</sup> Section 1(F) of the NAIC Model Insurance Holding Company System Regulatory Act.

<sup>11</sup> NAIC Group Supervision, [http://www.naic.org/cipr\\_topics/topic\\_group\\_supervision.htm](http://www.naic.org/cipr_topics/topic_group_supervision.htm) (last accessed March 7, 2014).

- The bill defines “affiliate” to include direct or indirect control through equity ownership of voting securities, common managerial control, or collusive participation by the management of the insurer and affiliate in the management of the insurer or the affiliate.
  - The bill moves the current definition of “affiliated person” in s. 628.461(12)(a), F.S., and places it in this new provision.
  - Consistent with the Model Holding Company Act, the bill uses a 10% threshold for the definition of “control.”
  - The bill also defines “NAIC” as the National Association of Insurance Commissioners and renumbers the current subsection for the definition of “transact.”
- **Section 3** amends s. 624.402, F.S., relating to the types of services that may be provided by an insurer under common ownership or control.

#### *Examination and investigation reports*

- **Section 2** of the bill amends s. 624.319, F.S., to provide that the production of documents during the course of an examination or investigation by the OIR or the DFS does not constitute a waiver of the attorney-client or work-product privileges.

#### *Acquisition and disclaimer of controlling stock*

- Currently, s. 628.461, F.S., requires an individual or affiliated person to file a letter of notification and a statement for the OIR’s approval before concluding a tender offer to acquire 5% or more of a domestic stock insurer or of a controlling company. The statute also sets forth the information required to be disclosed in the statement, such as criminal and regulatory history information.
  - Alternatively, a party acquiring less than 10% of the outstanding voting securities of an insurer may file a disclaimer of affiliation of control, and such disclaimer must fully disclose all material relationships and affiliation with the insurer, as well as the reason for the disclaimer.
  - This disclaimer is mandatory for acquisitions of more than 10% of the outstanding voting securities of an insurer.
  - During the pendency of the OIR’s review of an acquisition filing, the insurer is not permitted to make a “material change” to its operation or management, unless the OIR has approved or been notified, respectively. A “material change” consists of a disposal or obligation of 5% or more of the insurer’s capital and surplus, or a change in management involving a person who has the authority to dispose or obligate 5% of the insurer’s capital and surplus.
- **Section 10** of the bill amends s. 628.461, F.S., to comport substantially with the Model Act disclaimer requirements:
  - Increases the ownership threshold (which triggers the notification and statement requirements) from 5% to 10% or more of the outstanding voting securities of a domestic stock insurer or of a controlling company.
  - Deletes the provision stating “in lieu of filing an acquisition statement, a party acquiring less than 10% of the outstanding voting securities of an insurer, may file a disclaimer of affiliation and control.”
  - Specifies that effective January 1, 2015, the acquiring party’s statement must include an agreement to file an “annual enterprise risk report,” if control exists.
  - Adds language that states effective January 1, 2015, the person required to file the statement pursuant to s. 628.461(1), F.S., will provide the annual report specified in s. 628.801(2), F.S., if control exists.
  - Adds a provision that the presumption of control may be rebutted by either filing a disclaimer of control on a form prescribed by the office or by providing a copy of a Schedule 13G on file with the SEC. After a disclaimer is filed, the insurer is relieved of any further duty to register or report under s. 628.461, F.S., unless the OIR disallows the disclaimer.
    - It is noted that the option to file a Schedule 13G does not appear in the NAIC’s Model Holding Company Act.
    - The federal Securities and Exchange Act of 1934 (15 U.S.C. § 78a *et seq.*, as amended), and Regulation 13D-G (17 CFR Part 240.13d), require certain investment advisers and brokers to file acquisition and beneficial ownership reports with the SEC when they

directly or indirectly acquire more than 5% of any issuer's outstanding "Section 13" or "equity securities," which is measured at the end of each calendar year.

- Adds a provision that any controlling person of a domestic insurer that seeks to *divest* its controlling interest in the domestic insurer shall file with the OIR a confidential notice of its proposed divestiture at least 30 days prior to the relinquishment of control.
- Moves the definition of "affiliated person" to section 1 of the bill.
- Deletes the definition of "controlling company," which means any corporation, trust, or association that owns 25% or more of the voting securities of one or more domestic stock insurance companies, since the new requirements will be triggered at 10% ownership.

#### *Registration and regulation of insurance holding companies; enterprise risk reporting*

- Currently, all insurers authorized to do business in Florida and who are members of insurance holding companies, are required to register with the OIR and be subject to regulation in relation to their holding companies. The Financial Services Commission has rulemaking authority to adopt rules regarding registration, and those rules must include the requirements and standards of certain NAIC model regulations.<sup>12</sup>
- **Section 11** of the bill amends s. 628.801, F.S. (regarding the registration and regulation of insurance holding companies), to incorporate changes from the 2010 revisions to the NAIC Model Holding Company Act, and to permit subsequent updates that have a substantially consistent methodology. Effective January 1, 2015, this section also defines "enterprise risk," incorporates the NAIC "enterprise risk" reporting requirements and authorizes the OIR to conduct examinations of insurer affiliates. The bill:
  - Requires authorized insurers to file a registration statement on or before April 1 of each year. The bill also states a material transaction between an insurer and its affiliates shall be filed with the OIR as provided by rule.
  - Adds a provision that requires the ultimate controlling person of every insurer subject to registration file an annual enterprise risk report on or before April 1 and comply with the December 2010 NAIC Insurance Holding Company System Model Regulation and subsequent amendments.
  - Defines the term "ultimate controlling person" as a person that is not controlled by any other person.
  - Provides that the failure to file a registration statement or enterprise risk filing report is a violation of s. 628.801, F.S.
  - Defines new criteria under which an insurer may apply for waiver of the requirements contained in s. 628.801, F.S.
  - Provides that the filings and related documents filed pursuant to this section (which are confidential and exempt pursuant to the linked bill, CS/CS/HB 1273) are not subject to subpoena or discovery directly from the OIR.
  - Prohibits the waiver of any applicable privilege or claim of confidentiality in the enterprise risk report as a result of disclosures to the OIR.
  - Allows the insurer to satisfy the filing requirement by filing the parent corporation's reports that have been filed with the Securities and Exchange Commission if compliant with requirements.
  - This provision is effective January 1, 2015.

#### *Sanctions*

- Currently, the Insurance Code states that noncompliant insurance companies (and their directors, officers, employees, and agents) can be subject to a number of sanctions:
  - monetary penalties for failing to file registration statements or certificate,
  - civil forfeitures for knowingly engaging in transactions that have not been properly filed, approved, or in accordance with commission rule,

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<sup>12</sup> A domestic insurer who is fully compliant with the registration laws of its holding company's state of domicile (if NAIC-accredited) may request a waiver from the Florida filing requirements. Section 628.801(1), F.S.

- a cease and desist order for engaging in transactions or entering into contracts that violate commission rules, and rescission orders if in the best interests of the policyholders, creditors, or public.
- Additionally, an officer, director, or employee of an insurance holding company who willfully and knowingly submits a false statement, false report, or false filing with the intent to deceive the OIR, is guilty of a third-degree felony.
- **Section 12** of the bill amends s. 628.803, F.S., to incorporate a new NAIC sanction to provide that a violation of the enterprise risk requirements serves as an independent basis for the Office to disapprove dividends and distributions and to place the insurer under an order of administrative supervision. This provision is effective January 1, 2015.

### *Supervisory colleges*

- According to the Center for Insurance Policy & Research, “a supervisory college is a meeting of insurance regulators or supervisors where the topic of discussion is regulatory oversight of one specific insurance group that is writing significant amounts of insurance in other jurisdictions.”<sup>13</sup> Supervisory colleges also facilitate oversight of internationally active insurance companies at the group level and promote regulatory information-sharing, subject to applicable confidentiality agreements.<sup>14</sup> Supervisory college members are generally the states or jurisdictions where the largest insurance entities within a group are domiciled, premium underwritten and key corporate decision-makers in the organization are located.<sup>15</sup>
- **Section 14** creates s. 628.805, F.S., regarding supervisory colleges, with the following:
  - Allows the OIR to participate in supervisory colleges with other regulators and to initiate the establishment of a supervisory college, clarify membership, participation and functions of the role of other regulators, coordinate ongoing activities and establish a crisis management plan.
  - Allows the OIR to participate in a supervisory college if the insurance company is registered pursuant to s. 628.801, F.S., for any domestic insurer that is part of a holding company system.<sup>16</sup>
  - Allows the OIR to assess a registered insurer for the reasonable expenses to participate in a supervisory college.
  - This provision is effective January 1, 2015.

### *Group-wide supervision of international insurance groups*

- In July 2012, Pennsylvania signed into law PA Public Law 111, No. 136, which significantly amended Pennsylvania’s Insurance Holding Company Act to be in compliance with the NAIC Model Holding Company Act. The Pennsylvania legislation also included a statute authorizing its insurance regulator to act as the group-wide supervisor for any international insurance group.<sup>17</sup>
- **Section 13** creates s. 628.804, F.S., to similarly authorize the OIR to serve as group-wide supervisor for any international insurance group in which the ultimate controlling person is domiciled in this state. Where the person is not a Florida domiciliary, the OIR may determine it is the appropriate group-wide supervisor based on level of operations in this state, or acknowledge that another state should serve in this capacity. The bill sets forth criteria for making this determination. This provision is patterned after the Pennsylvania statute.
- The international criterion for determining a group-wide supervisor does not materially differ from the criteria contained within the *NAIC Financial Analysis Handbook* for determining the lead state.
- This provision is effective January 1, 2015.

<sup>13</sup> “Supervisory Colleges: A Regulatory Tool for Enhancing Supervisory Cooperation and Coordination,” [http://www.naic.org/cipr\\_newsletter\\_archive/vol4\\_supervisory\\_colleges.htm](http://www.naic.org/cipr_newsletter_archive/vol4_supervisory_colleges.htm) (last accessed March 1, 2014).

<sup>14</sup> NAIC on Supervisory Colleges, [http://www.naic.org/cipr\\_topics/topic\\_supervisory\\_college.htm](http://www.naic.org/cipr_topics/topic_supervisory_college.htm) (last accessed March 1, 2014). Additionally, the linked public records bill, HB 1273, creates a public records exemption for certain records containing proprietary business information, including information that is provided to or obtained by the OIR pursuant to participation in a supervisory college.

<sup>15</sup> OIR bill analysis of HB 1271, on file with the Insurance & Banking Subcommittee staff.

<sup>16</sup> According to the OIR, its participation does not delegate any of its regulatory authority over insurers in its jurisdiction. *Id.*

<sup>17</sup> 40 P.S. section 1406.2. It is noted that this language is currently not a NAIC accreditation requirement.

## **2. Risk-Based Capital for Insurers & Health Organizations (Model Laws #312 and #315); Trend Test Requirements**

Risk-based capital (RBC) is a capital adequacy standard that represents the amount of required capital that an insurer must maintain, based on the inherent risks in the insurer's operations. It is determined by a formula that considers certain material risks depending on the type of insurer, and generates the regulatory minimum amount of capital that a company is required to maintain to avoid regulatory action. RBC raises a safety net for insurers, is uniform among states, and operates as a tripwire system to give state insurance regulators authority for timely corrective action.<sup>18</sup> In March 2006, the NAIC adopted revisions to the *Risk-Based Capital for Insurers Model Act (#312)*, which provides that states must require both life and health and property and casualty insurers to submit RBC filings with their regulators. Presently, this requirement is reflected in the Insurance Code, but does not apply to health maintenance organizations (HMOs) and prepaid limited health service organizations.<sup>19</sup> "Prepaid limited health service organizations" provide limited health services (such as dental or vision care) through an exclusive panel of providers in return for a prepayment,<sup>20</sup> and "health maintenance organizations" generally provide a range of health coverage with providers under contract.<sup>21</sup>

In 2010, the NAIC adopted a recommendation to make the *Risk-Based Capital for Health Organizations (#315) Model Act* an accreditation standard.<sup>22</sup> This Model Act defines "health organization" to include health maintenance organizations and limited health service organizations.<sup>23</sup> Accordingly, effective January 1, 2015, member states must require HMOs and prepaid limited health service organizations to submit risk-based capital filings in order to maintain accreditation.

In addition, the NAIC has developed a new "trend test" within RBC calculations for life and health and P/C insurers, as well as for health organizations. The trend test flags companies whose RBC is trending in a negative direction, and companies failing the trend test would trigger a "company action level event" and be required to file a corrective action plan. The NAIC accreditation effective date for the P/C trend test is January 1, 2012, and the accreditation effective date for the life and health trend test is January 1, 2017.

The following provisions of the bill relate to the model RBC Act requirements:

- **Section 4** amends s. 624.4085, F.S., to expand the definition of "life and health insurer" to include health maintenance organizations and prepaid health service organizations (that are authorized in Florida and one or more other states, jurisdictions, or countries) for purposes of risk-based capital requirements.
  - The amended risk-based capital trend test requirement establishes a company action level standard triggered by the trend test for both property and casualty and life and health insurers allowing more time for the company to correct the conditions causing a deterioration of its level of risk-based capital. The risk-based capital requirement is a significant element required for NAIC accreditation.
- **Section 15** amends s. 636.045, F.S. (regarding minimum surplus requirements for prepaid limited health service organizations), with the following:
  - Subjects prepaid limited health service organizations to the risk-based capital requirements of s. 624.4085, F.S., and the confidentiality provision for risk-based capital information in s. 624.40851, F.S.
- **Section 16** amends s. 641.225, F.S. (surplus requirements for HMOs), with the following:

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<sup>18</sup> NAIC on Risk-Based Capital, [http://www.naic.org/cipr\\_topics/topic\\_risk\\_based\\_capital.htm](http://www.naic.org/cipr_topics/topic_risk_based_capital.htm) (last accessed March 4, 2014).

<sup>19</sup> Section 624.4085, F.S.

<sup>20</sup> Section 636.003(7), F.S.

<sup>21</sup> Section 641.19(12), F.S.

<sup>22</sup> NAIC Financial Regulation Standards and Accreditation Committee, at: [http://www.naic.org/committees\\_f.htm](http://www.naic.org/committees_f.htm) (last accessed March 4, 2014).

<sup>23</sup> Section 1(F) of the NAIC Risk-Based Capital for Health Organizations Model Act (#315).

- Subjects HMOs that are authorized in Florida and one or more other states, jurisdictions, or countries to the new RBC requirements of s. 624.4085, F.S., and the confidentiality provision for RBC information in s. 624.40851, F.S.
- **Section 17** amends s. 641.255, F.S. (acquisition, merger, or consolidation) with the following:
  - Subjects HMOs that are members of a holding company system to the acquisition and enterprise risk reporting requirements of s. 628.461, F.S., but not to the acquisition requirements for specialty insurers in s. 628.4615, F.S.

### **3. Property and Casualty Actuarial Opinion Model Law (#745); Captives**

The *NAIC Property and Casualty Actuarial Opinion Model Law (#745)* specifies that states must require property and casualty insurers to submit a Statement of Actuarial Opinion, which is a public document. The model act also requires the submission of an Actuarial Opinion Summary, an Actuarial Report and workpapers to support each actuarial opinion, which must be treated as confidential and privileged. The NAIC accreditation effective date was January 1, 2010.

Current law requires insurers (except those providing life insurance and title insurance) to provide to OIR an annual statement of its financial condition and a statement of opinion on loss and loss adjustment expense reserves prepared by an actuary or a qualified loss reserve specialists. These insurers are also required to provide supporting workpapers upon the OIR's request.<sup>24</sup> Currently, these materials are not exempt from public records disclosure.

**Section 5** of the bill relates to the NAIC's Property & Casualty Actuarial Opinion Model Law. It amends s. 624.424, F.S., to:

- Require insurers to provide actuarial opinion summaries, in accordance with NAIC instructions, with their annual statements to the OIR. This section excludes life and health insurers from this requirement.
  - The section also states that "proprietary business information" contained in these summaries are confidential and exempt from public records disclosure (pursuant to the linked bill, CS/CS/HB 1273). This section also protects the summary and related information from subpoena or discovery directly from the OIR, prohibits the OIR and its agents from testifying about such information in a private civil action, and allows the OIR to use such information in pursuing any legal or regulatory action against an insurer.
  - Updates the Financial Services Commission's rulemaking authority under this section to specify that rule must be in substantial conformity with the 2006 Annual Financial Reporting Model Regulation adopted by the NAIC.
- Additionally, the bill includes a new subsection (11) to address captives.
  - According to the NAIC, captives were traditionally established by non-insurance companies. However, a small number of life insurers have recently entered the market, utilizing captives to form captive reinsurance subsidiaries and insurance securitizations to transfer insurance risk and to relieve themselves from conservative reserve requirements.<sup>25</sup>
  - The NAIC issued a white paper in July 2013<sup>26</sup> to address the use and regulation of captives and engaged a consultant to make recommendations for address the solvency implications of life insurer-owned captive insurers and alternative mechanisms.
  - Based on these NAIC findings, the bill requires each insurer doing business in Florida and that reinsures through a captive insurance company to also file a report as a separate schedule with the OIR. This report must contain certain information specific to reinsurance assumed by each captive.

### **4. Standard Valuation Law (#820) / Principle-Based Reserving**

#### *Principle-Based Reserving*

<sup>24</sup> Section 624.424, F.S.

<sup>25</sup> NAIC on captive insurance companies, at [http://www.naic.org/cipr\\_topics/topic\\_captives.htm](http://www.naic.org/cipr_topics/topic_captives.htm) (last accessed March 7, 2014).

<sup>26</sup> "Captives and Special Purpose Vehicles: An NAIC White Paper," at <http://www.naic.org/store/free/SPV-OP-13-ELS.pdf>.

Life insurance policy reserves are the funds that an insurance company must set aside to pay future life insurance claims. Currently, life insurance reserves are calculated (“valued”) using pre-set, formulaic assumptions as prescribed by state laws and regulations, which must be updated as increasingly complex insurance products are introduced and as economic conditions change. Additionally, current formulas may not always accurately reflect the risks or true costs or obligations of the insurer, which can lead to excessively conservative reserves for some products and inadequate reserves for others.

Consequently, the NAIC introduced revisions to the Standard Valuation Law (SVL) and the Valuation Manual to include a new method for calculating life insurance policy reserves, referred to as Principle-Based Reserving (PBR). According to the NAIC, the new PBR approach is expected to “right-size” reserves and to eventually reduce the incentive for company “workarounds” designed to reduce reserves.

The new SVL was adopted by a supermajority of NAIC members in December 2012. The revised SVL and valuation manual does not become operative until adopted by at least 42 states (a supermajority) representing 75% of total U.S. premium volume. PBR will be implemented over approximately three years and will apply only for new policies, except for contracts issued by single-state domestic insurers who qualify for an exemption from PBR.<sup>27</sup>

As of February 1, 2014, 7 states (accounting for just under 8 percent of the total premium volume) have approved the revised model.<sup>28</sup> The requirements of the manual are applicable to life insurance contracts, accident and health contracts, and other specified contracts. Some products are not subject to PBR. However, some products, such as term life insurance policies and universal life insurance policies with a secondary guarantee, which are issued on or after the operative date of the manual would be subject to PBR once the manual is operative.<sup>29</sup>

**Section 6** of the bill amends s. 625.121, F.S. (relating to standard valuation law for life insurers), to apply to policies and contracts issued prior to the operative date of the valuation manual or otherwise exempt from PBR as a single-state domestic insurer.

- Current law requires life insurance companies to annually file an actuarial opinion of reserves and provides that any memoranda or material in support of the opinion is confidential and exempt from public records laws.
- The bill provides that such material is also not subject to subpoena or discovery directly from the OIR, and prohibits the OIR or any person with whom the OIR has shared this information, pursuant to this paragraph, to testify as to the confidential information in a private civil action.
- The bill also permits the OIR to use the information in furthering any legal or regulatory action brought against an insurer. Disclosure to the OIR does not result in a waiver of any applicable privilege or claim of confidentiality. Aside from the confidentiality provisions, the section includes only minor conforming changes to reflect pre-and post-valuation manual eras.

**Section 7** of the bill creates s. 625.1212, F.S., to incorporate the new PBR provisions and to set forth valuation of life insurance contracts, accident and health contracts, and deposit-type contracts issue on or after the “operative date of the valuation manual.”

- The operative date is defined as the later of January 1, 2017, or January 1 immediately following the July 1 of the year in which the OIR Commissioner certifies to the Financial Services Commission (commission) that the NAIC thresholds have been met (i.e., adopted by 42 of 55 states and territories, representing more than 75% of premium written).
- This section requires insurers to apply the standard prescribed in the valuation manual as the minimum standard for valuing reserves and use PBR for certain products specified in the valuation manual,

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<sup>27</sup> NAIC on Principle-Based Reserving, at [http://www.naic.org/cipr\\_topics/principle\\_based\\_reserving\\_pbr.htm](http://www.naic.org/cipr_topics/principle_based_reserving_pbr.htm) (last accessed March 7, 2014). However, insurers can implement PBR anytime during the 3-year transition period.

[http://www.naic.org/documents/committees\\_ex\\_pbr\\_implementation\\_tf\\_130621\\_legislative\\_brief.pdf](http://www.naic.org/documents/committees_ex_pbr_implementation_tf_130621_legislative_brief.pdf)

<sup>28</sup> OIR bill analysis of HB 1271, on file with the Insurance & Banking Subcommittee staff.

<sup>29</sup> A universal life policy with a secondary guarantee is also known as a no-lapse guarantee. The policy will not lapse if certain conditions are met.

except for product forms and lines exempted by single state domestic insurers meeting certain statutory criteria. The valuation manual currently requires the use of PBR for two products: term life insurance and universal life insurance with a secondary guarantee.<sup>30</sup> As under the existing SVL, this section requires insurers to submit an actuarial opinion of reserves and memorandum in support of each opinion.

- This section also provides for the manual to delineate future product lines and forms subject to PBR and sets forth requirements for companies using PBR. This section also requires insurers to provide regulators with access to models and software used to compute principle-based reserves.
  - According to the OIR, the public should have confidence that the assumptions used in these reserving models are reasonable and subject to regulatory oversight and review.<sup>31</sup>
- The commission is provided with express rulemaking authority to administer this section, including rules requiring the use of the NAIC 2009 Standard Valuation Law and the 2012 NAIC Valuation Manual.

**Section 8** of the bill creates s. 625.1214, F.S., to set forth privilege and confidentiality for “documents, reports, materials, and other information created, produced, or obtained” pursuant to sections 6 and 7 of the bill.<sup>32</sup>

The bill protects these items from subpoena or discovery directly from the OIR. The OIR may use the information as part of any official regulatory or legal action it brings against the company. Neither the OIR nor any person who receives the information in an official capacity, or with whom the information is shared, may be required to testify in any private civil action concerning the confidential and exempt information. Finally, a privilege created in another state that is substantially similar to the privilege in this state must also be available and enforced in any proceeding in this state.

**Section 9** of the bill amends s. 627.476, F.S., the Standard Nonforfeiture Law, which establishes minimum benefit values when life insurance policies lapse or are surrendered.

- According to the NAIC, changes to the Standard Nonforfeiture Law for life insurance is intended to be part of a package with the changes to the SVL so that mortality and interest rate assumptions are coordinated. However, such changes would apply to policies issued on or after the operative date of the valuation manual.
- The bill also specifies that the nonforfeiture interest rate may not be less than 4 percent, in order for a life insurance policy to meet maximum cash value requirements in the Internal Revenue Code and thus remain tax-qualified in favor of consumers. According to the OIR, this revision was adopted by the NAIC in December 2013.<sup>33</sup>

## B. SECTION DIRECTORY:

**Section 1.** Amends s. 624.10, F.S., to provide additional definitions applicable to the Insurance Code.

**Section 2.** Amends s. 624.319, F.S., to clarify that production of documents does not waive the attorney-client or work-product privilege.

**Section 3.** Amends s. 624.402, F.S., to conform a cross-reference.

**Section 4.** Amends s. 624.4085, F.S., to revise a definition; provide additional calculations for determining whether an insurer has a company action level event; revise provisions relating to mandatory control level events.

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<sup>30</sup> Future revisions to the SVL may subject additional products to PBR. NAIC on Principle-Based Reserving, at [http://www.naic.org/cipr\\_topics/principle\\_based\\_reserving\\_pbr.htm](http://www.naic.org/cipr_topics/principle_based_reserving_pbr.htm) (last accessed March 7, 2014).

<sup>31</sup> OIR bill analysis of HB 1271, on file with the Insurance & Banking Subcommittee staff.

<sup>32</sup> The linked public records bill, CS/CS/HB 1273, creates a public records exemption for proprietary business information contained in, among other records, certain documents related to the valuation manual, beginning on the operative date of the valuation manual.

<sup>33</sup> Document from the OIR (received January 16, 2014), on file with the Insurance & Banking Subcommittee staff.

**Section 5.** Amends s. 624.424, F.S., to require an insurer's annual statement to include an actuarial opinion summary and providing criteria for such summary, to provide an exception for life and health insurers, and to update provisions; to require insurers reinsuring through a captive insurance company to file a report containing certain information.

**Section 6.** Amends s. 625.121, F.S., to revise the Standard Valuation Law; distinguish the provisions from valuations done pursuant to the NAIC's valuation manual and incorporating certain provisions included in the manual; exempt certain documents from civil proceedings; revise the methods for evaluating the valuation of industrial life insurance policies; revise provisions relating to calculating additional premium; update provisions relating to reserve calculations for indeterminate premium plans.

**Section 7.** Creates 625.1212, F.S., to provide for the valuation of policies and contracts after the adoption of the NAIC's valuation manual; provide applicability; define terms; require the Office of Insurance Regulation to value insurer reserves; require actuarial opinions of the reserves and a supporting memorandum to the opinions; require the insurer to apply the standard prescribed in the valuation manual; provide exceptions; provide requirements for a principle-based valuation of reserves; require an insurer to submit certain data to the office; direct the Financial Services Commission to adopt rules.

**Section 8.** Creates s. 625.1214, F.S., to provide for the use of confidential information; prohibit the use of such information in private civil action.

**Section 9.** Amends s. 627.476, F.S., to revise the Standard Nonforfeiture Law; distinguish provisions subject to the valuation manual and provide for the application of tables found in the manual.

**Section 10.** Amends s. 628.461, F.S., to revise the amount of outstanding voting securities of a domestic stock insurer or a controlling company which a person is prohibited from acquiring unless certain requirements are met; to delete a provision authorizing insurers to file a disclaimer of affiliation of control in lieu of a letter notifying the office of the acquisition of the voting securities of a domestic stock company under certain circumstances; to conform a provision to changes made by the act; to provide that control is presumed under certain conditions; to specify how control may be rebutted and divested; and to delete definitions.

**Section 11.** Amends s. 628.801, F.S., to require insurers to file a registration statement by a specified date; to revise the requirements and standards for the rules establishing the information and statement form for the registration; to require an insurer to file an annual enterprise risk report; to authorize the OIR to conduct examinations to determine the financial condition of registrants; to provide that failure to file a registration or report is a violation of the section; to provide additional grounds, requirements, and conditions with respect to a waiver from this section.

**Section 12.** Amends s. 628.803, F.S., to provide for sanctions for persons who violate certain provisions relating to the acquisition of controlling stock.

**Section 13.** Creates s. 628.804, F.S., to provide for the groupwide supervision of international insurance groups; to define terms; to provide for the selection of a groupwide supervisor; and to authorize the commission to adopt rules.

**Section 14.** Creates s. 628.805, F.S., to authorize the OIR to participate in supervisory colleges and to authorize the OIR to assess fees on insurers for participation.

**Section 15.** Amends s. 636.045, F.S., to apply certain statutes related to solvency to prepaid limited health service organizations.

**Section 16.** Amends s. 641.225, F.S., to apply certain statutes related to solvency to health maintenance organizations.

**Section 17.** Amends s. 641.225, F.S., to provide for applicability of specified provisions to a health maintenance organizations that is a member of a holding company.

**Section 18.** Except as otherwise expressly provided in this act, the act shall take effect October 1, 2014, if HB 1273 (the public records bill) or similar legislation is adopted in the same legislative session or an extension thereof and becomes a law.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

### A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

See Fiscal Comments.

2. Expenditures:

See Fiscal Comments.

### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

### C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The OIR and the NAIC believe these revisions to the various model acts improve state insurance regulators' ability to provide necessary financial oversight, especially in the aftermath of the 2008 global financial crisis. Preserving OIR's accreditation benefits insurer operational efficiency. The American Council of Life Insurers, as it relates to revisions to the SVL, believes PBR is a more dynamic and appropriate reserving methodology that "right-sizes" insurer reserves based on a company's particular risk profile.<sup>34</sup> Advocates of PBR state that the method will reduce redundant reserves that are required under the current formulaic approach, and consequently increase consumer choices of products and free up capital for insurers. Insurers will have to option to phase in the PBR requirements over 3 years after the valuation manual is effective, which the bill provides would be no earlier than January 1, 2017.

Insurers may incur an indeterminate amount of administrative costs associated with complying with the additional reporting requirements and implementing principle based reserves, and the OIR's participation in the supervisory colleges. The PBR requirements would apply to policies issued on or after the operative date of the valuation manual.

### D. FISCAL COMMENTS:

According to the OIR, a specific fiscal impact to state government revenues and expenditures is not anticipated for fiscal year 2014-2015. The OIR believes it is premature to indicate a fiscal impact at this time due to the range of outstanding implementation issues that may or may not arise, including NAIC assumption of any impact that arises between the bill's effective date of October 1, 2014 to January 1, 2017 (the earliest that PBR could take effect in Florida).<sup>35</sup>

## III. COMMENTS

### A. CONSTITUTIONAL ISSUES:

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<sup>34</sup> *Id.*

<sup>35</sup> OIR bill analysis of HB 1271, on file with the Insurance & Banking Subcommittee staff.

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to require counties or municipalities to spend funds or take an action requiring the expenditure of funds, reduce the authority of counties or municipalities to raise revenues in the aggregate, or reduce the percentage of a state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill updates the Financial Services Commission's rulemaking authority to reflect the current NAIC requirements, including the adoption of the updated valuation manual and principle-based reserving.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

#### IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On March 19, 2014, the Insurance & Banking Subcommittee considered and adopted four technical amendments and reported the bill favorably as a committee substitute. The amendments:

- Provided conforming changes to provide an exemption for life and health insurers that will be subject to the new valuation manual after the operative date of the valuation manual,
- Corrected references to mortality tables adopted by the NAIC and codified in the statutes,
- Clarified the term "operative date" to allow certification to occur after July 1, if the triggers were met by that date, and
- Clarified and updated the requirement for foreign insurers to file a holding company registration statement with Florida, if they are domiciled in a state that is accredited by the NAIC.

On April 10, 2014, the Regulatory Affairs Committee considered and adopted two amendments and reported the bill favorably as a committee substitute. The amendments:

- Clarified that litigants seeking proprietary business information that is contained in actuarial opinion summaries, supporting memoranda, standard valuation law materials, and acquisition-related filings cannot obtain them directly from the OIR through subpoena or discovery, but must obtain them from the original custodian or any subsequent custodian instead.
- Clarified the two ways that a person or acquiring party may rebut a presumption of control in an insurer. A person or acquiring party may use a disclaimer of control form prescribed by the OIR or provide a copy of a Schedule 13G filed with the Securities & Exchange Commission.

This analysis has been updated to reflect the committee substitute as passed by the Regulatory Affairs Committee.