



85 7th Place East, Suite 500  
St. Paul, Minnesota 55101-2198  
[mn.gov/commerce/](http://mn.gov/commerce/)  
651.296.4026 FAX 651.297.1959  
An equal opportunity employer

August 7, 2013

Legislative Reference Library  
645 State Office Building  
100 Constitution Avenue  
St. Paul, Minnesota 55155

Re: In The Matter of the Proposed Rules of the State Department of Commerce Governing the Valuation of Life Insurance, Minnesota Rules, chapter 2747; Revisor's ID Number RD4116

Dear Librarian:

The Minnesota Department of Commerce intends to adopt rules governing the Valuation of Life Insurance. We plan to publish a Notice of Intent to Adopt Rules without a Public Hearing in the August 19, 2013, State Register.

The Department has prepared a Statement of Need and Reasonableness. As required by Minnesota Statutes, sections 14.131 and 14.23, the Department is sending the Library an electronic copy of the Statement of Need and Reasonableness at the same time we are mailing our Notice of Intent to Adopt Rules.

If you have questions, please contact me at 651-539-1456.

Yours very truly,

A handwritten signature in black ink, appearing to read 'Susan Bergh', with a long, sweeping horizontal line extending to the right.

Susan Bergh  
Rules Coordinator  
Minnesota Department of Commerce

Enclosure: Statement of Need and Reasonableness

## Minnesota Department of Commerce

### STATEMENT OF NEED AND REASONABLENESS

#### **Proposed Amendment to Rules Governing the Valuation of Life Insurance Policies, *Minnesota Rules, chapter 2747.***

#### **I. INTRODUCTION**

The Minnesota Department of Commerce (Department) proposes amendments to existing Minnesota Rules, chapter 2747, governing the valuation of life insurance policies.

Minnesota Statutes, chapter 61A, charges the Department with the responsibility of regulating the offer and sale of life insurance policies, annuities, and endowment contracts in Minnesota, and enforcing Minnesota Statutes, section 61A.25, the Standard Valuation Law, which provides specific guidance as to minimum standards for valuation of life insurance contracts issued in Minnesota, and requires every life insurance company doing business in Minnesota to annually value the reserve liabilities for all outstanding life insurance policies, and annuity and pure endowment contracts.

Minnesota Statutes, section 61A.25, subdivision 2, authorizes the Department to specify the mortality tables and methods that may be used by life insurance companies in calculating the reserves. Minnesota Statutes, section 61A.25, subdivision 3, authorizes the Department to use certain mortality tables adopted by the National Association of Insurance Commissioners ("NAIC"), and approved by rule adopted by the Department, in determining the minimum standard of valuation for life insurance contracts.

Minnesota Statutes, section 61A.25, subdivision 4, defines the method for determining reserve valuation of life insurance and endowment benefits. Minnesota Statutes, section 61A.25, subdivision 8, defines the conditions for determining reserves for a plan of life insurance for which the minimum reserves cannot be determined by the methods described in subdivision 4: (a) the reserves must be appropriate in relation to the benefits and the pattern of premiums for that plan, and (b) the reserves must be computed by a method which is consistent with the principles of the Standard Valuation Law, as determined by rules adopted by the Department. Given the complex actuarial nature of valuation methodologies and mortality tables, the legislature vested the Commissioner and the Department experts in this field with the duty to maintain minimum valuation standards that would protect the public from unsound financial conditions of life insurance companies.

In 1999, the NAIC adopted a model regulation for use in determining reserve liabilities for life insurance policies issued on or after the effective date. The NAIC model regulation was the basis for Minnesota Rules, chapter 2747, adopted in Minnesota to be effective for life insurance policies issued January 1, 2000, and later. The purpose of the rule is to provide (1) tables of select mortality factors and rules for their use, (2) rules concerning a minimum standard for the valuation of plans

with non-level premiums or benefits, and (3) rules concerning a minimum standard for the valuation of plans with secondary guarantees. In 2009, the NAIC adopted an update to the model regulation which is now proposed as a modification of Minnesota Rules, chapter 2747. The need for the modification of the rules is explained below.

Future benefits and future premium for the business subject to the Valuation of Life Insurance Policies Model Regulation (Minnesota Rules, chapter 2747) are determined using the Commissioners Standard Ordinary (CSO) Mortality Tables. The difference between actual premiums and the anticipated premiums determined using the CSO Mortality Tables is established as a deficiency reserve to fund reserves when actual premiums are lower. In the late 1990s, the effect of this difference was significant, and since future mortality was unlikely to be at CSO levels, the concept of X Factors was developed and is a fundamental component of the adopted rules. An X Factor is an experience factor that allows companies to reflect their actual anticipated mortality experience in developing the anticipated valuation premiums while still maintaining regulatory conservatism. The X Factor has been restricted in the regulation to be no less than 20% and non decreasing.

NAIC amended its Model Regulation to remove the constraints on the X Factors on the basis that deficiency reserves are redundant, because the role of the deficiency reserve has been supplanted by the asset adequacy analysis required by the Standard Valuation Law. The amended NAIC Model Regulation included the condition that the appointed actuary should make a statement in the actuarial opinion that discusses the X Factor development process and the resulting changes in X Factors consistent with the current requirements within the actuarial opinion model regulation as to the impact of the insufficiency of assets to support the payment of benefits and expenses and the establishment of statutory reserves.

In addition to conforming to the updated NAIC Model Regulation, the proposed modification to Minnesota Rules, chapter 2747, is intended to address a fundamental concern that the rules as originally adopted included outdated valuation mortality resulting in redundant reserves.

The proposed modifications to Minnesota Rules, chapter 2747, are based on the amended NAIC Model Regulation. The removal of the constraints on X Factors being proposed is identical to that adopted by the NAIC in 2009.

## **II. ALTERNATIVE FORMAT**

Upon request, this Statement of Need and Reasonableness (SONAR) can be made available in an alternative format, such as large print, Braille, or cassette tape. To make a request, contact Susan Bergh at the Department of Commerce, 85 7<sup>th</sup> Place East, St. Paul, MN 55101, phone: (651) 539-1456, email [Susan.Bergh@state.mn.us](mailto:Susan.Bergh@state.mn.us)

### III. STATUTORY AUTHORITY

This rulemaking is an amendment of rules for which the Legislature has not revised the statutory authority since and so Minnesota Statutes, section 14.125, does not apply.

The Department's statutory authority to adopt the rules is stated in Minnesota Statutes, section 45.023, which provides:

The commissioner of commerce may adopt, amend, suspend, or repeal rules in accordance with chapter 14, and as otherwise provided by law, whenever necessary or proper in discharging the commissioner's official responsibilities.

Further, Minnesota Statutes, section 61A.25, authorizes the Commissioner of Commerce to adopt rules to carry out the legislative intent of establishing minimum standards of valuation of life insurance policies, annuities, and pure endowment contracts.

Under these statutes, the Department has the necessary statutory authority to amend these rules.

### IV. REGULATORY ANALYSIS

Minnesota Statutes, section 14.131, sets out eight factors for a regulatory analysis that must be included in the SONAR. Paragraphs (1) through (8) below quote these factors and then give the Department's response.

**(1) A description of the classes of persons who probably will be affected by the proposed rule, including classes that will bear the costs of the proposed rule and classes that will benefit from the proposed rule:**

- The classes of persons who will be most directly affected include the life insurance companies licensed in Minnesota which sell, in particular, term insurance providing for non-level amounts of insurance or non-level premiums and universal life insurance or universal life-type policies providing for secondary guarantees. The required reserves under the proposed rules for policies with such characteristics may decrease for those companies. Consumers purchasing such policies may also be affected, and pay lower premiums for the described policies as companies could pass through the benefit of lower required reserves in their pricing.
- The cost of the proposed rules will be minimal, as the life insurance companies issuing the affected policies already have the systems to perform the reserve calculations required by the proposed rules. The intent of the proposed rules is to require that reserves for the affected policies be determined on a basis that is consistent with the provisions of the Standard Valuation Law and that reflects updated mortality experience.
- Those who will benefit from the proposed rules include the life insurance companies licensed in Minnesota that sell the affected policies, as well as the consumers of such policies. Companies will be better able to recognize their own mortality experience in establishing reserves for the affected policies, possibly resulting in lower reserves and better pricing.

**(2) The probable costs to the agency and to any other agency of the implementation and enforcement of the proposed rule and any anticipated effect on state revenues:**

- There is little chance there will be additional costs to the Department with regard to implementation and enforcement. Additional costs could arise if the Department elects to purchase specialized software used to audit reserves during field examinations. No purchase of such software has been necessary since the original rules were adopted and there is no intent at this time to purchase such software.
- There should be no costs to any other agency with regard to implementation and enforcement.
- There should be no effect on state revenues.

**(3) A determination of whether there are less costly methods or less intrusive methods for achieving the purpose of the proposed rule:**

- Since there is only a slight chance that there may be minor costs associated with the implementation and enforcement of the proposed rules (as described under Item 5 below), there is no need to identify less costly methods for achieving the purpose of the proposed rules.
- The proposed rules provide a valuable resource for life insurance companies in that there are clear standards set forth for determining minimum standard reserves for the affected policies in accordance with Minnesota Statutes, section 61A.25. The companies that are affected by the proposed rules are supportive of the uniform adoption of the rules across the states to clarify the application of the principles of that statute, and are supportive of the elimination of constraints on the X Factors. The Department believes that the proposed rules will not be intrusive on life insurance companies. Consequently, the Department has not been able to identify any less intrusive methods for achieving the purposes of the proposed rules.

**(4) A description of any alternative methods for achieving the purpose of the proposed rule that were seriously considered by the agency and the reasons why they were rejected in favor of the proposed rule:**

- Because of the highly technical nature of valuing reserves for the affected policies, experts in the actuarial field have analyzed the impact of removing the constraints on the X Factors, as included in the proposed modification to the rules, in order for life insurance companies to meet the requirements of Minnesota Statutes, section 61A.25. The Department was not able to discover any viable alternative methods for achieving the purpose of the proposed rules. The Department believes that the elimination of the constraints on X Factors not only complies with the intent of Minnesota Statutes, section 61A.25, but also ensures the financial solvency of life insurance companies both in Minnesota and nationwide. In addition, adoption of the proposed rules will be beneficial to regulated insurers who conduct business in more than one state. Uniform adoption of the proposed rules in all states is important to ensure consistency of regulation of the companies issuing the affected policies.

**(5) The probable costs of complying with the proposed rule, including the portion of the total costs that will be borne by identifiable categories of affected parties, such as separate classes of governmental units, businesses, or individuals:**

- Most of the companies that are affected by the proposed rules will already have developed or acquired the systems required to comply, because their state of domicile or key states in which they do business very likely have either adopted the proposed modifications to the rules or have begun the process to do so. Thus, the marginal additional costs of compliance with the proposed rules will likely be very minor.

**(6) The probable costs of not adopting the proposed rule, including those costs or consequences borne by identifiable categories of affected parties, such as separate classes of governmental units, businesses, or individuals:**

The consequences of not adopting the proposed amendments to Chapter 2747 include effects on companies affected by the rules, as well as on individual consumers of products to which the rules relate, that is, level term products and universal life insurance with secondary guarantees, two very important products in today's marketplace. Minnesota-domiciled companies, required to hold redundant reserves if the proposed amendments are not adopted, will be less able to effectively compete for business subject to the rules. This is because the cost of the higher required reserves is passed on in the form of higher prices for these products, negatively affecting consumers who are faced with those higher prices. Redundant reserves also tie up capital that Minnesota companies could otherwise use for business growth and opportunities.

**(7) An assessment of any differences between the proposed rule and existing federal regulations and a specific analysis of the need for and reasonableness of each difference:**

- There are no federal regulations that pertain to the proposed rules.

**(8) An assessment of the cumulative effect of the rule with other federal and state regulations related to the specific purpose of the rule:**

- There are no other federal or state regulations that pertain to the proposed rules.

## **V. PERFORMANCE-BASED RULES**

Minnesota Statutes, sections 14.002 and 14.131, require that the SONAR describe how the agency, in developing the rules, considered and implemented performance-based standards that emphasize superior achievement in meeting the agency's regulatory objectives and maximum flexibility for the regulated party and the agency in meeting those goals.

In the years since the adoption of the original rules, the NAIC's Life Actuarial Task Force has continued to work on its long-term project to revamp the valuation process to make it less prescriptive and more dependent on the professional judgment of the company's valuation actuary.

The removal of the constraints on the X Factors that is the substance of the proposed modification to the original rules, while being proposed at the time to provide capital and surplus relief to life insurance companies, is a further and appropriate step in this direction. The first important phase in the long-term NAIC project is proceeding toward conclusion and is expected to be completed by the end of 2012.

With the foregoing as background, it is noted that the proposed modification to the rules provides flexibility for regulated entities in the rules' application and is important to avoid uneven and costly regulation of the affected products throughout the country. Under the proposed modification to the rules, not only does the provision allowing insurance companies to use modified select mortality factors continue, but such modified select mortality factors can be better tailored to the given company's situation and actual mortality experience without the constraints outlined in the original rules. Of course, such tailoring must still be supported by the actuary's professional judgment and required actuarial opinion and related report. Adoption of the proposed rules has been encouraged by the NAIC in order to provide flexibility for the industry in addressing redundant reserves, while still providing for adequate reserves for solvency protection. By taking this step in Minnesota with the proposed modification to the rules, the Department is recognizing the need for further although continued prudent flexibility in the valuation process. The Department is continuing to monitor and be involved in the development of the larger, long-term NAIC project of overhauling the entire valuation system. The Department will continue to analyze and implement changes to the valuation process as methods for providing additional flexibility to insurers are evaluated and proposed as model regulations by the NAIC.

## VI. ADDITIONAL NOTICE

This Additional Notice Plan was reviewed by the Office of Administrative Hearings and approved in a July 15, 2013 letter and order by Administrative Law Judge M. Kevin Snell.

In addition to the statutory requirements to publish notice in the *State Register* and to mail notice to the persons on the Department of Commerce rulemaking list, the Department has provided the following additional notice:

1. Mailing the notice of the proposed rule amendments to the following persons:

C Bryan Cox  
Regional Vice President, State Relations  
American Council of Life Insurers  
101 Constitution Ave., NW, Suite 700  
Washington, DC, 20001-2133  
[bryancox@acli.com](mailto:bryancox@acli.com)

Robyn Rowen  
Executive Director  
Minnesota Insurance and Financial Services Council

407 River St  
Minneapolis, MN 55401  
[robynrowen@MNIFSC.org](mailto:robynrowen@MNIFSC.org)

Joseph J. Annotti  
President and CEO  
American Fraternal Alliance  
1301 West 22<sup>nd</sup> Street, Suite 700  
Oak Brook, IL 60523  
[jannotti@fraternalalliance.org](mailto:jannotti@fraternalalliance.org)

2. Placing a summary of the notice of rulemaking on the Department of Commerce web page at [www.commerce.state.mn.us](http://www.commerce.state.mn.us).

Our Notice Plan also includes giving notice required by statute. We will mail the rules and Notice of Intent to Adopt to everyone who has registered to be on the Department's rulemaking mailing list under Minnesota Statutes, section 14.14, subdivision 1a. We will also give notice to the Legislature per Minnesota Statutes, section 14.116. The notice and proposed rules will be published in the *State Register* on August 19, 2013.

Our Notice Plan did not include notifying the Commissioner of Agriculture because the rules do not affect farming operations per Minnesota Statutes, section 14.111. Our Notice Plan did not include submitting the rules to the state Council on Affairs of Chicano/Latino People at least 15 days before their initial publication in the State Register per Minnesota Statutes, section 3.922 because the rules will not have their primary effect on Chicano/Latino people.

## **VII. CONSULTATION WITH MMB ON LOCAL GOVERNMENT IMPACT**

As required by Minnesota Statutes, section 14.131, the Department will consult with Minnesota Management and Budget to help evaluate the fiscal impact and fiscal benefits of the proposed rules on units of local governments.

The Department will do this by sending to Minnesota Management and Budget copies of the documents required to be sent to the Governor's Office for review and approval by the Governor's Office on the same day we sent them to the Governor's office. We will do this before the Department publishes the Notice of Intent to Adopt. The documents include the Governor's Office Proposed Rule and SONAR Form; almost final draft rules; and almost final SONAR. Minnesota Management and Budget sent a memo dated July 25, 2013, with its comments. The Department will submit a copy of the cover correspondence and any response received from Minnesota Management and Budget to OAH with the documents it submits for ALJ review.



## **VIII. DETERMINATION ABOUT RULES REQUIRING LOCAL IMPLEMENTATION**

As required by Minnesota Statutes, section 14.128, subdivision 1, the Department has considered whether these proposed rules will require a local government to adopt or amend any ordinance or other regulation in order to comply with these rules. The Department has determined that they do not because the sole affect of the rules is on actuarial activities by insurance companies.

## **VIII. COST OF COMPLYING FOR SMALL BUSINESS OR CITY**

As required by Minnesota Statutes, section 14.127, the Department has considered whether the cost of complying with the proposed rules in the first year after the rules take effect will exceed \$25,000 for any small business or small city. The Department has determined that the cost of complying with the proposed rules in the first year after the rules take effect will not exceed \$25,000 for any small business or small city, because the cost of complying will be minimal and will solely be borne by domestic insurance companies, none of which qualify as small businesses.

## **IX. RULE-BY-RULE ANALYSIS**

The modifications to the individual rules discussed below are highlighted to explain the precise changes being proposed for adoption. The language is taken from the Statement of Need and Reasonableness prepared when the rules were originally adopted.

### **PART 2747.0030 GENERAL CALCULATION REQUIREMENTS FOR BASIC RESERVES AND PREMIUM DEFICIENCY RESERVES.**

#### **Subpart 2 Item C (2) and (3)**

Subpart 2 describes the methods that may be used by an insurer to establish deficiency reserves, if any. Deficiency reserves are those calculated for each policy as the excess, if greater than zero, of quantity A over the basic reserve. An insurance company is permitted options, such as tables adopted by the National Association of Insurance Commissioners (NAIC), for calculating reserves. If an insurance company elects to use select mortality factors, the requirements of Subpart 2 must be met, and Item C lists the criteria where an insurance company elects to use the X factor option. The constraints of Item C (2) and (3) were included in the original NAIC model regulation as a safeguard, because the use of company experience mortality for reserves was as yet untested. However, these two constraints were removed in the amended NAIC model regulation, because after over ten years of regulatory filings and review, experience demonstrated that they were unnecessary. All necessary assurance with regard to reserve adequacy is provided by the X factor actuarial opinion and supporting actuarial report which are required by Subpart 2, Item C (9) and Minn. Rules chapter 2711.

**Subpart 2 Item C (7)**

This item permits the actuary to decrease X at any validation date as long as X continues to meet the listed criteria, but the additional constraint that X must not decrease in any successive policy years has been removed. The additional constraint was included in the original NAIC model regulation because the use of company experience mortality for reserves was untested, and this constraint has been removed because ten years of regulatory filings and review have demonstrated that it was unnecessary.


**Subpart 2 Item C (9)**

If at any duration of a policy the X factor is less than 100 percent, Item C (9) has required the actuary to prepare an actuarial opinion and memorandum for the company in conformance with Minn. Rules chapter 2711. With the removal of the two X factor constraints in Item C (2) and (3), another safeguard has now been added to Item C (9), requiring the actuary to disclose the impact of any interim period asset insufficiency in the Regulatory Asset Adequacy Issues Summary.

**X. CONCLUSION**

Based on the foregoing, the proposed rules are both needed and reasonable.

7-22-13  
\_\_\_\_\_  
Date

  
\_\_\_\_\_  
Michael Rothman  
Commissioner of Commerce