



NEIL ABERCROMBIE
GOVERNOR

SHAN S. TSUTSUI
LT. GOVERNOR

STATE OF HAWAII
OFFICE OF THE DIRECTOR
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

335 MERCHANT STREET, ROOM 310
P.O. Box 541
HONOLULU, HAWAII 96809
Phone Number: 586-2850
Fax Number: 586-2856
www.hawaii.gov/dcca

KEALI' I S. LOPEZ
DIRECTOR

JO ANN M. UCHIDA TAKEUCHI
DEPUTY DIRECTOR

TO THE HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE

TWENTY-SEVENTH LEGISLATURE
Regular Session of 2014

Monday, March 10, 2014
2:00 p.m.

TESTIMONY ON SENATE BILL NO. 2821, S.D. 2 – RELATING TO INSURANCE.

TO THE HONORABLE ANGUS L.K. McKELVEY, CHAIR, AND MEMBERS OF THE
COMMITTEE:

My name is Gordon Ito, State Insurance Commissioner (“Commissioner”),
testifying on behalf of the Department of Commerce and Consumer Affairs
(“Department”). Thank you for hearing this bill. The Department strongly supports this
Administration bill.

The purposes of this bill are to: (1) adopt revisions to the National Association of
Insurance Commissioners’ (“NAIC”) model laws on Credit for Reinsurance Model Act,
Standard Valuation Law, Standard Nonforfeiture Law for Life Insurance, and Insurance
Holding Company System Regulatory Act; and (2) ensure that the Insurance Division
maintains its accreditation with the NAIC.

These revisions are part of NAIC’s Solvency Modernization Initiative (“SMI”), a
critical self-examination to update the U.S. insurance solvency regulation framework
and to review international developments regarding insurance supervision, banking
supervision, and international accounting standards and their use in U.S. insurance

regulation. The scope of the SMI is not limited to the evaluation of solvency-related areas and includes the entire U.S. financial regulatory system and all aspects concerning the financial condition of an insurer. The SMI focuses on key issues, such as capital requirements, governance and risk management, group supervision, statutory accounting and financial reporting, and reinsurance.

SECTIONS 1 AND 2 of the bill amend Hawaii Revised Statutes (“HRS”) §§ 431:4A-101 and -102 to reduce the reinsurance collateral requirements of non-U.S. licensed reinsurers that are licensed and domiciled in jurisdictions qualified by the NAIC. These amendments, which are modeled after NAIC’s Credit for Reinsurance Model Act, stem from the global financial crisis of 2008 and the resulting federal Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), which was signed into law on July 21, 2010. The Dodd-Frank Act includes the Nonadmitted and Reinsurance Reform Act (“NRRA”), which prohibits a state from denying credit for reinsurance if the domiciliary state of the ceding insurer recognizes such credit and is either an NAIC-accredited state or has financial solvency requirements substantially similar to NAIC’s accreditation requirements. The NRRA also preempts extraterritorial application of a non-domiciliary state’s laws, regulations, or other actions, and it reserves sole responsibility for regulating the reinsurer’s financial solvency to a reinsurer’s domiciliary state. Finally, the NRRA prohibits any state from requiring a reinsurer to provide financial information in addition to that required by its NAIC-compliant domiciliary state. The amendments to HRS §§ 431:4A-101 and -102 seek to incorporate these changes.

SECTION 3 of the bill repeals HRS § 431:4A-105, which contains dates that no longer apply to the current revision.

SECTION 4 of the bill amends HRS § 431:5-307 to introduce Principle-Based Reserving (“PBR”), a new method of calculating life insurance policy reserves that better measures the risks of innovative life insurance policies. Currently, preset formulas are used to value life insurance policy reserves. Once adopted by a

supermajority¹ of legislatures, PBR would replace this formulaic approach with an approach that uses a valuation manual containing reserving requirements, thereby more accurately reflecting the risks of life insurance products. PBR is also expected to “right-size reserves,” reducing reserves that are too high for some products and increasing reserves that are too low for others. Accordingly, the amendments modeled after NAIC’s Standard Valuation Law use a more nuanced method to assess the risks of highly complex life insurance policies.

SECTION 5 of the bill amends HRS § 431:10D-104 and is modeled after NAIC’s Standard Nonforfeiture Law for Life Insurance. These amendments are intended to exist as a package with NAIC’s Standard Valuation Law and preserve coordination between mortality and interest rate assumptions.

SECTION 6 of the bill adds a new section to article 11 of chapter 431, HRS, and SECTIONS 7 THROUGH 14 of the bill amend article 11 of chapter 431, HRS, to comply with NAIC’s accreditation requirement that states adopt significant elements of its Insurance Holding Company System Regulatory Act (“Regulatory Act”), effective January 1, 2016. The Regulatory Act resulted from the global financial crisis of 2008, which exposed the need for regulators to assess the enterprise risk of insurance holding company systems and its impact or contagion upon insurers in those systems. In accordance with the Regulatory Act, the addition and amendments to article 11 enhance certain features of group supervision by providing clearer windows into group operations while simultaneously building upon the existing walls that protect insurer solvency. The concepts addressed in this enhanced “windows and walls” approach include: (1) communication between regulators; (2) supervisory colleges; (3) access to and collection of information; (4) enforcement measures; (5) group capital assessment; and (6) accreditation.

More specifically:

SECTION 6 of the bill adds a new section to article 11 of chapter 431, HRS, to introduce supervisory colleges for regulators.

¹ PBR will be effective after at least 42 states (comprising more than 75% of U.S. direct written premiums) adopt the amended law and Valuation Manual.

SECTION 7 of the bill amends HRS § 431:11-102 by adding a new definition of “enterprise risk” and amending the definition of “person.”

SECTION 8 of the bill amends HRS § 431:11-104(a), (b), (d), and (g) by detailing the filing requirements for merging with or acquiring control of a domestic insurer. These amendments enhance regulators’ rights to access information, including the examination of affiliates and access to books and records to better ascertain the financial condition of the insurer.

SECTION 9 of the bill amends HRS § 431:11-104.2(b) by indicating exclusions to the applicability of HRS §§ 431:11-104.2 and 431:11-104.3 through -104.6.

SECTION 10 of the bill amends HRS § 431:11-105 by setting forth the registration requirements for insurance holding company systems.

SECTION 11 of the bill amends HRS § 431:11-106(a) by setting forth the standards for transactions of insurance holding company systems. Subsection (c), pertaining to domestic insurers, is also amended to delineate the makeup of directors and committees of the board of directors, as well as the quorum requirements for transacting insurance business during board or committee meetings.

SECTION 12 of the bill amends HRS § 431:11-107 by setting forth the Commissioner’s examination authority of insurers registered under HRS § 431:11-105, as well as their affiliates, to ascertain their financial condition and enterprise risk.

SECTION 13 of the bill amends HRS § 431:11-108 by setting forth the confidential treatment afforded to documents, materials, or other information obtained by or disclosed to the Commissioner in the course of an examination made pursuant to HRS § 431:11-107.

SECTION 14 of the bill amends HRS § 431:11-111 by imposing sanctions upon insurance holding company systems that violate article 11, including: fines, civil forfeiture, cease and desist orders, orders of supervision, criminal proceedings, and the disapproval of dividends.

We thank this Committee for the opportunity to present testimony on this matter and respectfully ask for its favorable consideration.

**Testimony of
Gary M. Slovin / Mihoko E. Ito
on behalf of
USAA**

DATE: March 9, 2014

TO: Representative Angus McKelvey
Chair, Committee on Consumer Protection and Commerce
Submitted Via CPCTestimony@capitol.hawaii.gov

RE: **S.B. 2821, S.D.2 – Relating to Insurance**
Hearing Date: Monday, March 10, 2014 at 2:00pm
Conference Room: 325

Dear Chair McKelvey and Members of the Committee on Consumer Protection and Commerce,

We submit this testimony on behalf of USAA, a diversified financial services company. USAA is the leading provider of competitively priced financial planning, insurance, investments, and banking products to members of the U.S. military and their families. USAA has over 82,000 members in Hawaii, the vast majority of which are military-based members.

USAA **strongly supports** S.B. 2821, S.D.2, which adopts revisions to the National Association of Insurance Commissioners' model laws on Credit for Reinsurance Model Act, Standard Valuation Law, Standard Nonforfeiture for Life Insurance, and Insurance Holding Company System Regulatory Act. USAA particularly supports Parts II and III of the bill, which propose to implement the NAIC model law for Hawaii's standard valuation law and standard nonforfeiture law. Updating these sections of the law would modernize Hawaii's procedure for setting reserves for life insurance.

USAA notes that this measure was amended in the S.D. 2 to make technical and other clarifying amendments. USAA supports these amendments and respectfully asks that the Committee move this bill forward.

Thank you very much for the opportunity to testify.

Gary M. Slovin
Mihoko E. Ito
Tiffany N. Yajima
Jennifer C. Taylor

1099 Alakea Street, Suite 1400
Honolulu, HI 96813
(808) 539-0840



TO THE HOUSE COMMITTEE ON CONSUMER PROTECTION AND COMMERCE

TWENTY-SEVENTH LEGISLATURE
Regular Session of 2014

MONDAY, MARCH 10, 2014

TESTIMONY ON S.B. 2821 S.D. 2-RELATING TO INSURANCE.

TO THE HONORABLE REPRESENTATIVE ANGUS McKELVEY, CHAIR,
AND MEMBERS OF THE COMMITTEE:

My name is Colbert Matsumoto and I am the Chairman and Chief Executive Officer of Island Insurance Companies.

Island Insurance agrees with the Insurance Commissioner in supporting this bill for the purpose of identifying and strengthening the risk management principles for those insurance companies that pose a high degree of risk to the State of Hawaii, but asks that the bill be amended to exempt insurance carriers below the proposed threshold; these carriers being mainly smaller, kama'aina insurance companies resident to the State of Hawaii.

As a domestic insurance company that has faithfully served its policyholders for 75 years, Island Insurance submits that the proposed bill adds another layer of costs to doing business in Hawaii. The requirements under the proposed bill would be in addition to several existing regulatory requirements and controls that currently already empower the Insurance Commissioner to monitor and investigate the financial risks of insurance companies such as:

- Form D which requires notification of significant intercompany transactions between an insurance company and its affiliates with the Insurance Commissioner's right to disapprove of those transactions
- An Annual Statement with detailed exhibits of assets, investments, liabilities, intercompany transactions, premiums, losses and expenses
- The annual filing of audited financial statements by an independent external auditor
- An annual Insurance Company Holding registration statement (Forms B & C) detailing, among other items, significant intercompany transactions
- Regulatory examinations conducted by representatives of the Insurance Division

The proposed bill also amends the language related to the examination of insurance companies. We support the Insurance Commissioner in this but ask that it be amended to provide more clarity as to the reason for the examination of affiliates of an insurance company.

Enterprise Risk Management & Governance

The exemption is one found in other jurisdictions and consistent in application with that found under the National Association of Insurance Commissioners (NAIC) Risk Management and Own Risk and Solvency Assessment (ORSA) Model Act.

The states of Texas and Kansas have passed similar legislation and have allowed for exemptions from the Enterprise Risk Reporting requirements for those carriers with direct or assumed premiums of less than \$300,000,000. Those carriers that meet the exemption qualification, however, are still mandated to comply with those requirements if they do not meet the risk based capital requirements or are deemed to be in hazardous financial condition.

Accordingly, we ask that this bill be amended to exempt those carriers with direct or assumed premiums of less than \$300,000,000 provided they meet the minimum risk based capital requirements and are not in a hazardous financial condition. This is below the \$500,000,000 spelled out under the NAIC Risk Management and ORSA Model Act.

The proposed changes are included as part of our written testimony.

Examination

The proposed bill strengthens the Insurance Commissioner's examination process and allows for an examination of the books and records of both an insurance company and its affiliates. As such, the examination powers being requested by the Insurance Commissioner are in excess of those found in states such as California and Texas.

Accordingly, we ask that the proposed bill be amended such that the grounds for the examination be specified and confined to those detailed in the examination order. Further, we ask that it be amended such that an examination of an insurance company's affiliates be made only if there is reason to believe that an affiliate's relationship with its related insurance company may adversely and materially affect the operations of the insurance company.

The proposed amendments which are attached are included as part of our written testimony.

Thank you for the opportunity to present this testimony and our concerns and if you have any questions please feel free to contact us for further information.

SUGGESTED AMENDMENTS

Section 10 is amended by modifying subsection (b)(5), deleting subsection (b)(8) and modifying subsection (l):

(b) (5) If requested by the commissioner, financial statements of or within an insurance holding company system, including all affiliates. Financial statements may include but are not limited to annual audited financial statements filed with the Securities and Exchange Commission pursuant to the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended. An insurer required to file financial statements pursuant to this paragraph may satisfy the request by providing the commissioner with the most recent recently filed financial statements of the parent corporation that have been filed with the Securities and Exchange Commission.

(l) The ultimate controlling person of every the following insurers subject to registration shall also file an annual enterprise risk report.:

(1) An insurer with annual direct written and assumed premiums of \$300,000,000 or more, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program.

(2) An insurer that is not in compliance with applicable risk-based capital standards, as determined by the commissioner, or

(3) An insurer that is in hazardous condition, as determined by the commissioner.

The report shall identify, to the best of the ultimate controlling person's knowledge and belief, the material risks within the insurance holding company system that could pose enterprise risk to the insurer. The report shall be filed with the lead state commissioner of the insurance holding company system as determined by the procedures within the Financial Analysis Handbook adopted by the National Association of Insurance Commissioners.

Section 11, item 2. (section 431:11-106(c)) is amended by modifying subsection (c)(5) and adding subsection (c)(6):

(5) Paragraphs (3) and (4) shall not apply to a domestic insurer if:

(A) The person controlling the insurer, such as an insurer, a mutual insurance holding company, or a publicly held corporation, has a board of directors and committees thereof that meet the requirements of paragraphs (3) and (4) with respect to the controlling entity; or

(B) The insurer's annual direct written and assumed premium, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, is less than \$300,000,000.

(6) An insurer may make application to the commissioner for a waiver from the requirements of this subsection based upon unique circumstances. The commissioner may consider various factors including but not limited to the type of business entity, volume of business written, availability of qualified board members, or the ownership or organizational structure of the entity."

SECTION 12 is amended by deleting the phrase "and its affiliates as are reasonably" from subsection (a), modifying subsections (b), (c), (d) and (e), and adding a new subsection (f):

(a) Subject to the limitation contained in this section and in addition to the powers [which] that the commissioner has under article 2 relating to the examination of insurers, the commissioner [shall also have the power to order] may examine any insurer registered under section 431:11-105 [to produce records, books, or

other information papers in the possession of the insurer or its] ~~and its affiliates as are reasonably necessary~~ to ascertain the financial condition of the insurer or to determine compliance with this article. In the event the insurer fails to comply with the order, the commissioner shall have the power to examine the insurer's affiliates to obtain the information, including the enterprise risk to the insurer by the ultimate controlling party, or by any entity or combination of entities within the insurance holding company system, or by the insurance holding company system on a consolidated basis.

(b) To evaluate whether the operations of an ultimate controlling person, affiliate or any combination of entities within the insurance holding company system may adversely and materially affect the operations, management or financial condition of an insurer, the commissioner may order any insurer registered under section 431:11-105 to:

(1) Produce the records, books, or other information in the possession of the insurer or its affiliates that are reasonably necessary to make such an evaluation; and

(2) Produce information not in the possession of the insurer if the insurer can obtain access to that information pursuant to contractual relationships, statutory obligations, or other methods. In the event the insurer cannot obtain the information requested by the commissioner, the insurer shall provide the commissioner a detailed explanation of the reason that the insurer cannot obtain the information and the identity of the holder of information. Whenever it appears to the commissioner that the detailed explanation is without merit, the commissioner may require, after notice and hearing, the insurer to pay a penalty of not less than \$100 and not more than \$500 for each day's delay, or may suspend or revoke the insurer's license.

~~[(b)]~~ (c) The commissioner may retain at the registered insurer's expense attorneys, actuaries, accountants, and other experts not otherwise a part of the commissioner's staff as shall be reasonably necessary to assist in the conduct of the examination under [subsection (a)] subsections (a) and (e). Any persons so retained shall be under the direction and control of the commissioner and shall act in a purely advisory capacity.

~~[(e)]~~ (d) Each registered insurer producing for examination records, books, and papers pursuant to [subsection (a)] subsections (a) and (e), shall be liable for and shall pay the expense of the examination in accordance with article 2.

(e) In the event the insurer fails to comply with an order, the commissioner may examine the affiliates to obtain the information; if the commissioner has cause to believe that:

(1) the operations of that person may adversely and materially affect the operations, management, or financial condition of that insurer; and

(2) the commissioner is unable to obtain relevant information from the controlled insurer.

The commissioner may also issue subpoenas, administer oaths, and examine under oath any person for purposes of determining compliance with this section. Upon the failure or refusal of any person to obey a subpoena, the commissioner may petition a court of competent jurisdiction, and upon proper showing, the court may enter an order compelling the witness to appear and testify or produce documentary evidence. Failure to obey the court order shall be punishable as contempt of court.

(f) An examination of affiliates by the commissioner under subsection (e) shall specify the grounds for the examination and shall be confined to those specified grounds.

LATE

TESTIMONY OF THE AMERICAN COUNCIL OF LIFE INSURERS IN SUPPORT OF
SENATE BILL 2821, SD 2, RELATING TO INSURANCE

March 10, 2014

Via e mail: cpctestimony@capitol.hawaii.gov

Honorable Representative Angus L. K. McKelvey, Chair
Committee on Consumer Protection & Commerce
State Senate
Hawaii State Capitol, Conference Room 325
415 South Beretania Street
Honolulu, Hawaii 96813

Dear Chair McKelvey and Committee Members:

Thank you for the opportunity to testify in support of SB 2821, SD 2, relating to Insurance.

Our firm represents the American Council of Life Insurers (“ACLI”), a Washington, D.C., based trade association with approximately 300 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers’ products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums. Two hundred twenty-five (225) ACLI member companies currently do business in the State of Hawaii; and they represent 92% of the life insurance premiums and 90% of the annuity considerations in this State.

SB 2821 adopts updated revisions to the National Association of Insurance Commissioners’ model laws relating to Credit for Reinsurance, Standard Valuation Law, Standard Nonforfeiture for Life Insurance and Insurance Holding Company System Regulatory Act.

The amended law would allow the insurance commissioner to implement new reserve methods and requirements for life insurers to calculate and report reserves held to pay future claims on life insurance, annuities, and accident and health policies.

Currently, life insurance reserves are calculated based on fixed formulas prescribed by state insurance laws and regulations.

This formulaic approach embedded in statute hampers regulators’ ability to update reserve rules as new designs in insurance products are introduced. The current system also locks in certain assumptions used to calculate reserves when a policy is first approved by the insurance regulator, allowing no flexibility to adjust for future changes.

For some products, the formulaic approach requires companies to hold higher reserves than necessary to pay future claims. This results in higher costs for consumers.

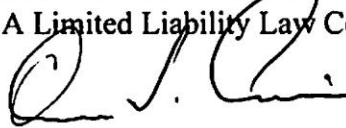
Over the past seven years, state regulators, with the support of the life insurers and actuaries, have developed a new method for calculating life insurance policy reserves. The new law would authorize implementation of this new, principle-based reserves (PBR) method that would enhance the current system for calculating policy reserves. As a result, reserve levels will more accurately reflect the risks assumed by life insurers for the policies they underwrite. Reserves under PBR will more accurately and appropriately reflect life insurers' risks but will be held at levels necessary to pay future claims.

The PBR approach has been designed to enhance regulatory oversight and provide regulators with more tools to properly monitor reserve levels. Under PBR, life insurers will be required to compare a formulaic reserve calculation with a calculation based on actual experience factors—like mortality, policyholder behavior, and expenses under a variety of economic conditions. Companies would then hold the higher of the two reserve levels. Additionally, policy assumptions that are locked in under the formulaic approach will be updated annually under PBR providing greater flexibility to account for future changes.

For these reasons, ACLI supports passage of SB 2821, SD 2.

Again, thank you for the opportunity to testify in support of SB 2821, SD 2, relating to Insurance.

LAW OFFICES OF
OREN T. CHIKAMOTO
A Limited Liability Law Company



Oren T. Chikamoto
1001 Bishop Street, Suite 1750
Honolulu, Hawaii 96813
Telephone: (808) 531-1500
Facsimile: (808) 531-1600
E mail: otc@chikamotolaw.com