MINNESOTA DEPARTMENT OF COMMERCE

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May 28, 2014

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 Annuity Mortality Tables, Minnesota Rules, chapter 2752; Revisor's ID Number RD4232

Dear Librarian:

The Minnesota Department of Commerce intends to adopt rules governing Annuity Mortality Tables. We plan to publish a Notice of Intent to Adopt Rules without a Public Hearing in the June 2, 2014, 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,

Susan Bergh

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 Annuity Mortality Tables, *Minnesota Rules*, chapter 2752; Revisor's ID Number 4232.

I. INTRODUCTION

The Minnesota Department of Commerce (Department) proposes amendments to existing Minnesota Rules, chapter 2752, governing annuity mortality tables.

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 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 and annuity contracts. The proposed modifications to Minnesota Rules, chapter 2752, are based on changes to a model regulation that were adopted in 2012 by the NAIC.

The proposed rules changes will require the use of updated individual annuity valuation mortality tables for new annuity purchases. "Valuation" of an annuity can be thought of as determining the present value of the stream of payments a company guarantees to make under an annuity contract. Companies need to hold assets in reserve equal to that present value in order to have sufficient funds available to be able to make all the promised future annuity payments. That present value, also called a "reserve," is determined for a life annuity in part by estimating how long the annuitant will live. This is done through the use of a mortality table, a table containing average probabilities of death at each age (or, said another way that is more appropriate for annuities, probabilities of living another year). Over the years, mortality tables have been developed from time to time, albeit infrequently given the scope of the undertaking, and are then reflective of current mortality expectations. But because people are continuing to live longer on average than in the past, mortality tables eventually become out of date and no longer reflect current mortality experience. For annuities, especially life annuities with very long expected future payment streams, this is a concern as reserves based on older tables can then become too low (inadequate reserves). As a result, there may not be sufficient assets held in reserve for the company to make all the promised future annuity payments. Thus, when an annuity mortality table becomes significantly out of date, it is generally replaced with a new table that is more appropriate for new annuity purchases.

The new updated 2012 valuation mortality tables in the proposed rules are reflective of current (2012) mortality experience and will be required for new annuity purchases in 2015. However, the mortality tables in the proposed rules are also accompanied by tables of projection factors that represent expected future annual improvements in mortality at each age. These projection factors are used with the 2012 mortality tables in the manner detailed in the examples in the proposed rules to dynamically update the mortality table in future years. For example, for annuity purchases in 2015, the expected effective year of the proposed rules, the 2012 mortality rates are adjusted for three years of improvement based on the projection factors. This combination of mortality rates and projection factors in the proposed rules effectively builds in future expected improvements in life expectancies for new annuity purchases, and reduces the likelihood that reserves for those annuities will become inadequate in the future. In addition, applying the projection factors also updates the 2012 mortality tables to make them appropriate for annuity purchases in future years, as in the 2015 example just noted. This dynamic adjustment feature in the proposed rules should maintain the appropriateness of the valuation mortality basis for all future annuity purchases.

Without these changes, it is possible that the use of outdated valuation mortality tables could result in inadequate reserves. Use of the related mortality improvement projection factors should also make it less likely that the new valuation mortality table will become out of date. This is because the 2012 "static" table will be adjusted by the improvement factors for annuity purchases in future years, resulting in "generational" valuation mortality tables.

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 audio. To make a request, contact Susan Bergh at the Department of Commerce, 85 7th Place East, St. Paul, MN 55101, phone: (651) 539-1456, email: 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 that sell individual annuity policies. The required reserves under the proposed rules for individual annuity policies may increase for those companies, due to the increase in life expectancies reflected in the new mortality tables. Consumers purchasing such policies may also be affected, and pay higher premiums for such policies, as companies pass through the increase in life expectancies in their pricing.
- The cost of the proposed rules will likely be minimal, as most life insurance companies issuing the affected policies already have the systems to perform the reserve calculations required by the proposed rules. Some companies that have not yet incorporated mortality improvement projection factors into their individual annuity reserving systems may need to do so. 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. Also, the use of the projection factors automatically provides for future expected mortality improvement, thereby lessening the chance that the valuation mortality table will become outdated and lead to inadequate reserves.
- 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. With an updated mortality table, companies will be assured to hold adequate reserves for individual annuity policies and, through the use of mortality improvement projection factors, will not be required to repeatedly update (due to rules changes) the valuation mortality tables used in establishing reserves for the affected policies. Consumers will benefit because companies will maintain adequate reserves for future annuity benefits and be able to pay the benefits promised.

(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. 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 companies that are affected by the proposed rules are supportive of the uniform adoption of the rules across the states. 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:

- 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. For these reasons, no alternative methods for achieving the purpose of the proposed rules were considered.

(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 will 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 2752 include effects on companies affected by the rules, as well as on individual consumers of products to which the rules relate.

(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.

The proposed rules include tables of projection factors that represent expected future annual improvements in mortality at each age. These projection factors are used with the 2012 mortality tables to dynamically update the mortality table in future years. This combination of mortality rates and projection factors effectively builds in future expected improvements in life expectancies for new annuity purchases, and reduces the likelihood that reserves for those annuities will become inadequate in the future.

VI. ADDITIONAL NOTICE

This Additional Notice Plan was reviewed by the Office of Administrative Hearings and approved in an April 7, 2014, order by Administrative Law Judge Eric L Lipman.

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 will provide 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

   Robyn Rowen
   Executive Director
   Minnesota Insurance and Financial Services Council
   407 River St
   Minneapolis, MN 55401
   robynrowen@MNIFSC.org

   Joseph J. Annotti
   President and CEO
   American Fraternal Alliance
   1301 West 22nd Street, Suite 700
   Oak Brook, IL 60523
   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.

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.

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 send 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; the proposed rules; and the SONAR. The Department will submit a copy of the cover correspondence and the response received from Minnesota Management and Budget to OAH at the hearing or 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 are discussed below. The language from the Statement of Need and Reasonableness prepared when the rules were originally adopted is modified to only clarify the precise changes being proposed for adoption.

PART 2752.0010 DEFINITIONS.

Subpart 1

The change in this subpart replaces specific citation to rule numbers with the phrase "this chapter."

Subpart 2

This subpart references a mortality table from the existing rules that was previously incorporated by reference. The underlined language is needed to show precisely where this prior table can be found.

Subpart 3

This subpart references a mortality table from the existing rules that was previously incorporated by reference. The underlined language is needed to show precisely where this prior table can be found.

Subpart 4

This subpart references a mortality table from the existing rules that was previously incorporated by reference. The underlined language is needed to show precisely where this prior table can be found.

Subpart 5

This subpart references a mortality table from the existing rules that was previously incorporated by reference. The underlined language is needed to show precisely where this prior table can be found.

Subpart 6

This subpart is needed to describe a generational mortality table, which is the form of mortality table included in the proposed rules, and which is developed by applying projection scale factors to a Period Table.

Subpart 7

This subpart is needed to define the term "period table."

Subpart 8

This subpart is necessary to define the individual annuity reserving table that is the ultimate subject of the proposed rules. It shows who developed the table and when it was adopted by the NAIC, as well as how the mortality rates are determined from the period table defined in subpart 9 and the mortality improvement projection scale defined in subpart 10.

Subpart 9

This subpart is necessary to define the 2012 Individual Annuity Mortality Period Life (2012 IAM Period) Table, explain who developed it, when it was adopted by the NAIC, and where it can be found in the proposed rules, i.e., in Tables 1 and 2.

Subpart 10

This subpart is necessary to define the Projection Scale G2 (Scale G2), explain who developed it, when it was adopted by the NAIC, and where it can be found in the proposed rules, i.e., in Tables 3 and 4.

PART 2752.0011 2012 INDIVIDUAL ANNUITY MORTALITY PERIOD LIFE; FEMALE.

This part is needed to show the female mortality rates by age for the 2012 Individual Annuity Period Life Table.

PART 2752.0012 2012 INDIVIDUAL ANNUITY MORTALITY PERIOD LIFE; MALE.

This part is needed to show the male mortality rates by age for the 2012 Individual Annuity Period Life Table.

PART 2752.0013 PROJECTION SCALE G2; FEMALE.

This part is needed to show the female mortality improvement rates by age for the Projection Scale G2.

PART 2752.0014 PROJECTION SCALE G2; MALE.

This part is needed to show the male mortality improvement rates by age for the Projection Scale G2.

PART 2752.0020 INDIVIDUAL ANNUITY OR PURE ENDOWMENT CONTRACTS.

Subpart 1

The changes in this subpart are needed to reflect the addition of a new subpart for the table being added in the proposed rules.

Subpart 2

The changes in this subpart are needed to reflect the addition of a new subpart for the table being added in the proposed rules.

Subpart 4

Subpart 4 provides that the 2012 Individual Annuity Reserving Table must be used to value the referenced contracts issued on or after January 1, 2015. This is necessary and reasonable in order to ensure that reserves on newly issued contracts are adequate; i.e., because of increases in life expectancies, the most current mortality table is needed for annuity valuation purposes.

PART 2752.0025 APPLICATION OF THE 2012 IAR TABLE.

This part is needed to explain in detail how the 2012 IAR Table is applied, and includes sample calculations showing how the 2012 IAM Period Table mortality rates are adjusted by the Projection Scale G2 mortality improvement rates to update the valuation mortality basis for anticipated future increases in annuitant life expectancies. This application of the table is reasonable because it addresses both existing annuity contracts, if issued on or after January 1, 2015, and subsequent annuity purchases, so that future mortality improvement is properly and consistently considered in the calculation of annuity reserves.

REPEALER.

The repealing of the indicated part is necessary and reasonable, because specific references to the location of the previous tables have been added to the proposed rules, replacing the incorporation by reference.

X. CONCLUSION

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

4-11-14
Date

Mike Rothman
Mike Rothman
Commissioner of Commerce