

STATEMENT OF SCOPE

Agency 145 Office of the Commissioner of Insurance

Rule No.: 145 - Ins 2.02, 2.04, and Ins 6.20

Relating to: The repeal of restrictions related to the allocation of dividends to participating life insurance policies issued by a stock company, rating practices for exceeding filed rate for substandard risks, and revisions to the definition of Investment Terms, limitations on the investments of Town Mutual Insurers, and the permissible scope of foreign investments.

Rule Type: Permanent

1. Finding/nature of emergency:

None

2. Detailed description of the objective of the proposed rule:

The Office of the Commissioner of Insurance (“OCI”) proposes to repeal or amend ss. Ins 2.02 and 2.04, related to restrictions that are placed on life insurers related to the dividend paid on participating life insurance policies and exceeding filed rates for substandard risks. Section Ins 2.02 was originally enacted in 1956 and has not been updated since 1979. It was based on a New York insurance statute which has since been changed and the Wisconsin statute that it interprets has been amended with a different standard for determining dividends. For these reasons, the code provision is no longer current.

Section Ins 2.04, relating to rating practices of life insurance companies insuring substandard risks, permits insurers to exceed filed rates when the risk insured is considered substandard or due to the insured’s engagement in hazardous work. This practice of exceeding filed rates was repealed by Chapter 374, laws of 1975. Section Ins 2.04 was originally promulgated in 1956, and last modified in 1976. For these reasons, the code provision is no longer current.

The proposed changes to s. Ins 6.20, are intended to modernize the OCI rules and requirements regarding the permissible investments that may be counted toward compulsory and security surplus. The proposed changes would include adding a general definition for derivative instruments and aligning Wisconsin’s requirements with the National Association of Insurance Commissioner’s (“NAIC”) Derivative Instrument Model Regulation. Section Ins 6.20, currently defines certain types of derivative instruments but does not include a general definition of derivatives. OCI would like to add a general definition that would capture all current derivative products and that would also encompass derivative products developed in the future. A general definition would allow s. Ins 6.20, to remain current with modern investment practices while eliminating the need to revise the code every few years keep pace with financial product innovations. In addition, better aligning OCI’s requirements with the NAIC model act would promote uniform regulation across the states.

The proposed changes would also revise the amount or percentage of assets which an insurer may invest in foreign assets for purposes of compulsory and security surplus. The current restrictions have not changed since 1996 and the proposed changes would allow a greater

amount of investment in foreign investments. This change will better align the investment restrictions with current investment practices and modern investment risk considerations. Finally, the proposed changes would revise the investment restrictions that currently apply to town mutual insurers. These rules have not been changed since 1996 and OCI would like to revise these rules to better align them with current investment practices.

3. Description of the existing policies relevant to the rule, new policies proposed to be included in the rule, and an analysis of policy alternatives:

With regard to s. Ins 2.02, the rule limits the amount of surplus that may inure to the benefit of stockholders for participating life insurance policies to 10% or \$.50 per \$1,000 per year. The statute that the rule is based on, s. 632.62, Stats., was revised to make clear that the amount of dividends to be paid to participating life insurance policies is a business judgment of the company's board of directors. OCI would like to amend or repeal the rule to make it consistent with the statute. The alternative would be to leave the outdated code provision in place.

Similarly, with regard to s. Ins 2.04, the rule permits insurers writing substandard risks to exceed the rates filed with the OCI. The statute authorizing the ability to exceed filed rates was repealed close in time to the promulgation of the current rule. OCI would like to amend or repeal the rule to bring the rule into alignment with rating requirements and current law. The alternative to promulgating this rule would be to leave the unauthorized code provision in place.

In the existing rule, foreign investments are restricted to 1% of assets in direct obligations of foreign governments and 2% of assets in other types of foreign investments (e.g. foreign securities). Section 620.22, Stats., also contains a "basket clause" which allows 5% of insurer's first \$500 million in assets and 10% of an insurer's assets exceeding \$500 million to be invested in any investment not specifically prohibited by law. An insurer could also invest all or some of the basket clause limits in foreign investments. The existing rule has no general definition of derivatives but does contain definitions of specific types of derivative instruments (e.g. "financial futures contracts" and "financial options contracts"). Current practice by OCI is to allow insurers to invest in derivative instruments that arguably do not fall within one of the specifically defined categories if an insurer agrees to comply with the rules applicable to the current categories of derivative instruments in the code. The new policy would be to increase the amount of permissible foreign investments that may be counted toward compulsory and security surplus, broaden the definition of derivatives to include modern financial instruments and financial instruments created in the future that may not meet the current definitions, and to better align Wisconsin's derivative regulation with the NAIC's Derivative Instrument Model Regulation.

For town mutual investments, the current rules mostly limit investments to bonds and certificates of deposits with only limited ability to invest in stock and mutual funds. OCI proposes to review the investment restrictions for town mutual insurers to determine what the proper allowance for investments, particularly investments in mutual funds, should be in light of modern investment practices.

The policy alternative is to not increase the limits on foreign investments, not change town mutual investment restrictions, and to leave the current, outdated scope of allowable derivative instruments in place.

4. Detailed explanation of statutory authority for the rule (including the statutory citation and language):

The statutory authority for these rules are generally found in ss. 227.11 and 601.41(3), Stats., which provide for the commissioner's rule making authority in general, and s. 601.42, Stats. which authorizes the commissioner to require certain reports and other disclosure of information. OCI has the authority to regulate the dividend practices of participating life insurance policies in s. 632.62, Stats. Wisconsin's investment regulations are found in Ch. 620, Stats. The commissioner has specific authority to regulate investments by rule in ss. 620.01 ("Except as otherwise provided, this chapter and the rules promulgated to interpret and implement it, apply to all insurers authorized to do business in this state."), 620.03 ("The commissioner may by rule prescribe for all or for certain classes of such insurers special procedural requirements including special reports, prior approval or subsequent disapproval of investments."), 620.21 ("Assets may be counted toward satisfaction of the compulsory surplus requirement or the security surplus standard only so far as they are invested in compliance with this chapter and applicable rules promulgated by the commissioner."), 620.22 ("Any of the following classes of investments may be counted for the purposes specified in s. 620.21 Any other investments that the commissioner authorizes by rule," Stats.

5. Estimate of amount of time that state employees will spend developing the rule and of other resources necessary to develop the rule:

200 hours and no other resources are necessary to develop the rule.

6. List with description of all entities that may be affected by the proposed rule:

The proposed changes to Ins 2.02 and 2.04, will apply to all licensed stock life insurers who issue participating life insurance policies in Wisconsin. The proposed investment rules will apply to all domestic insurers. Non-domestic insurers authorized to do business in this state would be subject to the investment rules of their state of domicile.

7. Summary and preliminary comparison with any existing or proposed federal regulation that is intended to address the activities to be regulated by the proposed rule:

The office is unaware of any proposed or existing federal laws or regulations that are intended to address the activities to be regulated by the proposed rule changes.

8. Anticipated economic impact of implementing the rule (note if the rule is likely to have a significant economic impact on small businesses):

The rule is unlikely to have a significant economic impact on small businesses. Only a few town mutual insurers would potentially meet the definition of small businesses and for those that do the rule is intended to change the investments they may invest in. The town mutual insurers costs incurred to invest will depend on their contractual arrangements with investment professionals and should not be negatively affected by this rule.

In addition, the proposed rule change is expected to have no economic impact with regard to regulatory costs as the proposed rule change only changes the type of investments that may be counted toward compulsory and security surplus requirements. It does not affect the required amount of that surplus or add additional regulatory requirements. The proposed changes regarding derivative investments should have little or no economic impact and cause little or no increase in regulatory costs.

The proposed changes to Ins 2.02 and 2.04 will have no economic impact as stock life insurers are already following the dividend requirements in s. 632.62, Stats., and are not exceeding filed rates for substandard risks.

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Department Head or Authorized Signature

Date Submitted