

# SENATE BILL REPORT

## SB 5432

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As Passed Senate, March 7, 1995

**Title:** An act relating to unearned premium, loss, and loss expense reserves of insurance companies.

**Brief Description:** Regulating unearned premium, loss, and loss expense reserves.

**Sponsors:** Senators Prentice and Hale; by request of Insurance Commissioner.

**Brief History:**

**Committee Activity:** Financial Institutions & Housing: 2/7/95, 2/14/95 [DP].  
Passed Senate, 3/7/95, 46-0.

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### SENATE COMMITTEE ON FINANCIAL INSTITUTIONS & HOUSING

**Majority Report:** Do pass.

Signed by Senators Prentice, Chair; Fraser, Vice Chair; Hale, Roach, Sellar and Smith.

**Staff:** David Cheal (786-7576)

**Background:** The Office of the Insurance Commissioner (OIC) oversees the corporate and financial activities of insurance companies authorized to transact insurance in Washington State. These companies must meet statutory requirements for capital, surplus capital, reserves, investments, and other financial and operational considerations. For instance, the OIC monitors company organization, financial condition, and investments. Important balance sheet items regarding insurance companies include reserves for unearned premiums, losses, and loss expense.

Unearned premium reserves is a deferred income account that represents the premiums insureds have paid in advance for the unexpired terms of their policies. As the policy matures, part of the paid premium becomes earned while the remainder remains unearned. It is only after the period of protection has expired that the whole premium is earned. Current law provides that the unearned premium be calculated based on the unearned premiums in force after deducting reinsurance, a statutory calculation, or a monthly pro rata basis.

Loss reserves are estimates of amounts expected to be paid on claims against the insurance company that apply to an accounting period, even though they may not have been reported to the insurance company. The loss reserves include both the expected cost to pay claims and the expected cost to settle claims. Loss reserves are important financial statement items because some claims may take months or years to complete. Current law provides statutory formulas for establishing reserves for losses and unallocated loss expense for personal liability policies, employer liability policies, and workers' compensation.

The National Association of Insurance Commissioners (NAIC) is an association of state insurance agencies that attempts to coordinate the regulation of insurance; insurance is regulated by the states rather than the federal government. One approach the NAIC uses to coordinate state regulation of insurance is development of model laws.

**Summary of Bill:** Modifications are made to current law regarding reserves insurance companies must maintain for unearned premiums and losses. The Insurance Commissioner may grant an insurance company permission to use a different method of calculation than specified in statute in order to consider uneven exposure to losses over the policy term. Statutory formulas for loss reserves for personal and employer liability policies are removed. These reserves are to be computed based on accepted standards and principles, and be consistent with instructions for annual financial statements by the National Association of Insurance Commissioners. Unallocated workers' compensation loss expense payments must follow the procedures established by the National Association of Insurance Commissioners.

**Appropriation:** None.

**Fiscal Note:** Not requested.

**Effective Date:** Ninety days after adjournment of session in which bill is passed.

**Testimony For:** The current statutory reserve calculation does not reflect realities of current practice. Losses are often concentrated in part of the policy period which justifies an unearned premium calculation to reflect that fact. Monetary figures in the statute for loss reserves are very out of date. A flexible system that reflects standard national practice is preferable.

**Testimony Against:** None.

**Testified:** Mel Sorensen, NAI (pro); John Woodall, Insurance Commissioner's office (pro); Lee Barclay, OIC (pro).