

Legislative Analysis



VALUATION OF BUSINESS ASSETS

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House Bill 5624 as introduced

Sponsor: Rep. Joe Hune

Committee: Insurance

First Analysis (2-6-06)

BRIEF SUMMARY: The bill would amend the Insurance Code to allow a domestic (Michigan-based) insurance company that acquires a "book of business" that includes life insurance or other business written by a life insurance company to recognize the value of the book of business as an asset in its required annual statement. Generally speaking, the bill would allow a domestic insurer to count the "value of business acquired" (VOBA) as an asset to a greater extent than is currently allowed.

FISCAL IMPACT: There is no fiscal impact on the State of Michigan or its local units of government.

THE APPARENT PROBLEM:

Life Insurance industry representatives are concerned about an industry accounting regulation that they say puts small and medium sized life insurance companies at a competitive disadvantage compared to larger life insurers when competing for acquisitions of other companies. The following description of this problem is taken from information provided by representatives of the Jackson National Life Insurance Company.

When a life insurance company acquires another life insurance company, one of the assets it will typically acquire is a book of life or annuity policies. The present value of the future stream of income from these in-force policies is known as "value of business acquired" or VOBA. The value of VOBA may be actuarially determined, and the value may be converted to cash through securitization. . . .

Current NAIC [National Association of Insurance Commissioners] accounting guidance includes VOBA in the definition of "goodwill," and limits the amount of goodwill a life insurance may recognize as an asset to 10 percent of the company's capital and surplus. Defining VOBA as goodwill is plainly incorrect. VOBA is not "goodwill" and shares none of the characteristics of goodwill. The present accounting guidance greatly impairs a small or medium size life insurance company's ability to make acquisitions to achieve efficient scale, or improve its market share. Even modest acquisitions will result in a small or medium size company quickly reaching the 10 percent limit on VOBA and goodwill. Acquisitions above the 10 percent limit result in the company not being allowed to report the value of the business acquired as an asset. This is potentially damaging to a company's ratings and its ability to compete with larger life insurers. . . .

Very large life insurance companies have a much higher limit under the accounting guidance, so they may make much larger acquisitions without being concerned with the NAIC accounting guidance. . . . The practical consequence of the NAIC guidance is to focus consolidation among the very largest life insurers, with small and medium size life insurance companies either being forced to stand on the sidelines as acquisitions occur, or worse yet, becoming acquisitions themselves.

THE CONTENT OF THE BILL:

The bill would amend the Insurance Code to allow a domestic (Michigan-based) insurance company that acquires a "book of business" that includes life insurance or other business written by a life insurance company to recognize the value of the book of business as an asset in the annual statement it is required to file annually with the commissioner of the Office of Financial and Insurance Services (OFIS). This would apply if the book of business has a readily determinable market value represented by the present value of the future after-tax profits that will be earned on the book of business in force at the date of acquisition. Such an acquisition could be by a business acquisition or a reinsurance transaction.

The value of the book of business acquired that could be recognized as an asset could not exceed the following:

**** Ten percent of that capital and surplus that is less than 300 percent of authorized control level risk based capital, plus**

**** Twenty-five percent of that capital and surplus equal to or greater than 300 percent, but less than 400 percent, of authorized control level risk based capital, plus**

**** Fifty percent of that capital and surplus equal to or greater than 400 percent, or less than 500 percent, of authorized control level risk based capital, plus**

**** Seventy-five percent of that capital and surplus that is equal to or greater than 500 percent of authorized control level risk based capital.**

The value of the book of business acquired would have to be amortized to income over the period in which the domestic insurer benefits economically, not to exceed 10 years. The value of the book of business acquired in excess of the amount allowable under the bill would not be an admitted asset in the annual statement.

MCL 500.1305

ARGUMENTS:

For:

According to representatives from the Jackson National Life Insurance Company,

In today's business environment, it is crucial for life insurance companies to be able to make strategic acquisitions of other life companies, or specific books of life and annuity policies, in order to achieve efficient scale, or achieve other financial synergies. This legislation will remove an arbitrary impediment for Michigan domiciled insurance companies to make such acquisitions, and allow them to compete effectively with very large insurance companies that are less impacted by the NAIC guidance.

The VOBA bill allows a Michigan domiciled life insurance company with excess capital to have a greater percentage of that excess capital in the form of VOBA. (Excess capital simply means the capital a life insurance company does not need to meet NAIC solvency standards.) Consequently, small and medium size life insurers domiciled in Michigan will have a greater ability to make critical business acquisitions, and appropriately report the full value of the acquisition of an asset. . . . By removing this impediment to acquisitions, Michigan domiciled life insurance companies will be able to make acquisitions that will add jobs in Michigan.

Insurance industry representatives say the legislation will in no way impair the safety, reliability, and public confidence in an insurance company because VOBA is a highly stable, secure, and desirable asset that is readily convertible to cash, and the bill only allows the use of a higher percentage of VOBA with regard to excess capital.

Against:

In its analysis of the bill provided to the House Insurance Committee, the Office on Financial and Insurance Services (OFIS) said the following:

The agency has worked with the company to analyze the issue over the last several months and needs some additional time to complete our review. To our knowledge, the issues presented have not been examined in other states or by the NAIC, which makes the need for a thorough, but expeditious review essential. Because this represents a significant deviation from normal statutory accounting practices, we need to understand the implications on individual companies and the industry in Michigan as a whole.

Because this legislation would apply to any company meeting the requirements set forth in the bill, we want to be sure the parameters set forth are appropriate.

POSITIONS:

Jackson National Life Insurance Company supports the bill. (2-2-06)

The Office of Financial and Insurance Services has no position on the bill at present. (2-2-06)

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.