

CLIENT ALERT

Iowa Adopts New Life Insurer Investment Law

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On April 28, 2023, Iowa Governor Kim Reynolds signed into law House File 271, which will go into effect on July 1, 2023. The law represents an overhaul of Iowa's investment laws applicable to life insurers. Currently, Iowa-domiciled life insurers are subject to a unique requirement under which they are obligated to invest funds equivalent to the company's "legal reserve" in specified investments. Under the newly passed law, Iowa's approach will be more closely aligned to the National Association of Insurance Commissioners' ("NAIC") *Investment of Insurers Model Act (Defined Limits Version)* (Model 280) (the "Defined Limits Model"), an approach followed by many other states. We have summarized below some key aspects of Iowa's existing law and how the new statute will change the state's approach.

Existing Law

Iowa's existing life insurer investment statute, Iowa Code § 511.8, requires that an insurer organized under chapter 508 of the Iowa Code invest "funds equivalent to its legal reserve" in the securities enumerated in that section. "Legal reserve" is defined as "the net present value of all outstanding policies and contracts involving life contingencies." Investments within the legal reserve must fall within the investment categories enumerated in Section 511.8, and certain categories may only make up a limited portion of the legal reserve. Additionally, an insurer's investment program must "take into account the safety of the company's principal, investment yield and return, stability in the value of the investment, and liquidity necessary to meet the company's expected business needs and investment diversification." Although investments outside the legal reserve are not subject to the enumerated investment categories, they are subject to this overall prudence principle.

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Under Section 511.8(16), securities equaling the legal reserve (with an allowance for some cash holdings) must be held on deposit with the commissioner “or at such places as the commissioner may designate.” This requirement may be satisfied under Section 511.8(21) by using securities deposited “with a custodian bank, or redeposited by a custodian bank with a clearing corporation, or held in the federal reserve book-entry system.”

The legal reserve framework has been a unique part of Iowa insurance law for nearly eighty years, and its definition has remained unchanged since its initial adoption in 1945. House File 271 will represent a significant change to Iowa’s regulatory approach that brings the state into closer alignment with the more uniform approach to insurer investment laws already implemented by other states.

New Law

House File 271 removes the legal reserve concept from Section 511.8 as well as from other statutes throughout the Iowa Code that previously incorporated the concept by reference. This includes the removal of the corresponding deposit requirement. In its place, the new law adopts an approach that is closely related to the Defined Limits Model, which provides a rules-based regime limiting investments based upon various categories. But while the general framework of Iowa’s new law is aligned with the Defined Limits Model, it also takes inspiration from approaches used in other states, with several new additions.

These additions include a section requiring insurers to consider certain “prudence evaluation criteria” in considering an investment portfolio or an investment policy. This requirement appears to be based upon the NAIC’s *Investment of Insurers Model Act (Defined Standards Version)* (Model 283), with additional criteria such as the insurer’s “level of expertise with various types of investments” and “ability of the insurer to model the underlying risks of an investment.” Investments must be made under a written investment policy that is both “annually reviewed and approved by the insurer’s board of directors” or its designee, and such policy “must include written guidelines and controls appropriate to the insurer’s business.”

The Defined Limits Model’s prohibitions on certain investments are also incorporated into House File 271, with limited changes. These include general prohibitions on an insurer’s “invest[ing] in an obligation or security, or mak[ing] a guarantee for the benefit of or in favor of an officer or director of the insurer” or investing in an entity in which ten percent or more of the voting or equity interests are beneficially owned by an officer or director, as well as limitations on when an insurer may act as a general partner.

The majority of the new law comprises specified limitations on various classes of assets. Unlike under the existing law, these limitations are now expressed as percentages of the insurer’s admitted assets as a whole, without reference to the now-defunct concept of the legal reserve. The categories of assets covered largely track the structure of the Defined Limits Model, although the percentage limitations differ in some instances. For instance, House File 271 uses a general five-percent diversification requirement (that an insurer generally may not hold more than five percent of its admitted assets in

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investments issued by a single person), which is broader than the Defined Limits Model's three-percent limitation. Conversely, the new law generally permits insurers to hold only ten percent of admitted assets in equity interests, a narrower allowance than the Defined Limits Model, which allows life insurers to invest twenty percent of admitted assets in equity interests that are listed on a qualified exchange.

Since House File 271 does not specify an effective date, it will become effective on July 1, 2023, which is the default effective date for bills signed by Governor Reynolds during this legislative session. Once effective, the new law will replace the existing Section 511.8 in its entirety, along with conforming changes to other sections throughout the insurance code. The law is available in its final form on the Iowa Legislature's website at <https://www.legis.iowa.gov/perma/0508202310711>.

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