Approved: January 28, 1994
Date

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE.

The meeting was called to order by Chairperson Richard Bond at 9:10 a.m. on January 27, 1994 in Room 529-S of the Capitol.

All members were present.

Committee staff present: William Wolff, Legislative Research Department
Fred Carman, Revisor of Statutes
June Kossover, Committee Secretary

Conferees appearing before the committee: Richard Brock, State Insurance Department
William Mitchell, Alliance Insurance Companies

Others attending: See attached list

Senator Corbin made a motion, seconded by Senator Petty, to approve the minutes of the meeting of January 26 as submitted. The motion carried.

The chairman opened the hearing on **SB 563**, which amends what is commonly known as the Standard Valuation Law relating to life, sickness and accident insurance valuation and reserve requirements. Richard Brock, State Insurance Department, appeared before the committee to explain this legislation and testify in favor of its passage. This bill would require an annual actuarial opinion which is more comprehensive than current requirements. It would also require the actuary to include an opinion as to whether the reserves are adequate and would authorize the Insurance Commissioner to develop a transition period during which any higher reserves recommended by the actuary would have to be established. (Attachment #1.) The bill also contains an amendment to exempt the information required to support the actuarial opinion from public disclosure.

In response to Senator Bond's question, Mr. Brock clarified that the opinion itself is a matter of record and does not require protection from disclosure while the records used to support the opinion are private. Senator Steffes questioned whether this bill is a reaction to a specific problem and Mr. Brock advised that it is more a reaction to greater emphasis on solvency issues.

Mr. Carman informed the committee that the original language in the statute dates back to the 1920's and it is virtually impossible to update this antiquated language; therefore, the language may be difficult to understand. Mr. Brock clarified for the committee that the American Academy of Actuaries (page 3, line 18) is the certifying body for actuaries.

There being no further questions and no other conferees, the hearing on **SB 563** was closed. Senator Steffes made a motion to move **SB 563** favorably. The motion was seconded by Senator Lawrence. The motion carried.

The hearing was opened on **SB 569.** Mr. Brock of the Insurance Department also testified in favor of this bill, which is designed to establish risk based capital requirements. (Attachment #2). The bill would require each Kansas domestic life insurer to calculate its risk based capital and would provide the Insurance Department with more specific authority to take regulatory action against a company in deteriorating financial condition. The language contained in the bill is from the NAIC model except for the amendment to the open records act. At present, the bill would only apply to life insurance companies but will be expanded eventually to include property and casualty companies. In response to Senator Steffes' questions, Mr. Brock advised that only two or three other states have enacted this legislation at this time and that no additional staff would be necessary if the bill is passed. Since there were no further questions and no other conferees, the hearing on **SB 569** was closed.

Senator Praeger made a motion to amend page 14, line 11, to read "...filed with the commissioner of insurance *in accordance with section 20...*" The motion was seconded by Senator Steffes and the motion carried.

Senator Steffes made a motion, seconded by Senator Praeger to pass the bill as amended. The motion carried. Senator Steffes will carry the bill.

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE, Room 529-S Statehouse, at 9:10 a.m. on January 27, 1994.

The hearing was opened on **SB 506** which deals with similarity of names. Dick Brock of the Insurance Department also appeared as a proponent of this legislation, which amends KSA 40-203 so that a domestic insurance company or fraternal benefit society may be organized and can preserve its name despite the fact that it may not yet have a certificate of authority to do business in Kansas. (Attachment #3.)

William Mitchell, Alliance Insurance Companies, explained the need for this legislation and provided a brief history of his company. (Attachment #4.)

Senator Lee moved to recommend **SB 506** favorably and to place it on the Consent Calendar. Senator Lawrence seconded the motion. The motion carried.

The committee adjourned at 9:52 a.m.

The next meeting is scheduled for January 28, 1994.

GUEST LIST

SENATE

COMMITTEE: FINANCIAL INSTITUTIONS AND INSURANCE DATE: 1-27-94

NAME	ADDRESS	ORGANIZATION
L M COANISH	Topeka	KS Life Assn
Richard Wilborn	McPherson	Alliance Ins. Co's
William L. Rabbitt	Hutchinson	Alliance Ins.
HARRY SPROUL	K.C.	Humana
Dick Brock	Topeka	Ins Dept

Testimony on
Senate Bill No. 563
by
Dick Brock
Kansas Insurance Department

Senate Bill No. 563 amends what is commonly known as the Standard Valuation Law. All states have laws that stipulate the requirements that insurers must meet in calculating the reserves necessary to assure payment of insurer obligations to policyholders and beneficiaries. The elements necessary to calculate these reserves are an interest rate, a mortality table and a method of valuation. All of these ingredients are contained in the Standard Valuation Law in some form. However, the type and issue date of the life insurance policies determines the particular application of these ingredients to the specific amount of reserve that must be established and how long it must be maintained. The same process and requirements apply to annuities and endowment contracts. Consequently, the bulk of this rather lengthy set of statutory provisions is devoted to designating the various types of life insurance products and, with respect to each, the mortality table, maximum interest rate that may be assumed as the rate of return on the assets held as reserves and the method of valuation which must be used to calculate the minimum reserves. In most cases, the method of valuation is the standard actuarial formula appearing in lines 41 through 43 on page 13 and 1 through 6 on page 14 of the bill and identified as the Commissioner's reserve valuation method.

The last amendment to the Standard Valuation Law was in 1982 when the legislature enacted NAIC changes to recognize updated mortality tables and interest rates. These changes included authority for the Commissioner to adopt new mortality tables by regulation and a formula based on Moody's corporate bond yield average as the basis for updating the maximum presumed interest rate.

Needless to say, the policy reserves are an extremely important consumer protection tool. In fact, they are so important that domestic life insurers

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are required to maintain a deposit with the State Treasurer and Insurance Commissioner cash, securities, mortgages or other acceptable assets in an amount equal to the net reserves of policies and annuity contracts in force. However, with or without the deposit requirement and whether or not the reserves conform to the statutory requirements for establishing the minimum reserves the real test is whether the reserves are and will be adequate to meet a company's obligations. For a number of years, state statute has required an annual valuation and actuarial certification of the reserves. In addition, a standard procedure in an on-site examination of most domestic life insurers is to acquire an independent actuarial valuation of the reserves. Senate Bill No. 563 takes this a step farther.

Senate Bill No. 563 incorporates a model NAIC provision to require an annual actuarial opinion that is much more comprehensive than the current requirement. Even more important, this amendment would require the actuary to include an opinion as to whether the reserves are adequate based on the company's earnings, assets, premium charges and so forth. Finally, the amendment would authorize the Commissioner to develop a transition period during which any higher reserves recommended by the actuary would have to be established.

Obviously, the information to be included in the actuarial memorandum required to support the opinion will be quite sensitive. Therefore, Senate Bill No. 563 also includes an amendment to the Kansas statutes governing public records to provide that the memoranda and other material used to support the actuarial opinion are not subject to public disclosure except for the reasons stated in subsection (b)(5)(G) of the bill.

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Testimony on

Senate Bill No. 569

by

Dick Brock

Kansas Insurance Department

Historically, insurance companies have been subject to what we call minimum financial requirements as a fundamental prerequisite to their ability to transact business in this state. For example, as of May 1 of this year, a stock life insurance company must have paid-in capital stock of at least $600,000 and a surplus of at least $600,000 in order to qualify for a Kansas Certificate of Authority. For a mutual life insurance company an equivalent requirement applies but, because a mutual does not have capital stock the $1.2 million applies to surplus only. Obviously, $1.2 million is not sufficient to cover an insurance company's obligations if it writes any business at all but if proper reserves are maintained, required deposits are made and the company's financial condition is appropriately monitored, it used to be theoretically presumed that the company's certificate would be revoked before the minimum capital and surplus was greatly impaired. If so, the company's minimum capital and/or surplus would be necessary only to accommodate minor miscalculations or contingencies because the insurer would only be statutorily insolvent. That is it would not have sufficient capital and/or surplus to continue in business but it would not be insolvent in the strict sense of having liabilities in excess of the company's resources.

When life insurers began to develop products that were designed to compete with investment-type securities, accident and sickness insurance claim costs became unpredictable, legal liability emerged as a frequent costly and volatile exposure, and as insurance attempted to accommodate increasingly complex risks, the financial stability of insurance companies became much more difficult to gauge. As a result, insurance regulators began to require more frequent financial reporting and development of more sophisticated tools such as the NAIC's automated early warning system to detect potential problem companies earlier. These efforts were and are productive but their success revealed another problem. Specifically, much of the advantage of

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detecting problem companies earlier was lost because the law until the early 70's for Kansas and much more recent for some states did not permit the regulator to take action until the company's capital and/or surplus was actually below the minimum statutory level.

In 1972 Kansas addressed this problem by enactment of what we call the "hazardous condition law". Under this law, the Commissioner is authorized to deem that a company is in a hazardous financial condition notwithstanding the fact that it may still be in compliance with whatever minimum financial requirements apply. Once deemed to be in a hazardous financial condition, the Commissioner can then order the company to take one or more actions such as the cessation of writing new business; placing a specified amount of securities on deposit for the protection of policyholders; require changes in the company's reinsurance program and so forth to either rectify the situation or protect policyholder interests while the insurer attempts to gain financial strength.

Senate Bill No. 569 is another step in this progression. In essence, this bill will require that insurers maintain an amount of capital and/or surplus that is commensurate with the perceived riskiness of their respective assets, liabilities and off-balance sheet activities. More specifically, the 4 major categories of risks to be measured are those associated with: (a) the insurer's assets, e.g. investment portfolio; (b) the type of insurance the company writes, e.g. predominantly traditional life insurance products versus interest sensitive contracts; (c) an insurer's profitability because of interest rate considerations, e.g. single premium deferred annuity products where the guaranteed interest rate is designed to compete with non-insurance investment products; and (d) other variable aspects of an insurer's operations, e.g. underwriting philosophy, marketing strategies, management goals, and so forth.

This bill would require each Kansas domestic life insurer to calculate its Risk Based Capital (RBC) and, in turn, provide the Department with more specific authority to take regulatory action against a company in deteriorating financial condition. It would also require insurers to

maintain a minimum level of capital specific to the risk inherent in each company's operations.

When a company is found to be inadequately capitalized, the bill calls for increasingly serious action by the Commissioner, commensurate with various levels of inadequacy of actual capital compared to risk based capital calculations.

Foreign insurers would also be required to file RBC reports with the Department, when requested by the Commissioner. If a foreign insurer's RBC is inadequate, the Commissioner would have authority to take specific regulatory action if the state of domicile does not react to the deficiency.

As previously indicated, utilization of risk based capital requirements is expected to be a more effective alternative to current fixed level minimum capital requirements in that RBC will be unique to each company and will vary as operating conditions change over time.

The RBC is calculated by applying factors to selected annual statement asset, liability, and reserve items. These factors are established by the National Association of Insurance Commissioners and represent the outcome of extensive technical analysis regarding the amount of capital needed to cover the identified risks. The calculation can be complex, with varying factors for different classes of assets and liabilities and different lines of business. Some factors may also vary by the concentration of the company's exposure in an area.

Based on the relationship the formula produced RBC bears to the company's actual capital and or surplus, four levels of progressively serious regulatory action are provided by the bill. Again, these actions are triggered by ratios of a company's adjusted capital to RBC calculations.

A Company Action Level Event occurs when capital to RBC ratios are: (a) 125% to 100% of RBC and trending negatively or (b) 100% to 75% of RBC. In this event, the company must file an RBC plan subject to regulatory review and approval. Within the RBC plan the company must:

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. identify conditions within the insurer that contribute to the deficient RBC level;

. propose actions the insurer intends to take to eliminate the RBC deficiency;

. provide a five year projection of income, capital, surplus, and new and renewal business;

. identify key assumptions and the sensitivity of projections to the assumptions; and

. identify business quality and problems, including assets, anticipated business growth and associated surplus strain, extraordinary exposure to risk, mix of business, and use of reinsurance.

A Regulatory Action Level Event occurs when capital to RBC ratios are between 50% and 75% of RBC. The event also occurs when a company fails to file an RBC report by the filing date without satisfactory explanation to the Commissioner or fails to timely submit a required RBC plan; when the Commissioner determines that an RBC plan is unsatisfactory; or when an insurer fails to adhere to its RBC plan in a way that has a substantial adverse effect.

When a Regulatory Action Level Event occurs, the insurer must submit a satisfactory RBC plan as previously described. The Commissioner will also examine the insurer and issue a Corrective Order specifying the required remedial actions.

An Authorized Control Level Event is triggered by a capital to RBC ratio of between 35% and 50% of RBC or the company's failure to respond to a Corrective Order. For an Authorized Control Level Event, the Commissioner will either take the action described above for a Regulatory Action Level Event or, if considered to be in the best interest of policyholders, creditors, and the public, the Commissioner can initiate receivership

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proceedings. If the Commissioner determines receivership is necessary, the Authorized Control Level Event is sufficient grounds for such action.

A Mandatory Control Level Event occurs when the capital to RBC level falls below 35% of RBC. When this occurs, the Commissioner is required to take the actions necessary to place the insurer in receivership. If the Commissioner reasonably expects that the Mandatory Control Level Event can be eliminated within 90 days, action may be delayed for no more than 90 days after the event.

Any of these regulatory steps is preceded by appropriate due process. Specifically, an insurer has a right to an administrative hearing following notification that:

. the Commissioner has adjusted an insurer's RBC report to correct an inaccuracy;

. the insurer's RBC plan is unsatisfactory, thus constituting a Regulatory Action Level Event;

. the insurer has failed to follow its RBC plan causing a substantial adverse effect on the company's ability to eliminate the company action level event; or

. the Commissioner is issuing a Corrective Order.

All RBC reports, RBC plans, work papers, and Corrective Orders must be kept confidential by the Commissioner except for purposes of enforcing actions taken under Kansas insurance laws. Comparison of an insurer's total adjusted capital to the RBC level will be used exclusively as a regulatory tool to indicate the need for possible corrective action. It is not intended as a means to rank insurers generally and, therefore, public disclosure, in any manner or form, of information regarding the RBC level or any component derived in the calculation of RBC levels of any insurer is prohibited. Insurers are likewise cautioned that this restriction forbids

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use of RBC ratios or RBC levels for advertising or any other public announcements.

Attached to my testimony is a chart I lifted from a newsletter distributed by the Illinois Insurance Department which hopefully more clearly portrays the various triggers and regulatory actions Senate Bill No. 569 authorizes.

Risk Based Capital
Life, Accident and Health

% RBC		
125 and trending negatively		
100	Company Action	File RBC Plan and projections. Review and approval by Regulators.
75	Company Action	File RBC Plan and projections. Review and approval by Regulators.
50	Regulatory Action	Same as above, but Regulator issues Corrective Order.
35	Authorized Control	Same as above, but Regulator has option to initiate Receivership.
	Mandatory Control	Receivership (or 90 day waiting period if Regulator believes problems can be solved in that time.)

Testimony on
Senate Bill No. 506
by
Dick Brock
Kansas Insurance Department

Senate Bill No. 506 proposes to amend K.S.A. 40-203 so that a domestic insurance company or fraternal benefit society may be organized and can preserve its name despite the fact that it may not yet have a certificate of authority to do business in Kansas.

In 1978, one of our Kansas life insurance companies, Alliance Life Insurance Company, was sold to a foreign insurer. After a number of subsequent sales and changes in ownership, the company was merged out of existence in 1993. The Kansas group of companies, Alliance Insurance Companies, which owned a substantial interest in the company before it was initially sold would like to preserve the name in the event life insurance becomes part of their operating structure in the future. However, in order to preserve the company's name at the present time, under K.S.A. 40-203, the company would have to be a licensed insurer. Senate Bill No. 506 would allow the name of the company to be preserved as soon as it is organized under the laws of Kansas.

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Since 1888

FARMERS ALLIANCE MUTUAL INSURANCE COMPANY

P.O. BOX 1401 McPHERSON, KANSAS 67460-1401 (316) 241-2200

Date Organized: 10/15/58 Stock Company

Date Admitted: 12/30/58 Kansas

Acquired by Western States, 8/31/78

Acquired KFIR Holding Co., Mark Herman, 12/16/85

Acquired by First Commonwealth Corporation, 12/1/89

Acquired by United Trust Group, 6/15/92

Merged With and Into Universal Guaranty Life Insurance Company, 6/30/93

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