

Approved

3/13/90

Date

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE

The meeting was called to order by SENATOR RICHARD L. BOND at
Chairperson

9:00 a.m./~~noon~~ on FRIDAY, MARCH 2, 1990 in room 529-S of the Capitol.

All members were present ~~except~~

Committee staff present:

Bill Edds, Revisors Office
Bill Wolff, Research Department
Louise Bobo, Committee Secretary

Conferees appearing before the committee:

David Hanson, Glenn & Cornish, Attorneys
Richard Bell, Midwest Securities Trust Company, Chicago
Dick Brock, State Insurance Department

Chairman Bond called the meeting to order at 9:15 a.m.

SB 752 and SB 754 - Relating to banks and trust companies and insurance company deposits.

David Hanson, Glenn & Cornish, addressed the committee on behalf of this proposed legislation and explained the change in the language of the ballooned version of SB 754. The first change on page 3 would give additional authority to the Insurance Commissioner. Mr. Hanson further explained that SB 752 applied to discretionary funds that insurance companies hold for reserves while SB 754 refers to mandatory deposits of securities. (Attachment 1)

Richard Bell, Midwest Securities Trust Company, Chicago, appeared before the committee in support of these two bills. He explained that passage of this bill would allow insurance companies in Kansas to invest directly in an out-of-state security company. Present Kansas law requires insurance companies to place their funds with a Kansas bank which, in turn, might invest in an out-of-state trust company. Mr. Bell suggested that this bill would promote greater efficiency and service by eliminating the middleman and affording insurance companies the opportunity to participate through computer links. (Attachment 2)

During the discussion which followed, committee members inquired if there was any supervision on behalf of the insurance companies or the consumers. Mr. Bell replied that they were subject to layers of federal regulation as well as state regulations. In addition, every aspect of this proposed legislation would have to be approved by the Insurance Commissioner. Concern was expressed about the ability to monitor and maintain any control over an out-of-state trust company.

Dick Brock, Insurance Department, informed the committee that the Insurance Department would still maintain control even though the trust company was out-of-state. He said that the main concern of the Insurance Commissioner was that if an insurance company becomes insolvent and their funds are in an out-of-state trust subject to the laws of another state would the out-of-state trust be able to withhold funds from Kansas. Mr. Brock further stated that his department had some reservation about the language in the ballooned version but that they did not disapprove of the bills. A committee member inquired what benefit this bill would be to the Kansas policyholder and Mr. Brock replied that if cutting out the middleman would reduce costs then this saving should be passed on to the consumer.

The Chairman asked Mr. Brock to provide improved amendatory language rather than that presented in the balloon.

The hearing closed on SB 752 and SB 754.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE,

room 529-S, Statehouse, at 9:00 a.m. ~~4:00~~ on FRIDAY, MARCH 2, 1920.

HB 2654 - Insurance: rate filings

Dick Brock, Insurance Department, rose in support of this measure which was requested by his department. He explained that this bill would permit the commissioner to require rating organizations to file only that portion of the rate that is reflective of "prospective loss costs". (Attachment 3)

The Chairman closed the hearing on HB 2654.

Senator Yost made a motion to pass HB 2654 out of committee favorably. Senator Parrish seconded the motion. The motion carried.

The meeting adjourned at 10:04 a.m.

1 state treasurer, who shall be vested with an interest therein for the
 2 benefit of the policyholders and the annuity bondholders of the
 3 depositing company. Such deposit may be withdrawn only upon the
 4 order of the commissioner. If the policies or annuity bonds, in whole
 5 or in part, of the company are assumed, reinsured or instruments
 6 substituted therefor by any other insurance company, whether or
 7 not organized under the laws of Kansas, by obligations running to
 8 the policyholders or annuity bondholders, and whether or not the
 9 depositing company shall be inert, insolvent or dissolved, the deposit
 10 existing at the time of such transaction shall not be released, reduced
 11 or withdrawn on account thereof. The new obligor shall make and
 12 maintain a like deposit, on like terms, as the prior depositing com-
 13 pany, up to the amount of the net reserve of the policies and annuity
 14 bonds covered by the new obligations.

15 (c) If there should be one or more further assumptions, rein-
 16 surances or substitutions, in succession, directly or indirectly, to any
 17 such new obligations, and whether or not the prior company shall
 18 be inert, insolvent or dissolved, the provisions of this act, applying
 19 in case of any assumption, reinsurance or substitution, shall govern
 20 with reference to the retention, continuance and further making and
 21 maintenance of the deposit, up to the amount of the net reserve of
 22 the policies and annuity bonds covered by such further obligations.

23 (d) Such deposits shall be kept by the state treasurer and com-
 24 missioner in strong, locked metal boxes within the built-in security
 25 type vault located in the state office building. Such security-type
 26 vault shall be under the custody, control and supervision of the
 27 commissioner except that the state treasurer shall maintain at all
 28 times during regular working hours one or more persons appointed
 29 and authorized by the state treasurer to be present in the security-
 30 type vault and act on behalf of the state treasurer in the acceptance,
 31 custody, control and release of all insurance company securities de-
 32 posited pursuant to the provisions of this code with the state treasurer
 33 and commissioner. The commissioner with the advice of the state
 34 treasurer shall be authorized and empowered to issue such rules and
 35 regulations governing the operation and supervision of such security-
 36 type vault to promote the efficient operation and security of all
 37 deposits maintained therein. Separate boxes shall be used for the
 38 deposits of each depositor, and if necessary, more than one box for
 39 the deposits of one depositor.

40 The boxes shall be securely fastened to the structure of the vault,
 41 or to a strong metal case or cases which cannot be removed from
 42 the vault except with difficulty. The locks on each box shall be kept
 43 fastened at all times except when ingress and egress are necessary

1 to carry out the duties of the state treasurer and commissioner as
 2 joint custodians of such deposits, and such boxes shall be fastened,
 3 or unfastened, only by the use of two keys. One key shall be in the
 4 custody of the state treasurer and the other in the custody of the
 5 commissioner. When access to any box shall be required, each state
 6 officer, or such officer's deputy, assistant or designated employee,
 7 shall use the key in custody to unfasten and fasten the lock. No
 8 other person shall have any key which can be used for such purpose.
 9 No persons other than the state treasurer, commissioner or persons
 10 appointed or authorized to act for them shall be permitted access
 11 to such security-type vault except with their express consent and in
 12 their company. The post auditor shall have access for the purpose
 13 of carrying out duties provided by law.

14 It shall be the duty of the commissioner to obtain and maintain
 15 the fixtures of such vault necessary to carry out the purposes of the
 16 provisions of this code relating to deposits of securities and invest-
 17 ments of insurance companies doing business in this state. In addition
 18 the commissioner shall appoint, within the provision of the civil
 19 service law, and available appropriations, such additional employees
 20 as may be necessary to properly carry out the custody, control and
 21 supervisory duties of such vault facilities. With the joint consent of
 22 the state treasurer and commissioner, and if there is space available
 23 in boxes not occupied by nor needed for insurance company deposits,
 24 deposits may be made by other state departments or agencies on a
 25 plan whereby the access to such boxes is by the use of two keys,
 26 one available only to the depositor and the other available to the
 27 commissioner of insurance.

28 (e) (1) Life insurance companies organized under the laws of this
 29 state are authorized to satisfy the deposit requirements of this section
 30 by depositing assets with a custodian bank having its principal place
 31 of business in Kansas, or with a custodian trust company that is
 32 registered as a clearing agency pursuant to section 17A of the se-
 33 curities exchange act of 1934, ~~has its principal place of business in~~
 34 ~~a state that has adopted the uniform reciprocal liquidation act and~~
 35 ~~is approved for the purpose by the commissioner of insurance,~~ pur-
 36 suant to a written agreement with such custodian bank or trust
 37 company. Such deposit shall have the same force and effect as the
 38 deposit of such assets directly with the commissioner under sub-
 39 section (a) and K.S.A. 40-230, and amendments thereto, but the
 40 requirements of K.S.A. 40-230, and amendments thereto, that the
 41 treasurer and the commissioner give receipts for such assets and that
 42 such assets be delivered only on the joint order of the treasurer and
 43 commissioner shall not apply to assets deposited pursuant to this

(delete) such
 in the sole discretion
 of and upon such terms
 and conditions as may
 be required by the
 commissioner of insur-
 ance, and

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1 subsection, and the requirement of subsection (b) that deposits be
2 withdrawn only on the order of the commissioner shall not apply to
3 assets deposited pursuant to this subsection.

4 (2) Assets deposited pursuant to this subsection shall be held by
5 the custodian bank or trust company on behalf of the commissioner
6 as in trust for the use and benefit of the company. Such assets shall
7 remain the specific property of the company and shall not be subject
8 to the claim of any third party against the custodian.

9 (3) The custodian bank or trust company is authorized to re-
10 deposit such assets with a clearing corporation as defined in K.S.A.
11 84-8-102, and amendments thereto, and as permitted by K.S.A. 40-
12 2b20, and amendments thereto. The custodian bank or trust company
13 is authorized to hold such assets through the federal reserve bank
14 book-entry system.

15 (4) The commissioner shall by rule and regulation establish such
16 requirements relating to deposits under this subsection as may be
17 appropriate to assure the security and safety of such deposits, in-
18 cluding, but not limited to the following:

- 19 (A) Capital and surplus of the custodian bank or trust company;
- 20 (B) title in which deposited assets are held;
- 21 (C) records to be kept by the custodian and the commissioner's
- 22 access thereto;
- 23 (D) periodic reports by the custodian to the commissioner;
- 24 (E) responsibility of the custodian to indemnify the company for
- 25 loss of deposited assets;
- 26 (F) withdrawal or exchange of deposited assets; and
- 27 (G) authority of the commissioner to terminate the deposit if the
- 28 condition of the custodian bank or trust company should threaten
- 29 the security of the deposited assets.

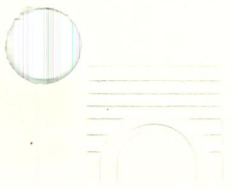
30 Sec. 2. K.S.A. 40-405 is hereby amended to read as follows: 40-
31 405. When the liability on any policy shall cease, the security de-
32 posited therefor, as hereinbefore provided, may be returned, by
33 direction of the commissioner of insurance, to the company depos-
34 iting the same, and whenever the aggregate of such securities shall
35 exceed the liability of the company on such secured policies, the
36 surplus of securities may be returned to the company. The state of
37 Kansas shall be fully responsible to every life insurance company for
38 the safe return of any securities, cash and all other property, actually
39 delivered, in accordance with the provisions of the insurance code,
40 to the commissioner of insurance or state treasurer.

41 Should the state of Kansas, for any reason, fail to return such
42 securities, cash or property, then an action may be brought here-
43 under to recover any liability of the state of Kansas in any court of

1 competent jurisdiction in the state of Kansas. Any such insurance
2 company may deposit with the commissioner as all or part of the
3 deposit required by the preceding section: (a) The written receipt
4 of a bank within the state of Kansas ~~having or a trust company that~~
5 ~~is registered as a clearing agency pursuant to section 17A of the~~
6 ~~securities exchange act of 1934 and is within a state that has adopted~~ (delete)
7 ~~the uniform reciprocal liquidation act,~~ provided that such bank or
8 trust company has a combined capital and surplus of at least \$500,000
9 and is approved for the purposes of this section by the commissioner
10 of insurance ~~or;~~ or (b) the joint custody receipt of any such bank
11 ~~and the or trust company and a federal reserve bank of Kansas~~
12 ~~City, Missouri,~~ stating that said bank the bank or trust company
13 holds, as a special deposit on behalf of and for the account of such
14 commissioner, bonds, debentures or certificates of stock which could
15 be deposited as provided in the preceding section. All such bonds,
16 debentures or certificates of stock shall be held by such bank or
17 trust company on behalf of said the commissioner as in trust for the
18 use and benefit of ~~such~~ the insurance company. The deposit with
19 the commissioner of such receipts shall have the same force and
20 effect as the deposit of such securities with the commissioner as
21 required by K.S.A. 40-404 and amendments thereto. When the li-
22 ability on any policy shall cease or such insurance company shall be
23 entitled to the release of any securities as provided in K.S.A. 40-
24 406 and amendments thereto, the surplus shall be returned to such
25 insurance company by said bank the bank or trust company upon
26 the written order of the commissioner or his a duly authorized
27 assistant commissioner. Deposit of such receipts as hereinbefore pro-
28 vided shall for all purposes including the certification of policies as
29 provided in K.S.A. 40-407 and amendments thereto be deemed the
30 equivalent of the deposit of such securities with the commissioner
31 and state treasurer under and a in compliance with sections K.S.A.
32 40-404 and 40-407 of the Kansas Statutes Annotated, and amend-
33 ments thereto.

34 The commissioner may, upon written order, direct said bank
35 may direct the bank or trust company to permit the exchange of
36 securities upon deposit of specified substituted securities, as provided
37 by K.S.A. 40-406 and amendments thereto. All forms for deposit,
38 withdrawal or exchange shall be prescribed, prepared and furnished
39 by the commissioner of insurance, and no facsimile signatures shall
40 be used or recognized. The commissioner of insurance or his a duly
41 authorized assistant commissioner or representatives may at any time
42 inspect the securities on deposit in any such bank: ~~Provided, how-~~
43 ~~ever;~~ or trust company, except that nothing in this act shall be

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**Midwest
Securities Trust
Company**

March 2, 1990

Senator Richard L. Bond
Chairman, Financial Institutions and Insurance Committee
Kansas Senate

Dear Sir:

The following is submitted as written testimony in favor of a proposed amendment of sections 404 and 405 of the Kansas Insurance Code, which would permit Kansas life insurance companies to deposit their legal-reserve securities in a registered clearing agency approved by the Commissioner of Insurance.

1. The Proposed Amendment

At present, sections 404 and 405 of the Kansas Insurance Code (K.S.A. 40-404 and 40-405) permit a Kansas life insurance company to deposit its legal-reserve securities only in a Kansas bank. It is proposed that sections 404 and 405 be amended to permit life insurance companies to deposit their legal-reserve securities also in an entity that is:

- (1) a trust company;
- (2) registered as a clearing agency pursuant to section 17A of the Securities Exchange Act of 1934; and
- (3) approved by the Commissioner of Insurance.

2. Benefits

a. Efficiency

There have been great changes in financial services recently. Among the most important are those related to securities. Reliable communications networks, uncertificated securities, book-entry transactions, and uniform regulation by the states, have given institutional investors access to wider ranges of services and greater efficiencies. Specialized securities depositories and clearing corporations are major providers of services to institutional investors, not only within specific regions but across the entire nation.

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Kansas life insurance companies now have access to the services of clearing agencies only through Kansas banks, which may act as primary custodians of the insurers' securities and arrange for deposits of the securities in clearing agencies. The proposed amendment will provide an alternative by permitting a life insurance company to deposit its securities directly in a clearing agency that met certain qualifications. This alternative, though limited, promises a number of advantages: eliminating the cost of an intermediate custodian; obtaining immediate on-line access to information about the insurance company's securities accounts; having direct control over the delivery and receipt of securities to or from its accounts; and receiving faster crediting of interest and dividends from securities to its accounts.

b. Safety

The qualifications required by the proposed amendment limit the number of potential new custodians to (at most) five or six. Each of these operates under stringent and pervasive regulation by state and federal authorities. Thus, the amendment does not permit Kansas insurers to place their securities in the custody of an indefinite number of trust companies operating in many different regulatory environments. The similarity of the few newly-eligible custodians and their environments makes possible a meaningful comparison of risk entailed by the amendment and risk entailed by current Kansas law.

The major assurance of safety is in federal regulation pursuant to section 17A of the Securities Exchange Act of 1934 (the "Exchange Act"). This regulation is applicable to any trust company registered as a clearing agency, but for present purposes it will be helpful to refer specifically to Midwest Securities Trust Company ("MSTC").

1. Services of MSTC

MSTC receives deposits of securities from its participants. MSTC provides a variety of services with respect to participants' securities that are placed in its custody. These services include:

- Safekeeping the securities in MSTC's vaults.
- Providing a centralized facility through which

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- interest payments and dividends are collected and disbursed to participants;
 - proxy statements and other security-holder solicitations are received and distributed to participants; and
 - securities are tendered for redemption.
- Recording securities positions in participants' accounts, and providing each participant with a daily report of its account.
 - Recording securities transfers between participants, and providing each participant with a daily report of its transactions.
 - Collecting or paying amounts owed because of securities transfers between participants.

2. Federal Regulation of MSTC

In performing the services described above, MSTC is subject to comprehensive federal regulation.^{1/} MSTC is a clearing agency as

^{1/} MSTC is also subject to state regulation. (a) MSTC is chartered under Illinois' Business Corporation Act as a limited-purpose trust company, to provide such services as are described above. As such, MSTC may not and does not engage in other activities, such as lending, that would pose risks to MSTC and to its participants. (b) MSTC is subject to Illinois' Trust Companies Act and Corporate Fiduciary Act. MSTC has qualified as a trust company under standards established by state law and is subject to supervision by the commissioner of banks and trust companies. MSTC is required to file or publish certain reports or statements of condition. MSTC is subject to on-site examination by the commissioner or his appointees at least once a year. The examiner must inquire about the following subjects and certify the results in a written report: the condition and resources of MSTC generally; the mode of conducting and managing MSTC's affairs; the action of MSTC's directors; the investments of MSTC's funds; the safety and prudence of MSTC's management; the security afforded to MSTC's participants; and MSTC's compliance with the requirements of its charter and of the (Footnote Continued)

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defined by the Exchange Act.^{2/} Section 17A (b)(1) of the Exchange Act requires that MSTC be registered as a clearing agency with the Securities and Exchange Commission.

Section 17A(b)(3) of the Exchange Act requires that the Securities and Exchange Commission make certain findings before granting registration to a clearing agency. One required finding is that the clearing agency's organization and capacity enable it to facilitate the clearance and settlement of securities transactions, safeguard securities and funds, comply with the Exchange Act, and carry out the purposes of section 17A of the Exchange Act.^{3/} The other eight findings are with regard to the clearing

laws.

^{2/} By section 3(a)(23)(A) of the Exchange Act, the term "clearing agency" includes a securities depository that "(i) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates, or (ii) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates." A bank that performs such functions only as part of its customary banking activities, or only on behalf of a clearing agency or one of its participants in connection with the clearing agency's services, is excluded from the definition by section 3(a)(23)(B)(iii) of the Exchange Act.

^{3/} Section 17A(a)(1) of the Exchange Act sets forth the finding of the Congress that:

(A) The prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership and the safeguarding of securities and funds related thereto, are necessary for the protection of investors and persons facilitating transactions by and acting on behalf of investors.

(B) Inefficient procedures for clearance and settlement impose unnecessary costs on investors and persons facilitating transactions by and acting on

(Footnote Continued)

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agency's rules. The Securities and Exchange Commission must find that the rules (1) provide reasonable access to the clearing agency's services, (2) ensure fair representation of participants in the administration of the clearing agency's affairs, (3) equitably allocate dues and fees, (4) do not impose a schedule of prices for services that are rendered by participants, (5) provide for appropriate disciplining of participants, (6) are in accordance with the Exchange Act's standards of fairness for procedures followed in disciplinary actions and denials of access, (7) serve the purposes of section 17A of the Exchange Act, and (8) do not impose any unjustified burden on competition.

Rule 17Ab2-1 under the Exchange Act requires a clearing agency to apply for registration on, and in accordance with the instructions to, Form CA-1. Form CA-1 calls on the clearing agency to file certain information with the Securities and Exchange Commission in order to enable the Commission to determine whether the requirements of section 17A of the Exchange Act are satisfied. The requisite information includes the name and principal business address of the clearing agency, its form of organization, and the date on which it was organized. The clearing

behalf of investors.

(C) New data processing and communications techniques create the opportunity for more efficient, effective, and safe procedures for clearance and settlement.

(D) The linking of all clearance and settlement facilities and the development of uniform standards and procedures for clearance and settlement will reduce unnecessary costs and increase the protection of investors and persons facilitating transactions by and acting on behalf of investors.

The Congress therefore directed the Securities and Exchange Commission, in Section 17A(2),

having due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents, to use its authority . . . to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of transactions in securities

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agency must also disclose any arrangements with others under which another person processes, keeps, transmits, or maintains any securities, funds, or records relating to its activities as a clearing agency. Form CA-1 calls for information about the types of insurance carried or provided by the clearing agency, the clearing agency's exposure to loss in the event of a participant's failure to meet its obligations to the clearing agency, and the existence and amount of any differences in securities. It also calls for information about any material pending legal proceedings and copies of all contracts with a national securities exchange, national securities association, clearing agency, or securities market for which the clearing agency performs services.

The clearing agency must file exhibits with Form CA-1. These include a list of persons who may control or direct the management or policies of the clearing agency, a list of the corporate officers who supervise or are directly responsible for the conduct of its activities as a clearing agency, a description of the clearing agency's organizational structure, and copies of its currently effective articles of incorporation or association, by-laws, rules, procedures, and schedules of charges imposed for its services as a clearing agency. The requisite exhibits also include the most recent financial statements of the clearing agency. It must furnish exhibits that demonstrate its operational capabilities, including: descriptions of each service, descriptions of the measures taken or procedures followed to secure any system that performs functions of the clearing agency against tampering or unauthorized use, a description of the measures or procedures to safeguard securities and funds in the clearing agency's custody or control, and a description of all back-up systems or subsystems designed to prevent interruption of the clearing agency's activities by malfunction of its automated equipment.

Further exhibits must be filed to show that the clearing agency's services are reasonably accessible to participants. The clearing agency must submit a list of current participants or persons who have applied for participation. It must also submit a description of any criteria that limit, are interpreted as limiting, or have the effect of limiting access to, or use of, any services that it offers as a clearing agency. Finally, the clearing agency must file a copy of any form contract governing the terms on which persons may subscribe to its services.

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In deciding whether to grant or deny registration to a clearing agency, the Securities and Exchange Commission applies specific standards. A copy of SEC Release No. 34-16900, which promulgated these standards, is attached as Exhibit 1. Scrutiny of a clearing agency under these standards -- at the time that the clearing agency has applied for initial registration and thereafter each time it applies for renewal or reregistration -- may be expected to disqualify any applicant that would expose its participants to significant risk of loss.

3. The Rules of MSTC

Of course, the proposed amendment, as revised, would not make any registered clearing agency an eligible custodian of a Kansas life insurance company's legal-reserve securities. The Kansas Insurance Department's approval would still be required. Moreover, its approval would depend on an analysis of the clearing agency's rules that satisfies the Department about risk.

Under applicable federal standards and MSTC's Rules, MSTC is required to:

- Assert no lien on securities in a participant's account, other than securities which the participant^{4/} has contracted to purchase but has not yet paid for.
- Protect against loss to itself and to its solvent participants and their customers in the event of a participant insolvency, by actions that include:
 - adoption of procedures for returning to the deliverer securities which the insolvent participant has not paid for, or for liquidating such securities to cover the insolvent participant's payment obligation; and


^{4/} Because MSTC has no interest in participants' fully paid-for securities, they would not, in the unlikely event of MSTC's failure, be deemed assets of MSTC available to satisfy the claims of its creditors. Unlike a bank custodian, MSTC does not engage in securities transactions for its own account, so there is no possibility that a participant's securities could not be identified as such.

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- maintenance of a "participants fund" -- a pool of highly liquid assets of participants, which is designed to offset extraordinary losses arising out of a participant's insolvency that cannot be covered under procedures described above.^{5/}
- Maintain strict financial and operational standards for admission to participation and for continued participation, by actions that include regular examination of participants' financial statements.
- Maintain an internal audit department, which monitors the effectiveness of MSTC's systems of internal accounting control and reports periodically to MSTC's board of directors.
- Have an annual audit of its internal accounting controls by independent public accountants, who must certify that throughout the period covered by the report (not merely as of the end of the year) these controls are free of material weakness. (A copy of the report is delivered to all of MSTC's participants.)

A copy of MSTC's Rules is attached as Exhibit 2. A copy of MSTC's form Participant's Agreement is attached as Exhibit 3. A copy of MSTC's form Participants Fund Agreement is attached as Exhibit 4.

Respectfully,



Richard S. Bell

BA/rsb0145

^{5/} MSTC has never had to resort to a solvent participant's contributions to the participants fund to meet an insolvent participant's liabilities.

Kansas Insurance Department
Testimony Before the
Senate Financial Institutions and Insurance Committee
on House Bill No. 2654
Presented by Dick Brock

House Bill No. 2654 will permit the Commissioner of Insurance to require rating organizations who develop and file rates for various kinds and classes of insurance on behalf of member and subscriber companies to develop and file only that portion of the total rate that is estimated to be necessary to cover losses. Individual insurance companies would have to supplement the so-called "loss cost rate" (prospective loss costs) with the amount necessary to reflect their expenses, profit and the effect of their individual investment results. This can, perhaps, be illustrated as follows:

Components of an Insurance Rate

- . Loss and Loss Adjustment Expenses
(Prospective Loss Costs)

- . Underwriting Expenses
 - Commission and brokerage
 - Other acquisition expenses
 - General expenses
 - Taxes, licenses and fees

- . Investment Results

- . Profit and Contingencies

Attachment 3

While competition has produced overall rate levels that generally reach the same goals, the mandatory application of this technique on those kinds and classes of insurance where it is appropriate, will assure a more universal use of rates that are reflective of individual company management performance. It will also produce a more accurate public perception of the role of rating organizations while continuing to permit the absolutely essential use of loss data reflective of the experience of the industry as a whole.

Enabling legislation is the necessary vehicle because the orderly transition to loss cost rate filings will require great flexibility with regard to the kinds and classes of insurance to be affected and the time frames to be used. The use of administrative regulations to implement the process provides the necessary flexibility while continuing to allow legislative oversight on such implementation. Consequently, House Bill No. 2654 would simply add a section to the existing rate regulation acts governing property and casualty coverages respectively permitting the commissioner to require rating organizations to file only that portion of the rate that is reflective of "prospective loss costs" as defined in the bill.