Approved 3/4/92
Date

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE.

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

9:14 a.m./p.m. on Tuesday, March 3, 1992 in room 529-S of the Capitol.

All members were present except: Senators Bond, Francisco, Kerr, Moran, Parrish, Salisbury, Strick, Ward, and Yost.

Committee staff present:

Fred Carman, Revisor
Bill Wolff, Research
June Kossover, Committee Secretary

Conferees appearing before the committee:

Richard Brock, State Insurance Department

The meeting was called to order by Chairman Bond at 9:14 a.m. Senator Salisbury made a motion, seconded by Senator Strick, to approve the minutes of the meeting of February 27, 1992, as submitted. The motion carried.

The Chairman announced that Senate bills must be out of committee by Monday, March 9, 1992.

Senator Strick made a motion to send **SB 535**, coverage of procedures relating to skeletal bones and joints, to Senate Ways and Means Committee. Senator Francisco second the motion, and the motion carried.

Chairman Bond opened the hearing on **HB 2797**, a model act by the National Association of Insurance Commissioners which provides for the licensing and regulation of reinsurance intermediaries. Richard Brock, State Insurance Department, appeared before the committee to testify in support of **HB 2797**. (Attachment #1.) Mr. Brock advised the committee that this bill is a technical tool to provide guidelines and structure for those involved in reinsurance, "reinsurance" being defined as the means by which an insurance company spreads the risk under a primary policy among different carriers. The bill is required by the NAIC to maintain accreditation. At Chairman Bond's request, Mr. Brock clarified the language in Section (8). Mr. Brock also clarified, in response to Senator Ward's question, that reinsurance does not change anything in a consumer contract and that reinsurance companies are underwriting the primary carrier and not the policy holder.

There being no further conferees, the Chairman declared the hearing on **HB 2797** closed. Senator Salisbury made a motion to move **HB 2797** favorably. The motion was seconded by Senator Parrish. The motion carried.

Chairman Bond opened the hearing on **HB 2777**. Richard Brock, State Insurance Department, appeared before the committee in support of **HB 2777**, an NAIC model bill which provides for disclosure and contractual safeguards when an insurance broker or brokers also has a controlling interest in the writing company. (Attachment #2.) The bill also provides a cause of action to the Commissioner to seek restitution to a company damaged by the improper actions of a producing and controlling broker.

There being no questions and no further conferees, the Chairman declared the hearing on **HB 2777** closed. Senator Strick made a motion, seconded by Senator Moran, to move **HB 2777** favorably. The motion carried.

A motion was made by Senator Parrish to place both **HB 2797** and **HB 2777** on the Consent Calendar. Senator Strick seconded the motion. The motion carried.

The committee adjourned at 9:40 a.m.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

GUEST LIST

SENATE

COMMITTEE: FINANCIAL INSTITUTIONS AND INSURANCE DATE: 3/3/92

NAME	ADDRESS	ORGANIZATION
Dick Brock	Topeka	Ins Dept
JIM OLIVER	"	PIAK
L.M. CORNISH	"	Ks Assn P/C
Bill Sneed	Topeka	State Farm

Testimony by

Dick Brock, Kansas Insurance Department

Before the Senate Committee on Financial Institutions and Insurance

House Bill No. 2797

House Bill No. 2797 is another solvency regulation tool that is necessary if the Kansas Insurance Department is to maintain its NAIC accreditation. Obviously, the accreditation in and of itself is a nice tribute to the legislature, Governor and Insurance Department that jointly made receipt of such distinction possible. However, a far more important part of the accreditation process is the much stronger state insurance solvency regulation system that will result. This objective is the purpose of House Bill 2797 which provides for the licensing and regulation of reinsurance intermediaries.

Needless to say, reinsurance is by its nature a vital component of insurance company solvency. For various reasons, the insurance mechanism performs better if the risk of a particular consumer is covered by a single insurer. There is only one insurer for the policyholder to deal with in the event of a claim, only one contract covering the risk, only one company's premium or rates and rating plans involved, and the company itself does not have to coordinate inspection services, safety initiatives, audits or other servicing responsibilities. However, by assuming all the liability under an insurance contract, the primary insurer may expose itself to excessive losses as a result of a single event, simultaneous losses under multiple policies resulting from the same event or some other unanticipated adversity. Therefore, insurers attempt to protect themselves from this result by transferring a part of the risk they have assumed to other insurers. The insurers to whom the primary liability or some of the primary liability is transferred may in turn transfer all or part of what they have assumed to still other insurers and this can continue until the risk originally written by the primary insurer is spread among a multitude of companies both in this country and abroad. This whole process of assuming and transferring or ceding risk is, of course, reinsurance and, as I said, it plays a very large role in a primary insurer's ability to remain solvent because no

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matter how much liability is spread throughout the insurance industry, the primary insurer remains solely responsible to its policyholders for any and all covered losses. This is an extremely complicated mechanism which, for a number of reasons, does not lend itself to direct regulation of reinsurance contracts, rates, placements and so forth. One of these reasons is that the system works very well the vast majority of the time because reinsurance transactions almost always involve knowledgeable and experienced "buyers and sellers". Nevertheless, more than a few well-managed, well-established insurance companies have found themselves incurring very significant, unanticipated losses even to the point of causing insolvency because the reinsurance they thought they had was not collectible when it was needed.

Because direct regulation of reinsurance transactions is virtually impossible and if attempted would unquestionably be counterproductive, House Bill No. 2797 imposes licensing requirements and performance responsibilities on the persons who solicit or negotiate reinsurance contracts with insurance companies. House Bill 2797 refers to these individuals and firms as reinsurance intermediaries and requires them to be licensed either as an agent or broker; or, be specifically licensed as a reinsurance intermediary. A licensed agent or broker does not have to be separately licensed as a reinsurance intermediary but, if he or she, transacts business as a reinsurance broker or reinsurance manager, compliance with the provisions relating to reinsurance intermediaries is required. The license for a reinsurance intermediary is a new provision and is basically a registration requirement. However, under the act there are two kinds of reinsurance intermediaries. The first is a reinsurance broker who would find other insurers willing to accept or assume risk from an insurer the broker represents and perhaps negotiate the terms of the contract but not be authorized to bind the reinsurance. The other reinsurance intermediary established by House Bill 2797 is a reinsurance manager who would be authorized to bind or manage risk assumed from another insurer. Because of this binding authority the

Commissioner can require reinsurance managers to file a bond and maintain errors and omissions coverage but otherwise the licensing requirements are the same for reinsurance brokers and managers.

Beyond the licensing requirement, Sections 4 and 5 of House Bill 2797 establish the basic responsibilities of a reinsurance broker. The foundation of these responsibilities is included in Section 4 which includes a requirement that transactions between the reinsurance broker and any insurer it represents must be governed by a written authorization that delineates the rights and responsibilities of both parties. Section 5 sets forth a list of the records a reinsurance broker must maintain for a period of at least 10 years on each transaction.

Section 6 prohibits an insurer from using a reinsurance broker unless such person or firm is properly licensed.

Section 7 relates to reinsurance managers and imposes requirements quite similar to those applicable to reinsurance brokers; however, because a reinsurance manager can actually bind coverage, the contract between a reinsurance manager and reinsurer must be approved by the reinsurer's board of directors and a copy of such contract must be filed with the Commissioner. Also, reinsurance managers are subject to some specific prohibitions as listed in Section 8.

Section 9 prohibits insurers from using a reinsurance manager that is not properly licensed.

Section 10 authorizes the Commissioner to examine reinsurance intermediaries the same as insurance companies; Section 11 establishes the penalties for violation of the act; Section 12 authorizes the Commissioner to adopt regulations; Section 13 permits existing contracts with reinsurance intermediaries to continue in effect until June 30,

1993; and, Section 14 would make House Bill 2797 effective December 31, 1992.

Testimony by

Dick Brock, Kansas Insurance Department

Before the Senate Committee on Financial Institutions and Insurance

House Bill No. 2777

House Bill No. 2777 is intended to provide additional safeguards preventing abusive practices which have occurred when the same individual or firm controlled production, underwriting and claims of an insurance company. Specifically, it provides for disclosure and contractual safeguards when an insurance broker or brokers also has a controlling interest in the writing company. The bill also provides a cause of action to the Commissioner to seek restitution to a company damaged by the improper actions of a producing and controlling broker.

The provisions of the bill can be summarized as follows:

The definition of control found in Section 2 simply refers to the Holding Company Act which states that control is presumed to exist if a person, in this case a broker, owns or controls 10% or more of the voting securities.

Pursuant to Section 3, House Bill 2777 is applicable to insurers domiciled in this state or domiciled in a state that is not an accredited state having in effect a similar law.

The provisions of the bill generally apply to a broker in any calendar year in which the controlling broker's written premium is equal to or greater than 5% of the admitted assets of the controlled insurer.

Section 4B contains the provisions that must be included in the contract between the controlling broker and the controlled insurer. The insurer may terminate the contract for cause. The broker shall render accounts, remit all funds at least monthly and hold funds in a fiduciary capacity. The contract shall provide for commissions, charges and fees no greater than those applicable to comparable business placed by other than controlling brokers. The contract shall provide a limit on the timing of

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compensation to the broker and a limit on the amount of business the controlling broker may place with the controlled insurer.

Other provisions require every controlled insurer: to have an audit committee which shall meet with the independent auditors and the independent actuary; and to report to the Insurance Department yearly on its loss ratios, loss reserves and the amount of commissions paid to the controlling broker. Also disclosure of the relationship of the insurer and the broker must be made to the prospective insured prior to the effective date of the policy; and, finally, if the controlled insurer is to be liquidated or rehabilitated, the receiver may maintain a civil action for recovery of damages if he believes the controlling broker has not complied with the act.

The House Committee amendment deletes the definition of "captive insurers" because the term is not used in the bill.

The act would, if enacted, become effective December 31, 1992.