Approved: 3/15/95
Date

MINUTES OF THE Senate Committee on Financial Institutions and Insurance.

The meeting was called to order by Chairperson Dick Bond at 9:08 a.m. on March 14, 1995 in Room 529-S of the Capitol.

All members were present.

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

Conferees appearing before the committee: Bob Storey, Lloyd's of London
James A. Greer, II, Lloyd's of London
Don Gaskill, Kansas Insurance Department
William Caton, Consumer Credit Commissioner

Others attending: See attached list

Senator Steffes made a motion, seconded by Senator Emert, to approve the minutes of the meeting of March 9 as submitted. The motion carried.

The chairman opened the hearing on **SB 368**, relating to reinsurance. Bob Storey, Lloyd's of London, explained that he has worked closely with the Kansas Insurance Department to draft and amend this bill, and he introduced James A. Greer, Lloyd's of London, who presented testimony in support of this legislation. (Attachment #1) In response to Senator Bond's question, Mr. Greer explained that "reinsurance" permits the initial insurer to remove its outstanding potential liability by the amount of insurance it has laid off on a higher level. Currently, Kansas law does not permit reinsurance unless the reinsurer posts a letter of credit or other collateral with the initial insurer. Senator Steffes cited the serious financial difficulties Lloyd's of London experienced a few years ago and Senator Bond expressed concern about the safety and soundness of domestic companies; i.e., whether they will be placed in any jeopardy by removing collateral. Mr. Greer stated that this is not a possibility.

Don Gaskill, Kansas Insurance Department, requested an amendment to limit reinsurance credits to Lloyd's of London. (Attachment #2) As explained by Dr. Woolf, other amendments included in the Kansas Insurance Department's balloon are intended to contain the entire reinsurance issue in one statute. Mr. Gaskill also explained that the reinsurer must have in trust a minimum of $100 million in excess of its liability, and that the Kansas Insurance Department supports this bill as amended.

There were no further questions and no other conferees; the hearing on **SB 368** was closed. On the advice of Dr. Woolf and Mr. Carman, Senator Praeger made a motion to include the suggested amendments in a substitute bill and to pass **Substitute for SB 368** favorably. Senator Clark seconded the motion. The motion carried. Senator Corbin will carry the bill on the Senate floor.

The hearing was opened on **HB 2068**, which deletes extraneous language from the Consumer Credit Code. Bill Caton, Consumer Credit Commissioner, testified that since the UCCC no longer permits precomputed transactions, the language that this bill deletes is contradictory and should be removed. (Attachment #3) There were no questions and no other conferees; the hearing was closed. Senator Emert made a motion to pass **HB 2068** favorably and to place it on the Consent Calendar. The motion was seconded by Senator Petty; the motion carried.

The hearing was opened on **HB 2253**. Mr. Caton also appeared in support of this legislation, stating that no companies currently offer investment certificates and the fund guaranteeing them is depleted with no means of recovery; therefore, it is appropriate to repeal the Guaranty Fund Act. (Attachment #4) There were no questions and no other conferees. The hearing was closed. Senator Emert made a motion to pass **HB 2253** and to place it on the Consent Calendar. Senator Praeger seconded the motion; the motion carried.

The committee adjourned at 9:41 a.m. The next meeting is scheduled for Wednesday, March 15

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.

SENATE FINANCIAL INSTITUTIONS & INSURANCE
COMMITTEE GUEST LIST

DATE: 3/14/95

NAME	REPRESENTING
Bill Caton	Consumer Credit
Jim Maag	KBA
Chuck Stones	"
Kathy Taylor	"
Carriann Richey	Golden Rule Insurance Co.
Danielle Noe	KCUA
Roger Franzke	FFC
Joe Lieber	KS-Co-op Council
Shelby Smith	—
Jay Green	Lloyd's of London
Bob Storey	Lloyd's of London
Patrick Mulvihill	KS. Ins. Dept.
Shannon Peterson	KBA
Don Gaskill	Ins Dept
Linda DeCoursey	KS Insurance Dept.
Sue Bond	
Lee Wright	Farmers Ins. Group

TESTIMONY OF JAMES A. GREER II
PARTNER, LEBOUEF, LAMB, GREENE & MACRAE
IN SUPPORT OF SENATE BILL NO. 368

Background:

This legislation relates in part to Lloyd's of London, for which my law firm, LeBoeuf, Lamb, Greene & MacRae, is United States General Counsel. Lloyd's of London is not an insurance company but a marketplace where approximately 20,000 persons called "Names" participate by accepting insurance risks for their own account. Lloyd's is famous for writing unique coverages, such as Betty Grable's legs. But Lloyd's is far more important as a source of world leadership in the placement of hard-to-place reinsurance and commercial insurance. For example, Lloyd's Underwriters have long led the catastrophe reinsurance programs of insurers throughout the world. In Kansas and elsewhere, reinsurance protection against the perils of damage from tornados and hail has been sought from Lloyd's over the years. Lloyd's Underwriters have also provided substantial amounts of reinsurance for medical malpractice and other forms of professional indemnity coverage written by insurers in the United States and elsewhere. Both of these types of reinsurance have been and continue to be in demand. In addition, Lloyd's Underwriters have traditionally provided reinsurance of a wide variety of hard-to-place health, disability and accident coverages.

Historically, membership at Lloyd's has been restricted to natural persons. To enhance the market's capacity, Lloyd's for the first time admitted Corporate Names beginning in January, 1994. This has enhanced Lloyd's financial strength and has helped maintain its capacity to underwrite difficult-to-obtain coverages, including reinsurance against catastrophes and professional liability.

The Legislation:

The bill adopts without change substantial portions of the National Insurance Commissioners' ("NAIC") Model Credit-for-Reinsurance bill as it was amended in 1993.[1]

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[1]Reinsurance is "insurance of insurance companies." It is a well-recognized contractual arrangement, whereby an insurer can transfer excess risks to other insurers, thereby strengthening its financial condition. When an insurer incurs a loss or other liability that is covered by reinsurance it has ceded to another insurer, it may take credit on its financial statement for the receivable from the reinsurer, provided the reinsurer is licensed or otherwise approved ("accredited") by the insurance regulator in the insurer's state of domicile. Heretofore, Kansas domestic companies could only take credit for reinsurance ceded to other companies licensed in the state of Kansas unless the reinsurer provided the insurer with collateral in the form of cash, marketable securities, or a clean, irrevocable, evergreen letter of credit. As a result, Kansas domestic insurers have less freedom to chose

(continued...)

Senate F I & I
3/14/95
attachment #1

The portions of the bill relating to Lloyd's appear in the last two sentences of Sec. 2. (a). The balance of the bill, which is also taken verbatim from the NAIC model, was included at the request of the Kansas Insurance Department.

The proposed amendments do not alter the primary basis of Lloyd's long-established United States trading privileges, which is the continued existence of the Lloyd's American Trust Fund. In this connection, the Trustee of the Lloyd's American Trust has reported that, as of December 31, 1994, the Lloyd's American Trust Fund amounted to more than $10.8 billion. We are also informed by Lloyd's that this figure included a surplus over liabilities of more than $1 billion. The financial trust fund standards for Lloyd's in the existing NAIC-approved provisions in the Model Law relating to Lloyd's are unchanged. The new Lloyd's provisions merely contain technical revisions to the previous version of the Model law required in order to describe Lloyd's more accurately now that it has decided to admit corporate members. The new Lloyd's provisions in the Model also contain language to ensure that these corporate entities are subject to the same solvency controls as the rest of Lloyd's members and that they do not engage in any other business besides participating in the Lloyd's market.

The proposed amendments insofar as the relate to Lloyd's are part of a nationwide effort. The NAIC has already approved these credit-for-reinsurance amendments, and similar amendments have been adopted or enacted in 37 states to date, including South Dakota, Minnesota, New York, California, New Jersey, Pennsylvania and Texas. Of the remaining states, action to amend their laws, where required, is anticipated during the 1995 legislative session.

Impact on Kansas

Adoption of the NAIC Model Credit-for-Reinsurance law provisions with the Lloyd's amendments will enable the Lloyd's market to improve its service to Kansas domestic insurers as a leading international market for reinsurance, including such classes as medical malpractice and catastrophe reinsurance, and hard-to-place health, accident and disability risks.

If Lloyd's Underwriters' status as accredited reinsurers is accepted, there could be a reduction in cost or increase in availability to the Kansas domestic insurance companies that now obtain reinsurance from the Lloyd's market. Whether or not they currently cede reinsurance to our clients, Kansas domestic insurers may find there would also be an increase in the attractiveness of their reinsurance cessions with a consequent decrease in the cost or increase in availability of reinsurance, or both, at least some of which benefits would

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[1](...continued)
the markets to which they may cede reinsurance than non-domestic insurers licensed to do business in Kansas. In addition, they may have had to pay higher prices for the reinsurance they have purchased. Any attendant increase in costs or decrease in availability of coverage may have been passed to the Kansas policyholders of Kansas domestic insurers.

probably be passed on to Kansas direct policyholders in the form of lower premiums, increased coverage, or both. Kansas domestic companies might also benefit because most of their major competitors are licensed in Kansas but domiciled in other states, and therefore would not be subject to the same inhibitions as those currently suffered by Kansas domestic insurers.

To: Committee on Ways and Means

From: Don Gaskill, Chief Examiner
Kansas Insurance Department

Re: S.B. No. 368

Date: March 14, 1995

The Kansas Department of Insurance supports Senate Bill No. 368 which provides for enactment in Kansas of that portion of the NAIC Model Credit for Reinsurance Law that grants financial statement credit for reinsurance ceded by Kansas domestic insurers to Lloyds of London without resorting to funding procedures provided in subsection (b) of K.S.A. 40-221a.

The Department of insurance does believe, however, that the bill should be amended to provide reinsurance credits only for a group of incorporated and individual unincorporated underwriters. Language that refers to assuming insurers should be replaced by referring to assuming underwriters group which refers only to Lloyds of London and not other foreign or alien insurers. A copy of a proposed amendment is attached to this testimony.

Senate W&M
3/14/95
Attachment #2

40-221a Reinsurance

(a) Any insurance company organized under the laws of this state may

(1) with the consent of the commissioner of insurance, cede all of risks to any other solvent insurance company authorized to transact business in this state or accept all of the risks of any other company,

(2) accept all or any part of an individual risk or all or any part of a particular class of risks which it is authorized to insure, and

(3) cede all or any part of an individual risk or all or any part of a particular class of risks to another solvent insurer or insurers having the power to accept such reinsurance.

(b) Any insurance company organized under the laws of this state may take credit as an asset or as a deduction from loss and unearned premium reserves on such ceded risks to the extent reinsured by an insurer or insurers authorized to transact business in this state, but such credit on ceded risks reinsured by any insurer which is not authorized to transact business in this state may be taken in an amount not exceeding:

(1) The amount of deposits by, and funds withheld from, the assuming insurer pursuant to express provision therefor in the reinsurance contract, as security for the payment of the obligations thereunder, if such deposits or funds are held subject to withdrawal by, and under the control of, the ceding insurer or are placed in trust for such purposes in a bank which is insured by the federal deposit insurance corporation or its successor, if withdrawals from such trust cannot be made without the consent of the ceding company; or

(2) The amount of a clean and irrevocable letter of credit issued by a bank which is insured by the federal deposit insurance corporation or its successor if such letter of credit is initially issued for a term of at least one year and by its terms is automatically renewed at each expiration date for at least an additional one-year term unless at least 30 days prior written notice of intention not to renew is given to the ceding company by the issuing bank or the assuming company and provided that such letter of credit is issued under arrangements satisfactory to the commissioner of insurance as constituting security to the ceding insurer substantially equal to that of a deposit under paragraph (1) of this subsection.

(3) The amount of loss and unearned premium reserves on such ceded risks to a group <u>of underwriters</u> including incorporated and individual unincorporated underwriters, if the assuming <u>underwriters group</u> maintains a trust fund in a qualified United States financial institution, as defined in subsection (b)(3)(v), for the payment of the valid claims, as determined by the commissioner for the purpose of determining the sufficiency of the trust fund, of its United States policyholders and ceding insurers, their assigns and successors in interest. The assuming <u>underwriters group</u> shall report annually to the commissioner information substantially the same as that required to be reported on the National Association of Insurance Commissioners annual statement form by licensed insurers to enable the commissioner to determine the sufficiency of the trust fund.

(i) The trust shall consist of a trusteed account representing the group's liabilities attributable to business written in the United States. The group shall maintain a trusteed surplus of which $100,000,000 shall be held jointly for the benefit of United States ceding insurers of any member of the group. The incorporated members of the group shall not be engaged in any business other than underwriting as a member of the group and must be subject to the same level of solvency regulation and control by the group's domiciliary regulator as are the unincorporated members. The group shall make available to the commissioner an annual certification by the group's domiciliary regulator and its independent public accountants as to the solvency of each underwriter.

(ii) Such trust must be in a form approved by the commissioner of insurance. The trust instrument shall provide that contested claims shall be valid and enforceable upon the final order of any court of competent jurisdiction in the United States. The trust shall vest legal title to its assets in the trustees of the trust for its United States policyholders and ceding insurers, their assigns and successors in interest. The trust and the assuming <u>group</u> shall be subject to examination as determined by the commissioner. The trust, described herein, must remain in effect for as long as the assuming <u>group</u> shall have outstanding obligations due under the reinsurance agreements subject to the trust.

(iii) *No later than February 28 of each year the trustees of the trust shall report to the commissioner in writing setting forth the balance of the trust and listing the trust's investments at the preceding year end and shall certify the date of termination of the trust, if so planned, or certify that the trust shall not expire prior to the next following December 31.*

(iv) *The credit authorized under subsection (b)(3)(i) through (iii) shall not be allowed unless the assuming group agrees in the reinsurance agreements:*

(A) *that in the event of the failure of the assuming group to perform its obligations under the terms of the reinsurance agreement, the assuming group, at the request of the ceding insurer, shall submit to the jurisdiction of any court of competent jurisdiction in any state of the United States, will comply with all requirements necessary to give such court jurisdiction, and will abide by the final decision of such court or of any appellate court in the event of an appeal; and*

(B) *to designate the commissioner or a designated attorney as its true and lawful attorney upon whom may be served any lawful process in any action, suit or proceeding instituted by or on behalf of the ceding company.*

(C) *This provision is not intended to conflict with or override the obligation of the parties to a reinsurance agreement to arbitrate their disputes, if such an obligation to do so is created in the agreement.*

(v) *A "qualified United States financial institution" means, for purposes of those provisions of this law specifying those instituions that are eligible to act as a fiduciary of a trust, an institution that:*

(A) *is organized, or (in the case of a U.S. branch or agency office of a foreign banking organization) licensed, under the laws of the United States or any state thereof and has been granted authority to operate with fiduciary powers; and*

(B) *is regulated, supervised and examined by federal or state authorities having regulatory authority over banks and trust companies.*

The foregoing provisions of paragraphs (1), (2), *and (3)* of subsection (b) shall not apply to a domestic title insurance company subject to the provisions of K.S.A. 40-1107a and amendments thereto.

(c) Any reinsurance ceded by a company organized under the laws of this state or ceded by any company not organized under the laws of this state and transacting business in this state must, pursuant to express provisions contained in the reinsurance agreement, be payable by the assuming insurer *or assuming underwriters group* on the basis of the liability of the ceding company under the contract or contracts reinsured without diminution because of the insolvency of the ceding company and any such reinsurance agreement which may be canceled on less than 90 days' notice must provide in the reinsurance agreement for a run-off of the reinsurance in force at the date of cancellation.

HISTORY L. 1965, ch. 296, § 2; L. 1967, ch. 249, § 1; L. 1970, ch. 175, § 1; L. 1974, ch. 185, § 1; L. 1985, ch. 157, § 1.

CITED BY 40-2-21; BULLETIN 1974-18; BULLETIN 1985-17

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KANSAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

Bill Graves
Governor

Wm. F. Caton
Commissioner

TESTIMONY
HOUSE BILL 2068
SENATE FINANCIAL INSTITUTIONS AND INSURANCE
MARCH 14, 1995
WM. F. CATON

Thank you for the opportunity to present testimony on House Bill 2068. The purpose for introduction of this bill is to delete language in the Kansas Uniform Consumer Credit Code (UCCC) which refers to the method of computing finance charges on retail sales contracts and consumer loans.

During the 1993 Legislature, legislation was passed that discontinued the use of "pre-computed" contracts. Interest on pre-computed contracts was calculated without regard to the date the payment was made; all months had 30 days and the pre-computed amount of interest was added to the principal amount of the loan. If the consumer paid the loan off early, a formula called the "rule of 78ths" was used to refund the unearned interest that was added to the loan. This system of interest computation was obsolete, and although this system was generally fair to the consumer because of "averaging" the interest on payments, it did not reward consumers for early payments nor compensate lenders for late payments. Prepayment early in the contract usually penalized the consumer and some lenders were taking advantage of this by encouraging borrowers to re-write the loan early in its life.

Before I introduced the 1993 legislation, I asked the consumer credit industry to provide me with reasons that pre-computed contracts should continue to be used, and they had no valid reasons. It was the position of this office that the UCCC needed to be updated to disallow pre-computed contracts. The computation of "simple interest" is not complicated and can be computed quickly on a $5 calculator (or even a pencil and paper by most 6th graders). The simple interest formula is: outstanding principal balance times the interest rate times the actual days since the last payment divided by 365. It is absolutely fair to both the borrower and the lender.

The language this bill eliminates should have been deleted in the 1993 amendments, but was inadvertently overlooked. This language is contradictory and needs to be removed. Please consider favorable action on House Bill 2068.

Senate FI&I
3/14/95
Attachment #3

JAYHAWK TOWER, 700 S.W. JACKSON, SUITE 1001 / TOPEKA, KANSAS 66603 / (913) 296-3151

KANSAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

Bill Graves
Governor

Wm. F. Caton
Commissioner

TESTIMONY
HOUSE BILL 2253
SENATE FINANCIAL INSTITUTIONS AND INSURANCE
MARCH 14, 1995
BILL CATON

House Bill 2253 repeals the Kansas Investment Certificate Guaranty Fund Act. This act was passed in the early 1980's to provide insurance up to $10,000 for investment certificate holders in thrift institutions commonly known as investment certificate companies. The sole remaining investment certificate company declared bankruptcy in 1991 and has subsequently been liquidated. Senate Bill 95 has an appropriation of approximately $59,000 from the Consumer Credit Fee Fund which represents the shortfall the Guaranty Fund had in making all depositors recover their investments up to $10,000.

Investment certificate companies have been around since the turn of the century. They generally raised capital by selling investment certificates to local investors similar to certificates of deposits that financial institutions sold to depositors. Their primary purpose was to provide reasonably priced consumer loans to borrowers who usually did not qualify for conventional bank loans. In the late 1970's, interest rates soared to all time highs and investment certificate companies found it very difficult to raise capital because bank's C.D.'s were paying in the range of 15% and had no risk because of FDIC insurance. These investment certificates, prior to the Guaranty Fund Act, were not insured and investors assumed a higher degree of risk for a higher return on their investment.

The sole purpose of the Guaranty Fund Act was to provide the investment certificate industry with a guaranty fund that would aid the companies in retaining current investors, attract new investors and compete with commercial banks, savings and loans and credit unions for deposits. The legislation creating the Guaranty Fund was designed by the industry, for the industry, and was even overseen by the industry. The statute never seemed to address the financial stability and viability of the Guaranty Fund itself.

Although the statute specifically excluded the State from any liability arising from the Guaranty Fund Act, the State has acknowledged some responsibility in the shortfall previously mentioned. My initial projections concluded the Guaranty Fund could possibly be up to $1,000,000 short in paying off the investors, but a successful liquidation of the company's assets brought that figure down to $59,000.

I believe repeal of the Guaranty Fund Act is appropriate as I doubt the State wants to learn or can afford another hard lesson in the "deposit insurance" business.

Senate FI&I 3/14/95 attachment #4

JAYHAWK TOWER, 700 S.W. JACKSON, SUITE 1001 / TOPEKA, KANSAS 66603 / (913) 296-3151