

Approved: March 12, 1996
Date

MINUTES OF THE HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE.

The meeting was called to order by Chairperson Bill Bryant at 3:30 p.m. on March 5, 1996 in Room 527S-of the Capitol.

All members were present except: Representative Phill Kline
Representative Tom Sawyer
Representative Delbert Crabb

Committee staff present: Bill Wolff, Legislative Research Department
Bruce Kinzie, Revisor of Statutes
Nikki Feuerborn, Committee Secretary

Conferees appearing before the committee: Bob Kennedy, Kansas Insurance Department
Bill Sneed, AmVestors
Jim Maag, Kansas Bankers Association
Tad Kramar, SBG
Steve Bowser, SBG
Dave Hanson, Kansas Life Association
Tom Wilder, Kansas Insurance Department

Others attending: See attached list

SB 450: Securities to be deposited by insurance companies to be deposited in a Kansas bank or depository institution

Robert Kennedy, Jr., Assistant Commissioner of Insurance, spoke on behalf of the bill which would privatize the security vault now maintained by the Kansas Insurance Department (Attachment 1). Kansas domestic insurance companies are required to file with the Insurance Department capital and surplus amounts to qualify to do business as well as protect their financial condition. These securities and other assets including real estate deeds amounting to \$2.8 million are kept in a vault in the Docking State Office Building. \$3.9 million is on deposit with custodial banks under written trust or other custodial agreements. The KID pays Facilities Management \$47,000 per year for their services in the management and maintenance of this vault. This bill could convert all deposit arrangements to some form of custodial bank arrangement.

Bill Sneed, AmVestors, issued testimony supporting the bill which would allow insurance companies to handle their deposits in a fiscally prudent manner (Attachment 2).

Jim Maag, Kansas Bankers Association, referred to the antiquated system now being used by the Insurance Department for the storage and handling of deposits (Attachment 3). The proposed method would be the same way public funds are handled.

Ted Kramar, Security Benefit Group of Companies, reminded the Committee that the security vault was created many decades ago by legislation which no longer reflects the modern financial world (Attachment 4). The bill would reform the deposit requirements which are more substantial than in other states. The current deposit requirements are not necessary to safeguard the interest of Kansas insurance companies as other regulatory rules are in effect now.

David Hanson, on behalf of the Kansas Life Association, voiced support for the proposed legislation.

SB 549: Life insurance company investments in foreign jurisdictions and currencies

Tad Kramar, Security Benefit Life Insurance Company, explained that the bill would allow life insurance companies to invest limited portions (20%) of their portfolios in foreign entities and in investments denominated in foreign currencies (Attachment 5). The bill which is modeled after the Model Investment Law approved by the NAIC Working Group would allow companies to increase their quality and yield by taking advantage of a wider investment opportunity. A list of "Yankee Bonds" was attached to his testimony. The bill would limit investment in foreign investment in any single country to three percent of admitted assets except in countries having a debt rating of SVO 1.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE,
Room 527S-Statehouse, at 3:30 a.m. on March 5, 1996.

Steve Bowser, SBG, informed the Committee that Yankee Bonds are the most lucrative and are dealt with through leeway clauses if they are sold in dollars. At this time Kansas life insurance companies cannot invest in foreign derivatives.

Tom Wilder, Kansas Insurance Department, spoke in support of the bill which would allow investment by a life insurance company in an obligation of a foreign jurisdiction or assets domiciled in a foreign jurisdiction up to 40% of the admitted assets of the life insurer under certain circumstances. (Attachment 6). This bill would not take investment capital out of Kansas.

Dave Hanson, Kansas Life Insurance Association, supported the proposed legislation.

SB 572: Securities lending transactions by life insurance companies

Ted Kramar, representing SBG, explained that the bill would allow Kansas life insurance companies to engage in securities lending, repurchase, and reverse repurchase transactions. (Attachment 7). This would enable Kansas life insurance companies to achieve a greater return on their investments at virtually no additional risk. He explained the mechanics of the operation which is used primarily by securities dealers as it is the least expensive way to acquire a security which they have sold short and need to deliver. The bill requires that the insurance company receive securities having a market value of at least 102% of the purchase price paid by the insurance company. A reverse repurchase transaction is a secured cash loan with the insurance company as the borrower when they have need for short-term funds.

Tom Wilder, Kansas Insurance Department, urged approval of the bill which would make changes in the investment powers of domestic life insurance companies by permitting investments in reverse repurchase agreements and allow securities lending (Attachment 8).

SB 550: Property and casualty insurance company securities transactions

Tom Wilder, Kansas Insurance Department, told the Committee how the proposed legislation would allow domestic property and casualty companies to invest in repurchase agreements, reverse repurchase agreements and dollar roll transactions, and engage in the lending of securities (Attachment 9). Included in his testimony was testimony on securities lending from the Mt. Hawley Insurance Company who have requested the legislation. The company recently moved to Kansas from Delaware.

Discussion and action on SB 412: Life insurance companies in tax lien certificates

The purchase of tax lien certificates is relative to Kansas domestic companies only and would be limited to 10% of admitted assets.

Representative Smith moved for the favorable passage of the bill from Committee. The motion was seconded by Representative Gilbert. Motion carried.

Discussion and action on SB 442: Medicare insurance supplement policies

This bill would allow the Insurance Commissioner to adopt rules more stringent than the federal Medicare Act for supplemental policies.

Representative Smith moved to place the unopposed legislation on the Consent Calendar. The motion was seconded by Representative Correll. Motion carried.

Discussion and Action on SB 450: Securities to be deposited by insurance companies to be deposited in a Kansas bank or depository institution

Representative Graeber moved to pass the bill favorably. Motion was seconded by Representative Smith. Motion carried.

Discussion and Action on SB 549: Life insurance company investments in foreign jurisdictions and currencies

Representative Humerickhouse moved to pass the bill out favorably. The motion was seconded by Representative Landwehr. Motion carried.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE,
Room 527S-Statehouse, at 3:30 a.m. on March 5, 1996.

Steve Bowser, SBG, informed the Committee that Yankee Bonds are the most lucrative and are dealt with through leeway clauses if they are sold in dollars. At this time Kansas life insurance companies cannot invest in foreign derivatives.

Tom Wilder, Kansas Insurance Department, spoke in support of the bill which would allow investment by a life insurance company in an obligation of a foreign jurisdiction or assets domiciled in a foreign jurisdiction up to 40% of the admitted assets of the life insurer under certain circumstances. (Attachment 6). This bill would not take investment capital out of Kansas.

Dave Hanson, Kansas Life Insurance Association, supported the proposed legislation.

SB 572: Securities lending transactions by life insurance companies

Ted Kramar, representing SBG, explained that the bill would allow Kansas life insurance companies to engage in securities lending, repurchase, and reverse repurchase transactions. (Attachment 7). This would enable Kansas life insurance companies to achieve a greater return on their investments at virtually no additional risk. He explained the mechanics of the operation which is used primarily by securities dealers as it is the least expensive way to acquire a security which they have sold short and need to deliver. The bill requires that the insurance company receive securities having a market value of at least 102% of the purchase price paid by the insurance company. A reverse repurchase transaction is a secured cash loan with the insurance company as the borrower when they have need for short-term funds.

Tom Wilder, Kansas Insurance Department, urged approval of the bill which would make changes in the investment powers of domestic life insurance companies by permitting investments in reverse repurchase agreements and allow securities lending (Attachment 8).

SB 550: Property and casualty insurance company securities transactions

Tom Wilder, Kansas Insurance Department, told the Committee how the proposed legislation would allow domestic property and casualty companies to invest in repurchase agreements, reverse repurchase agreements and dollar roll transactions, and engage in the lending of securities (Attachment 9). Included in his testimony was testimony on securities lending from the Mt. Hawley Insurance Company who have requested the legislation. The company recently moved to Kansas from Delaware.

Discussion and action on SB 412: Life insurance companies in tax lien certificates

The purchase of tax lien certificates is relative to Kansas domestic companies only and would be limited to 10% of admitted assets.

Representative Smith moved for the favorable passage of the bill from Committee. The motion was seconded by Representative Gilbert. Motion carried.

Discussion and action on SB 442: Medicare insurance supplement policies

This bill would allow the Insurance Commissioner to adopt rules more stringent than the federal Medicare Act for supplemental policies.

Representative Smith moved to place the unopposed legislation on the Consent Calendar. The motion was seconded by Representative Correll. Motion carried.

Discussion and Action on SB 450: Securities to be deposited by insurance companies to be deposited in a Kansas bank or depository institution

Representative Graeber moved to pass the bill favorably. Motion was seconded by Representative Smith. Motion carried.

Discussion and Action on SB 549: Life insurance company investments in foreign jurisdictions and currencies

Representative Humerickhouse moved to pass the bill out favorably. The motion was seconded by Representative Landwehr. Motion carried.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE,
Room 527S-Statehouse, at 3:30 a.m. on March 5, 1996.

Discussion and Action on SB 572: Securities lending transaction by life insurance companies; SB 550: Property and casualty insurance company securities transactions

The Chair announced the bulking of these two bill as they refer to the same type of lending transactions for life and property and casualty insurance companies.

Representative Correll moved for the favorable passage of both bills. The motion was seconded by Representative Humerickhouse. Motion carried.

Representative Graeber moved for the approval of the minutes of February 22. Motion was seconded by Representative Gilbert. Motion carried.

The meeting adjourned at 5:05 p.m. The next meeting is scheduled for March 6, 1996.

HOUSE FINANCIAL INSTITUTIONS AND INSURANCE COMMITTEE GUEST LIST

DATE: 3/5/96

NAME	REPRESENTING
Tom Wilder	Kansas Insurance Department
Bill Speed	Amvestors
John BOTTEBERG	Am Gen Life
TAD KRUMER	SECURIM BENEFIT
STEVEN M. BOWSER	SECURITY BENEFIT
Chris Wheeler	Security Benefit
Lee Wright	Farmers Ins Group
Roger Frazee	FFC
Tim Randolph	Beneficial
Jim Mang	KBA
Dennis Stack Corp	KID
Bob Kennedy	KID
Alan Ebert	KID
Patrick Mulvihill	KID
Chuck Stokes	KBA
Dave Hanson	Ks Insur. Assocs.
Rogers Brazier	ST. TREASURER
Chris Wakim	Household Financial Grp, LTD.



Kathleen Sebelius
Commissioner of Insurance
Kansas Insurance Department

House Financial Institutions and Insurance
March 5, 1996

Robert L. Kennedy, Jr.
Assistant Commissioner

Written testimony on SB 450

This bill was introduced at the request of the Commissioner of Insurance. It privatizes the Security Vault maintained by the Kansas Insurance Department.

Insurance companies are required to deposit securities or other assets with the Insurance Commissioner and the State Treasurer for a variety of reasons. Among those reasons are: depositing capital and surplus amounts to qualify to do business as a domestic insurance company, to shore up their financial condition if our examiners determine their financial condition has weakened, and statutory requirements to maintain with the Commissioner part of their claims reserves.

Currently, insurers comply with the deposit requirement, some instances, by putting assets in a Kansas bank, with approved written trust or other legal agreements, to assure they cannot be removed without permission of the Commissioner. Insurers can meet those requirements also by physically depositing those assets with the Commissioner to be held in our vault facility.

The Security Vault is located in the basement of the Docking State Office Building. Currently we have on deposit almost \$6.7 billion dollars, with about \$2.8 billion held in our Security Vault. Almost \$3.9 billion is on deposit with custodial banks under written trust or other custodial agreements. In reality, about 80% of the assets held in our Security Vault are joint custody receipts, evidencing deposits in banks, so a small portion of the total deposits in our Vault are actually securities or other assets.

SB 450 converts all deposit arrangements to some form of custodial bank arrangements. In addition to privatizing all these deposit arrangements, the bill extends to domestic property and casualty companies deposit arrangements now available only to domestic life insurance companies and eliminates a requirement currently imposed on domestic life insurance companies that is not required of foreign life insurance and property and casualty companies - the obligation to deposit assets equal to claims reserves. The first change would allow property and casualty companies an option involving much less paperwork. The second would eliminate a requirement that unfairly differentiates between companies.

The Senate amended the bill to restrict the deposit requirements to Kansas domiciled banks.

*House F&I
Attachment 1
3/5/96*

420 SW 9th Street
Topeka, Kansas 66612-1678

913 296-3071
Fax 913 296-2283
Printed on Recycled Paper

Consumer Assistance Hotline
1 800 432-2484 (Toll Free)

MEMORANDUM

TO: The Honorable Bill Bryant
House Financial Institutions and Insurance Committee

FROM: William W. Sneed, Legislative Counsel
AmVestors Financial Corporation
American Investors Life Insurance Company

DATE: March 5, 1996

RE: S.B. 450

Mr. Chairman and Members of the Committee: My name is Bill Sneed and I am Legislative Counsel for AmVestors Financial Corporation and its subsidiary American Investors Life Insurance Company. We appreciate the opportunity to testify before this committee in support of S.B. 450.

We have met with the Insurance Department to discuss this issue on prior occasions. We have reviewed the Department's legislation eliminating the existence of a state vault for deposit of securities by insurance companies and support it wholeheartedly. We believe that this move into the twentieth century will save the State money while allowing insurance companies to handle their deposits in a fiscally prudent manner.

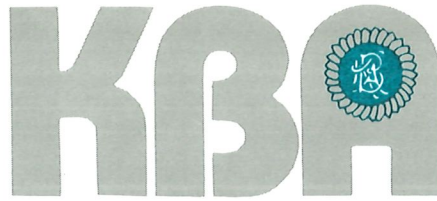
Thus, we request your favorable action on S.B. 450. Please contact me if you have any questions.

Respectfully submitted,



William W. Sneed

House F.I.D.
Attachment 2
March 5, 1996



The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

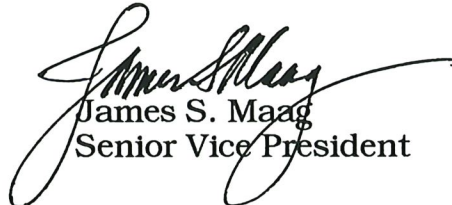
March 5, 1996

TO: House Committee on Financial Institutions and Insurance
RE: **SB 450** - Deposit of securities by insurance companies

Mr. Chairman and Members of the Committee:

Thank you for this opportunity to appear before the committee in support of **SB 450** which amends numerous statutes relating to the deposit of securities by insurance companies. We strongly agree with the Insurance Commissioner's recommendation in this bill that all cash, securities, real estate deeds, mortgages or other assets be deposited with a Kansas financial institution.

For both legal and economic reasons we see this requirement as a positive step for Kansas. It is a requirement which has served the state well for many years in the investment of public funds as well as the holding of insurance company securities. We respectfully request that the committee recommend **SB 450** favorably.


James S. Maag
Senior Vice President

*House File
Attachment 3
March 5, 1996*

March 5, 1996

To the House Committee on Financial Institutions and Insurance

Re: Senate Bill No. 450

Dear Chairman and Committee Members:

The Security Benefit Group of Companies is a financial services organization specializing in the sale and service of annuity, mutual fund and life insurance products. The parent company, Security Benefit Life Insurance Company, has been in business for over 100 years. The Security Benefit Group of Companies has over \$5 billion in assets under management and employs approximately 550 Kansans.

We support Senate Bill No. 450. This bill would reduce expenses and increase the operating efficiency of both the Insurance Department and Kansas insurance companies by modernizing the law governing the security vault. It would also eliminate current unnecessary regulatory requirements which discriminate against Kansas life insurance companies and place them at a competitive disadvantage compared to insurance companies domiciled in other states.

The security vault was created many decades ago by legislation which no longer reflects the modern financial world. As a result of the development of custodial arrangements with banks and other financial institutions, the maintenance of a security vault at the Insurance Department is now an unnecessary expense. Most securities, in fact, are not even held in physical form, but rather in book-entry form, at depositories such as Depository Trust Corporation and the Federal Reserve System. Therefore, we support the provisions of Senate Bill No. 450 which would eliminate the security vault.

Senate Bill No. 450 would also reform the deposit requirements for Kansas insurance companies to more closely resemble the requirements of other states. Currently, Kansas insurance companies must maintain substantial deposits in the security vault or in custodial arrangements with other financial institutions. These deposits are much larger than those required of insurance companies domiciled in most other states. This places Kansas insurance companies at a competitive disadvantage, especially when competing against foreign insurance companies doing business in Kansas.

Haunce F. D. S.
Attachment 4
March 5, 1996

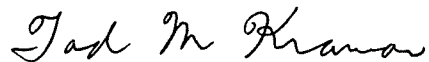
March 5, 1996

Page 2

The substantial deposit requirements in Kansas are not necessary to safeguard the interest of Kansas insurance consumers. Many less burdensome regulatory tools are now available, such as risk-based capital laws, annual audits by independent certified public accountants, periodic reporting, and audits by the Insurance Department. Accordingly, we support the provisions of Senate Bill No. 450 which would reform the deposit requirements, and hope that you will take favorable action on this bill.

Thank you for your time and consideration. I would be happy to address any questions you may have.

Very truly yours,



Tad M. Kramar
Assistant Vice President and
Assistant Counsel



The Security Benefit
Group of Companies

Security Benefit Life Insurance Company
Security Benefit Group, Inc.
Security Distributors, Inc.
Security Management Company

700 SW Harrison St.
Topeka, Kansas 66636-0001
(913) 295-3000

March 5, 1996

To the House Committee on Financial Institutions and Insurance

Re: Senate Bill No. 549
Investments by Life Insurance Companies in Foreign Entities and Currencies

Dear Chairman and Committee Members:

Security Benefit Life Insurance Company respectfully requests your favorable consideration of Senate Bill No. 549. This bill amends K.S.A. 40-2b04 to allow Kansas life insurance companies to invest limited portions of their portfolios in foreign entities and in investments denominated in foreign currencies. This bill is substantially the same as the foreign investment provisions of the final draft of the Model Investment Law approved by the NAIC Working Group, except for changes requested by the Kansas Insurance Department, and language which relates exclusively to the Kansas investment laws.

This bill would enable life insurance companies to increase the quality and yield of their investments by allowing them to take advantage of a wider range of investment opportunities. Access to foreign investments would provide Kansas life insurance companies with a substantially larger number of investment choices exhibiting greater yields and better diversification opportunities. Greater diversification reduces the overall risk of an investment portfolio.

Our primary purpose in seeking passage of this bill is to acquire authority to invest in "Yankee Bonds". These are bonds of foreign entities denominated in U.S. dollars. A chart attached to our testimony shows the high ratings of some of the primary issuers of Yankee Bonds. Under current law, we could not invest in any of these bonds except under the "basket" or "leeway" clause, which permits investments of almost any type up to an aggregate of ten percent of admitted assets. Since other types of investments are included under the leeway clause, it is highly undesirable to rely solely on the leeway clause for making foreign investments. This important category of investments needs to be explicitly authorized for life insurance companies to take full advantage of foreign investment opportunities and further diversify their portfolios.

Subsection (b) of this bill limits foreign investments to 20 percent of admitted assets. It also limits foreign investments made in any single country to three percent of admitted assets, except that ten percent of admitted assets may be invested in countries which have a sovereign debt rating of SVO 1--the highest rating category. Subsection (c) imposes similar limits on investments in foreign currencies, except that they must not exceed ten percent of admitted assets.


House F.D.S.
Attachment 5
March 5, 1996

In addition, each foreign investment must satisfy the same requirements as domestic investments of the same type, including rating requirements. Also, under subsection (f), each foreign investment counts against the investment limit for domestic investments of the same type. Consequently, this bill does not increase the permissible level of any type of investment, but it expands the range of opportunities available for each of the primary investment types by authorizing foreign investments.

This bill is needed to allow Kansas life insurance companies to compete more effectively with other financial institutions for the best investment opportunities in the global economy.

Thank you for your time and consideration. I would be happy to address any questions you may have.

Very truly yours,



Tad M. Kramar
Assistant Vice President
and Assistant Counsel

Yankee Bond Issuers

Banks	Moody's/S&P Rating
ABN - AMRO	Aa2/A+
Dresdner	Aa1/AA
Swiss Bank	Aa2/AA
Westpac	A1/A+
World Bank	Aaa/AAA
 Other Companies	
British Telecom	Aaa/AAA
Grand Metropolitan (Pillsbury/Burger King)	A2/A+
British Gas	A1/AA-
Telecom Malaysia	A1/A+
Nestlé	Aaa/AAA
Philips Electronics	A3/BBB+
Bass Ale	A1/A+
British Petroleum	A1/AA-
Hanson PLC	A2/A+
Imperial Oil	AA2/AA+
Ford BV	A1/A+



Kathleen Sebelius
Commissioner of Insurance

Kansas Insurance Department

MEMORANDUM

To: House Financial Institutions
and Insurance Committee

From: Tom Wilder, Director of
Government and Public Affairs

Re: S.B. 549 (Investment in Foreign Securities)

Date: March 5, 1996

The Kansas Department of Insurance supports S.B. 549 which allows Kansas life insurance companies to invest in foreign securities. Currently, domestic life insurers are permitted to invest in Canadian government obligations without limit and to generally invest in other foreign government obligations up to 5% of their admitted assets. The bill allows investment by a life insurance company in an obligation of a foreign jurisdiction or assets domiciled in a foreign jurisdiction up to 40% of the admitted assets of the life insurer under certain circumstances.

The legislation is patterned after a section in the Model Investment Act developed by the National Association of Insurance Commissioners. A number of amendments were made to the bill by the Senate Financial Institutions and Insurance Committee at the request of the Insurance Department.

Senate Bill 549 will give domestic life insurance companies more investment flexibility. The Insurance Department requests the Committee approve S.B. 549 as amended.

*House FID
Attachment 6
March 5, 1996*



The Security Benefit
Group of Companies

Security Benefit Life Insurance Company
Security Benefit Group, Inc.
Security Distributors, Inc.
Security Management Company

700 SW Harrison St.
Topeka, Kansas 66636-0001
(913) 295-3000

March 5, 1996

To the House Committee on Financial Institutions and Insurance

Re: Senate Bill No. 572
Securities Lending and Repurchase Transactions by Life Insurance Companies

Dear Chairman and Committee Members:

Security Benefit Life Insurance Company respectfully requests your favorable consideration of Senate Bill No. 572. This bill amends K.S.A. 40-2b21 to allow Kansas life insurance companies to engage in securities lending, repurchase, and reverse repurchase transactions. This bill has substantially the same language as found in the final draft of the Model Investment Law approved by the NAIC Working Group, except for changes requested by the Kansas Insurance Department, and language which relates exclusively to the Kansas investment laws.

Securities lending would enable Kansas life insurance companies to achieve a greater return on their investments at virtually no additional risk. In a typical securities lending transaction, a life insurance company would lend a bond from its portfolio to a securities dealer. This bill would require the dealer to give the insurance company collateral in the form of cash, or securities nearly equivalent to cash, equal to at least 102% of the market value of the loaned securities. The insurance company would invest the collateral and expect to obtain a higher return on its investment than the fee it pays the dealer for the use of the collateral. On a date specified in the securities lending agreement, or upon demand from the insurance company, the dealer would deliver the same or an equivalent security to the insurance company, and the insurance company would return the collateral to the dealer.

Securities dealers are the primary borrowers of securities because they often find it is the least expensive way to acquire a security which they have sold short and need to deliver. Other reasons for borrowing are the implementation of sophisticated trading and arbitrage strategies which require borrowing securities, and a desire to acquire securities from a non-dealer to disguise a trading strategy from other dealers.

A repurchase transaction is basically a secured cash loan, with the insurance company as lender. In a repurchase transaction, a life insurance company purchases securities from a business entity, which is obligated to buy back the identical securities from the insurance company at a specified price within a specified time period or upon demand. The bill requires that the insurance company receive securities having a market value of at least 102% of the purchase price paid by the insurance company. When an insurance company has funds to invest on a short-term basis, it may

*House FFD
Attachment 7
March 5, 1996*

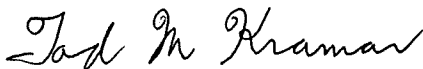
find that a repurchase transaction offers the highest return, depending on conditions in the market for repurchase transactions compared to the returns offered by other short-term investments.

A reverse repurchase transaction is essentially a secured cash loan, with the insurance company as borrower. The insurance company sells securities to a business entity and is obligated to buy back the identical securities from the business entity at a specified price within a specified time period or upon demand. An insurance company would engage in a reverse repurchase transaction if it had a short-term need for funds, did not consider it advantageous to sell securities at that time, and found a reverse repurchase transaction to be less expensive than other forms of borrowing.

This bill would enable Kansas life insurance companies to enhance the return on their investments by engaging in securities lending, and to enter into repurchase and reverse repurchase transactions whenever market conditions, and the investment and liquidity objectives of the insurance company, would render such transactions advantageous to the company.

Thank you for your time and consideration. I would be happy to address any questions you may have.

Very truly yours,



Tad M. Kramar
Assistant Vice President
and Assistant Counsel



Kathleen Sebelius
Commissioner of Insurance
Kansas Insurance Department

MEMORANDUM

To: House Financial Institutions
and Insurance Committee

From: Tom Wilder, Director of
Government and Public Affairs

Re: S.B. 572 (Life Insurance Companies/Investments)

Date: March 5, 1996

The Kansas Department of Insurance supports S.B. 572 which would make changes in the investment powers of domestic life insurance companies. Currently, Kansas life insurers are permitted to invest in repurchase agreements. The legislation would also permit investments in reverse repurchase agreements and "dollar roll" transactions and allows securities lending.

There were a number of amendments made to the bill at the request of the Insurance Department. Most of the changes bring the language of the statute into line with the provisions set out in the NAIC Model Investment Law. The Senate Financial Institutions and Insurance Committee also deleted references in the legislation to "dollar roll" transactions which is a type of repurchase agreement. The Insurance Department requested this change to give the Department more time to study these types of transactions.

The Kansas Insurance Department asks that you approve S.B. 572 as amended.

*House PSD
Attachment 8
March 5, 1996*



Kathleen Sebelius
Commissioner of Insurance
Kansas Insurance Department

MEMORANDUM

To: House Financial Institutions
and Insurance Committee

From: Tom Wilder, Director of
Government and Public Affairs

Re: S.B. 550 (Securities Lending and Repurchase Agreements)

Date: March 5, 1996

The Kansas Department of Insurance supports S.B. 550 which makes a number of changes to the investment authority granted to property and casualty companies domiciled in this state. The legislation amends K.S.A. 40-2a21 to allow domestic companies to invest in repurchase agreements, reverse repurchase agreements and dollar roll transactions and to engage in the lending of securities. Currently, the Kansas Insurance Code only permits companies to invest in repurchase agreements.

This bill was introduced at the request of Mt. Hawley Insurance Company. The insurance company was recently licensed as a Kansas domestic insurer. The provisions in the bill are based on the Model Investment Law being developed by the National Association of Insurance Commissioners ("NAIC"). This bill is similar to S.B. 572 which makes changes in the investment powers granted to domestic life insurance companies.

There were a number of amendments made to the bill at the request of the Insurance Department. Most of the changes bring the language of the statute into line with the provisions set out in the NAIC Model Investment Law. The Senate Financial Institutions and Insurance Committee also deleted references in the legislation to "dollar

roll” transactions which is a type of repurchase agreement. The Insurance Department requested this change to give the Department more time to study these types of transactions. Mt. Hawley Insurance Company indicated they agreed to the amendments to the bill.

The Kansas Insurance Department requests the House Committee recommend the bill as amended favorably for passage.

Mt. Hawley Insurance Company

Testimony on Securities Lending Legislation - Kansas

I. Company Background.

- Mt. Hawley Insurance Company (MTH) recently redomesticated to the state of Kansas in December 1995. Previously we were domiciled in the state of Delaware.
- We are a surplus lines insurer and began doing business in December, 1979.
- Policyholder surplus has grown from \$31.4 million in 1990, to \$82.6 million in 1995.
- The Company is rated "A" (excellent) by A.M. Best.
- We are 100% owned by RLI Insurance Company (RLI), an Illinois corporation. RLI is also an "A" rated A.M. Best company who's surplus has grown from \$70.7 million in 1990, to \$172.3 million in 1995.
- Both RLI and MTH are subsidiaries of RLI Corp. (the holding company) which is publicly traded on the New York Stock Exchange.

II. Securities Lending - What is it?

- The bill before you today is related to securities lending activity. Securities lending transactions began just after World War II when brokers began loaning securities to one another as a favor in the settlement of securities transactions. The real growth of securities lending began in the mid 1970's as large institutional investors such as insurance companies and endowment funds began lending their securities. Pension plans began lending activity in 1981 after the U.S. Department of Labor issued an exemption from the prohibited transactions rules under ERISA. This led to explosive growth in securities lending business during the 1980's.
- Today, the value of securities loans runs into the hundreds of billions of dollars.
- The definition of securities lending is a transaction that involves the lending of eligible securities (corporate and government bonds and U.S. equities) from the portfolios of participating organizations to approved borrowers in return for a fee. It is in effect similar to a repurchase agreement, where the dealer sells securities to an investor overnight and agrees to repurchase them the next day at an agreed upon price.
- All loans are fully collateralized with cash, U.S. government securities or irrevocable LOC's at 102% of the market value of the security, plus accrued interest. Loaned securities and securities received as collateral are marked to market daily and the collateral is maintained at 102% of the market value plus accrued interest of the loaned securities.
- The owner of the loaned securities retains all beneficial rights to those securities. This includes receipt of interest, dividends and capital structure changes.

Mt. Hawley Insurance Company

Testimony on Securities Lending Legislation - Kansas

- Loans are made on a day to day basis, therefore securities can be traded freely without regard to the loan status and no action required of the lender to operate as though no loan was in place.
- The process of securities lending is as follows:
 - A loan is initiated by the borrower with the lender.
 - Terms of the loan are negotiated between both parties.
 - Collateral is received by the lender from borrower.
 - The security is lent to the borrower.
 - The lender marks to market the loaned security.
 - The security and collateral are then returned to both parties.
 - The lender retains a fee for the transaction.

III. Why is Securities Lending Available

- **Settlement Needs** - Reduces the costs associated with failed trades if a borrower is unable to deliver a security they have sold.
- **Short Selling** - Allows borrowers to settle trades when they have sold a security short.
- **Arbitrage** - Provides for settlement of trades in arbitrage trading.

IV. Risks to the Lender

- **Borrower Bankruptcy** - Possibility of a borrower not returning the borrowed security.
- **Collateral Deficiencies** - This is the risk of the collateral being insufficient to replace the loaned security in case of default. It also relates to both the value of the loaned security as well as the value and quality of the investments from the cash collateral.
- **Operations concerning settlements, corporate actions, interest and dividends** - This risk is no greater than is experienced in normal trading.
- **Securities lending is regulated by the ERISA, the Department of Labor, and the Federal Financial Institutions Examination Council.**

V. Mt. Hawley's Risk Management

- Borrower default is managed by our providers strict credit standards that a borrower must meet before being approved, and also by Mt. Hawley's requirement to further approve or reject any borrower used by our provider.

Mt. Hawley Insurance Company Testimony on Securities Lending Legislation - Kansas

- Collateral Deficiencies are managed by the provider marking to market daily, the loaned security. Any collateral short falls must be made up that day. Our provider also has strict investment guidelines regulating the types of and maturity structure of the investments of cash collateral. The Company also monitors this risk by restricting the types of collateral the provider may invest the cash collateral in. These restrictions relate to the quality, asset types and overall average maturity of the collateral investments.
- Regulation - Our securities lending agreement with our provider allows us to further regulate how our program is run. Our ability to restrict specific borrowers, limit the amounts loaned to any one borrower and ability to restrict certain types of investment vehicles used by the bank for investing the cash collateral, helps insure that we actively participate in the overall risk management of this program along with our provider.

VI. Why Securities Lending?

- Large loanable portfolio of U.S. Government and Agency securities and enhanced revenue stream.
- Mt. Hawley has been participating in securities lending since 1992. During that time we have generated income in excess of \$130,000, and currently have an annual revenue potential of \$60,000 to \$70,000 annually.

VII. Our Proposed Bill

- The bill before you is drafted based upon the language and requirements proposed by the National Association of Insurance Commissioners (NAIC), under their Model Investment Law. This law has been several years in the making, having been drafted, reviewed and revised by the NAIC, the Model Investment Law Working Group and various other industry committees.
- Therefore we feel that this bill not only takes into account the needs and requirements of the insurance companies, allowing them to take advantage of these additional investment opportunities, but also serves to protect the policyholders.

We feel that passage of this bill is very important to our operations, as well as other insurance companies and wish we could personally be there to represent Mt. Hawley Insurance Company. However, your next scheduled House of Representatives Meeting directly conflicts with our quarterly Board of Directors meetings. We apologize for not being present but look forward to passage of this bill and a strong relationship with the state of Kansas.