

MINUTES OF THE Senate Committee on Financial Institutions and Insurance.

The meeting was called to order by Chairperson Dick Bond at 9:00 a.m. on February 6, 1996 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: Chuck Stones, Kansas Bankers Association
Tom Wilder, Kansas Insurance Department
Tim Krueger, Mt. Hawley Insurance Company

Others attending: See attached list

Senator Steffes made a motion to approve the minutes of the meeting of February 5 as submitted; Senator Emert seconded the motion. The motion carried.

The chairman reopened the hearing on **SB 414**, concerning certain exemptions for annuity contracts. Dr. Woolf refreshed the committee on the intent of this legislation and explained the proposed amendment.

Chuck Stones, Kansas Bankers Association, testified in opposition to this bill, stating that he does not believe annuities should be protected from creditors during bankruptcy action. He requested that the committee act to defeat this bill. (Attachment #1)

Tom Wilder, Kansas Insurance Department, testified that the Insurance Department supports this bill; if an insured or beneficiary of a life insurance contract is exempted from claims of creditors, this protection should also be extended to annuity contracts. (Attachment #2)

Senator Emert questioned whether or not we are making it possible for people to hide assets prior to declaring bankruptcy and Senator Steffes commented that this might be a selling point for annuities salesman. Mr. Wilder responded that the possibility now exists for attempting to hide assets during bankruptcy and the courts are prepared to deal with such attempts.

There were no further questions and no other conferees; the hearing on **SB 414** was closed.

The hearing was opened on **SB 550**, which relates to an insurance company's ability to engage in securities lending. Tom Wilder, Kansas Insurance Department, advised the committee that this legislation was introduced at the request of Mt. Hawley Insurance Company, which was relocated to Kansas and would be unable to continue its practice of securities lending investment strategy under current Kansas law. Mr. Wilder stated that the bill contains numerous drafting errors which should be corrected and that the Insurance Department would also requested that all references to "dollar roll" be removed. (Attachment #3)

Tim Krueger, Mt. Hawley Insurance Company, testified as a proponent of this legislation, stating that the bill is based largely on language proposed by the NAIC. (Attachment #4) Mr. Krueger stated that his company does not disagree with the changes proposed by the Insurance Department and does not need "dollar roll" capability.

There were no further questions and no other conferees. The chair requested that Mr. Wilder meet with representatives from Mt. Hawley Insurance Company and Security Benefit Group (who has a companion bill dealing with life insurance companies to be heard in committee on 2/7/96) and bring to the committee a cleaned-up version of this bill so that the committee members may know exactly what the bill will do.

The chairman also reminded committee members of the subcommittee meeting today at 4:00 p.m. on SB 476.

The committee adjourned at 9:45 a.m. The next meeting is scheduled for Wednesday, February 7.

SENATE FINANCIAL INSTITUTIONS & INSURANCE COMMITTEE GUEST LIST

DATE: 2/6/96

NAME	REPRESENTING
Jully	KBA
Jim Krueger	Mt. Hawley Ins. Co.
STEVE PIPP	MT HAWLEY INS. CO.
Bill Speed	Investors
John C. Soterby	ALLER JOE LIFE
Jane Bond	
Carol Ridgway	KS Insurance Dept.
Tom Wilder	KANSAS Ins. Dept
TAD KRUMER	SECURUM BENEFIT
Kathy Oyer	KBA
Chuck Stones	KBA
R. Brazier	ST. Treasurer
Kelly Kultala	KTLA
Patrick Mulvihill	Kansas Ins. Dept.
Melissa Wangemann	Hein, Ebert & Weir
David Hansen	KS Insur. Assoc

Kansas Bankers Association

800 SW Jackson, Suite 1500

Topeka, KS 66612

913-232-3444 Fax - 913-232-3484 E-Mail - kba@ink.org

1-16-96

To: Senate Financial Institutions and Insurance Committee
From: Chuck Stones, Director of Research

RE: SB 414

Mr Chairman and Members of the Committee,

Thank you for the opportunity to appear before you today in opposition to SB 414. SB 414 would add annuities to the list of financial assets that could be shielded from creditors in bankruptcy court. We think there are several considerations this body must make before passing SB 414.

Exemptions to bankruptcy have been carefully crafted over the years. They have been put into place to allow persons filing bankruptcy to be assured of having the essentials in life, and the ability to make a living after filing bankruptcy. Bankruptcy exemption laws have also tried to eliminate the ability to shield assets from creditors. They have done this by limiting the exemptions to essential assets and even placing time limits on acquiring certain assets prior to filing bankruptcy.

In the marketplace, annuities have always been considered an investment alternative, rather than an alternative to an essential insurance product. Other non-essential investment products, such as CD's, Treasury Securities, etc., are not exempt. Any erosion in the secured creditors ability to collect debt could have a negative effect on credit availability.

The non-essential, investment nature of annuities should preclude them from becoming exempt in bankruptcy proceedings. We urge you to vote NO on SB 414.

*Senate 7/4/1
2/6/96
Attachment #1*



Kathleen Sebelius
Commissioner of Insurance
Kansas Insurance Department

MEMORANDUM

To: Senate Financial Institutions
and Insurance Committee

From: Tom Wilder, Director
Government and Public Affairs

Re: S.B.414 (Exemption of Annuity Contracts)

Date: January 29, 1996

The Kansas Department of Insurance supports S.B. 414 and requests the Senate Financial Institutions and Insurance Committee consider the bill favorably for passage. The legislative proposal would exempt the interest of an insured or a beneficiary in an annuity contract from the claims of their creditors under certain conditions. This exemption is currently granted for life insurance agreements and the statutory exemption has apparently been in effect for such contracts since 1927.

The Kansas Insurance Department, in a legal opinion issued in 1986 at the request of Representative James Braden, noted that annuity contracts were defined differently in the Insurance Code and it would be necessary to amend K.S.A. 40-414 to add annuity agreements to the exemptions allowed for life insurance contracts from the claims of creditors. The United States District Court for the District of Kansas has also stated that the claims exemptions statute does not include annuity contracts for the purposes of an exclusion under the federal bankruptcy laws (Stutterheim v. First State Bank, Almena; 109 B.R. 1010 [D. Kan. 1989]).

If the legislative policy is to allow the interest of an insured or beneficiaries in a life insurance contract to be exempt from the claims of creditors it makes little sense to not extend that exemption to annuity contracts. This proposed amendment will "level the playing field" for sellers of annuity agreements and life insurance contracts.



Kathleen Sebelius
Commissioner of Insurance
Kansas Insurance Department

MEMORANDUM

To: Senate Financial Institutions
and Insurance Committee

From: Tom Wilder, Director of
Government and Public Affairs

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

Date: February 6, 1996

The Kansas Department of Insurance gives its qualified support for 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. The provisions in the bill are based on the Model Investment Law being developed by the National Association of Insurance Commissioners ("NAIC"). It is important to note that the NAIC has not yet approved a final version of the Model Investment Law and additional changes may be made by the association to the proposed model act.

As you are aware, this bill is similar to S.B. 572 which will be discussed by the Committee later this week. That legislative proposal makes changes in the investment powers of domestic life insurance companies. The Committee should coordinate the two bills so that the investment authority granted to property and casualty insurance companies are the same as those allowed life insurers.

*Senate 4/41
2/6/96*

Attachment #3

The Insurance Department is very concerned about the provisions which allows domestic companies to invest in "dollar roll transactions." The Department is not aware of any domestic property and casualty companies which want to make these type of investments. More importantly, the Department is unable to determine how a dollar roll transaction would work and whether these type of investments are suitable for insurance companies. The bill should be amended to remove all references to dollar roll transactions as a permitted investment for domestic property and casualty companies.

The bill as drafted deletes a section in the existing law which requires the Board of Directors of the insurance company to specifically approve the investment in repurchase agreements. This language should be included in S.B. 550. I have attached a proposed amendment to this testimony for your consideration.

The Insurance Department also wants further clarification regarding Subsection (4) starting on line 42 on page 4 of the bill. This section apparently makes an exception to the investment limitations currently set out in the Kansas Insurance Code for property and casualty companies. The limitations would not apply to "investments in the counterparty", however, the Insurance Department is not certain exactly what this provision means. The language in this subsection is different than what is set out in the NAIC Model Investment Code.

There are also a number of typographical errors in the bill draft. In addition, there are several provisions which do not match up with the current version of the NAIC Model Investment Act. A list of those errors is attached to my testimony. The bill should be amended to make these corrections.

The Kansas Insurance Department will support passage of Senate Bill 550 provided the references to dollar roll transactions are removed from the bill and to further define the exemption for investment limitations for counterparty transactions. The bill should also be amended to include a requirement for the Board of Directors of the insurer to approve these types of investments. In addition, the errors noted in the attachment should be corrected.

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1 (12) "SVO" means the securities valuation office of the national as-
2 sociation of insurance commissioners or any successor office established
3 by the national association of insurance commissioners.

4 (b) Any property and casualty insurance company organized under
5 any law of this state may enter into securities lending, repurchase, reverse
6 repurchase and dollar roll transactions, subject to the following require-
7 ments:

8 (1) The insurer's board of directors shall adopt a written plan which
9 specifies guidelines and objectives to be followed, such as:

10 (A) A description of how cash received will be invested or used for
11 general corporate purposes of the insurer;

12 (B) operational procedures to manage interest rate risk, counterparty
13 default risk and the use of acceptable collateral in a manner that reflects
14 the liquidity needs of the transaction; and

15 (C) the extent to which an insurer may engage in these transactions.

16 (2) The insurer shall enter into a written agreement for all transac-
17 tions authorized in this section other than dollar roll transactions. Such
18 agreement shall adequately identify each security to which the agreement
19 applies and shall required that each transaction terminate on a specified
20 date no more than one year from its inception or upon earlier demand of
21 the insurer. In a repurchase transaction, the agreement must also state
22 that in the event of default by the party agreeing to repurchase the se-
23 curities described in the agreement at the terms contained in the agree-
24 ment, title to the described securities must pass immediately to the insur-
25 ance company without recourse. Such agreement shall be with the
26 counterparty business entity. For securities lending transactions the
27 agreement may be with an agent acting on behalf of the insurer, if such
28 agent is a qualified business entity, and if such agreement:

29 (A) Requires the agent to enter into separate agreements with each
30 counterparty that are consistent with the requirements of this section; and

31 (B) prohibits securities lending transactions under the agreement
32 with the agent and its affiliates.

33 (3) Cash received in a transaction under this section shall be invested
34 in accordance with K.S.A. 40-2a01 et seq. and amendments thereto, and
35 in a manner that recognizes the liquidity needs of the transaction, or shall
36 be used by the insurer for its general corporate purposes. For so long as
37 the transaction remains outstanding, the insurer, its agent or custodian
38 shall maintain, in the United States, as to acceptable collateral received
39 in a transaction under this section, either physically or through book entry
40 systems: (A) Possession of the acceptable collateral; or (B) a perfected
41 security interest in the acceptable collateral.

42 (4) For purposes of calculating the limitations of K.S.A. 40-2a01 et

pass a resolution approving such investments and

Suggested Drafting Changes to S.B. 550

- (1.) Page 2, line 8: the word "know" should be "known"
- (2.) Page 2, line 12: the words "180 days" should be "90 days" to be consistent with the NAIC Model Act.
- (3.) Page 2, line 15: the word "agency" should be "organization" to be consistent with the NAIC Model Act.
- (4.) Page 2, line 17: the word "governmental" should be "government"
- (5.) Page 2, line 23: the phrase "from the business entity" should be "from the same business entity"
- (6.) Page 2, line 25: the words "Mortgage-backed securities" should be "Asset backed securities"
- (7.) Page 2, line 29: the phrase "asset-back securities" should be "other asset-backed securities"
- (8.) Page 3, line 36: the word "the" should be deleted
- (9.) Page 3, line 41: the word "manuals" should be "manual"
- (10.) Page 3, lines 42 and 43: the phrase "as determined from time to time by the public securities association" should be deleted to be consistent with the NAIC Model Act
- (11.) Page 4, line 19: the word "required" should be "require"
- (12.) Page 4, line 27: the phrase "with an nt" should be "with an agent"
- (13.) Page 4, line, 32: the word "and" should be "or"
- (14.) Page 4, line 40: the following phrase should be added after the word "systems" in order to be consistent with the proposed NAIC Model Act:

"of the Federal Reserve, Depository Trust Company, Participants Trust Company or other securities depositories approved by the Commissioner"
- (15.) Page 6, line 9: the word "may" should be "shall"
- (16.) Page 6, line 12: the word "related" should be "relate"
- (17.) Page 6, line 24: the word "extend" should be "extent"

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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.

*Senate 7141
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Attachment #4*

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.**

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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.

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